
Cyprus and India sign new tax treaty, India removes Cyprus as a notified jurisdictional area, and Cyprus Parliament approves new IP box regulations

December 21, 2016

In brief

The Indian government announced in a press release dated December 16, 2016, that it has rescinded Cyprus's 'notified jurisdictional area' (NJA) classification retroactive to November 1, 2013. India announced also that the new tax treaty and accompanying protocol between Cyprus and India, signed in November 2016, will take effect April 1, 2017, in India. The new tax treaty will take effect January 1, 2017 in Cyprus.

The Cyprus Parliament on November 4, 2016, approved the implementing regulations (the Regulations) for the latest intellectual property (IP)-related amendments to the Cyprus Income Tax Law (ITL). Refer to the [Insight dated October 21, 2016](#) for prior coverage. The Regulations fully align the new Cyprus IP box, which provides for an 80% deduction on qualifying IP profits, with the Organisation for Economic Co-operation and Development's (OECD's) Base Erosion and Profit Shifting (BEPS) Action 5 report. The Regulations took effect July 1, 2016.

In detail

New tax treaty between Cyprus and India; India removes Cyprus as a notified jurisdictional area

The Indian government announced in a press release dated December 16, 2016 that it has rescinded Cyprus's NJA classification retroactive to November 1, 2013, the date that the Indian authorities previously classified Cyprus as an NJA. India announced

also that the new tax treaty and accompanying protocol between Cyprus and India, signed in November 2016, will take effect April 1, 2017 in India. The new tax treaty will take effect January 1, 2017 in Cyprus.

The new tax treaty provides for a 10% withholding tax rate on dividends. The protocol clarifies that this rate does not apply in India

because Indian domestic law does not impose withholding tax on dividends paid by Indian companies to its shareholders.

A 10% withholding tax rate also applies to interest, royalties, and fees for technical services, except for interest when the beneficial owner of the interest is:

- the government, a political sub-division, or a local

authority of the other Contracting State

- in the case of India, the Reserve Bank of India, the Export-Import Bank of India, or the National Housing Bank, or
- any other institution as agreed upon by the competent authorities of Cyprus and India through exchange of letters.

In such cases, no withholding tax applies.

The new tax treaty also provides for source-based taxation of capital gains from the disposal of shares in the following cases:

- shares of a resident of the source State, and
- shares of a company whose property principally consists, directly or indirectly, of immovable property situated in the source State.

The protocol includes an important ‘grandfathering’ clause for shares acquired before April 1, 2017, providing the seller’s State with the exclusive right to tax a future disposal of such shares.

Observations

These are welcome developments that are expected to strengthen the bilateral economic ties between the two countries.

Taxpayers previously subject to withholding tax in India due to the NJA classification should now consider applying for refunds.

The grandfathering of shares acquired before April 1, 2017, is a welcome development and provides clarity for taxpayers’ existing investments. When a Cyprus tax resident is the seller of grandfathered investments, the new tax treaty provides Cyprus with the

exclusive right to tax gains realized, as is the case with the existing tax treaty between the two States.

Regardless of the withholding taxes on dividend and interest under the new treaty, the Cyprus ITL does not impose withholding tax on payments of dividends and interest to non-Cyprus tax residents.

Further, regardless of the withholding taxes on royalties and fees for technical services under the new treaty, the Cyprus ITL imposes withholding tax on such payments to non-Cyprus tax residents only when the royalties or fees relate to rights or activities used or performed within Cyprus.

Cyprus approves new IP box regulations

The Cyprus Parliament on November 4, 2016, approved the Regulations for the latest intellectual property (IP)-related amendments to the Cyprus Income Tax Law (ITL). The Regulations took effect July 1, 2016.

Qualifying IP assets

The Regulations list the types of IP that constitute ‘qualifying IP’ under the new Cyprus IP box:

- patents
- copyrighted software
- utility models
- IP assets that grant protection to plants and genetic material
- orphan drug designations
- extensions of patent protection, and
- other IP that is non-obvious, useful and novel, that is certified as such by a designated authority, if the taxpayer satisfies certain size criteria: annual IP-related revenue does not exceed 7.5 million euros (EUR) for the taxpayer, and group

total annual revenue does not exceed EUR 50 million, using a five-year average for both calculations.

The qualifying IP assets must be legally or economically owned.

The Regulations clarify that tradenames, including brands, trademarks, image rights, and other IP rights used for the marketing of goods and services do not qualify.

Qualifying IP profits

Qualifying IP profits for the new Cyprus IP box are determined under the OECD BEPS Action 5 modified-nexus approach. The following types of profits are considered qualifying IP profits under the new Cyprus IP box:

- royalties or other amounts related to the use of qualifying IP
- amounts for the grant of a license to exploit qualifying IP
- amounts derived from insurance or compensation related to qualifying IP
- trading income from the sale of qualifying IP, and
- IP income embedded in the sale of products or services or the use of processes directly related to qualifying IP assets.

The R&D fraction

The Regulations apply a fraction to qualifying IP profits based on research and development (R&D) activity. Qualifying IP profits are multiplied by the R&D fraction (modified-nexus fraction) to arrive at the IP profits that qualify for the 80% deduction under the new Cyprus IP box.

The R&D fraction is calculated as:

$$\frac{(OE+UE) \times QA}{OE}$$

OE

Where:

- QE is the business' qualifying R&D expenditures incurred wholly and exclusively for the development, improvement, or creation of the qualifying IP, excluding items such as acquisition expenditures and expenditures for outsourcing to related parties
- UE is the lesser of 30% of QE or expenditures for acquisitions and outsourcing to related parties
- OE is the sum of QE and expenditures for acquisitions and outsourcing to related parties, and
- QA is qualifying IP profits.

Qualifying taxpayers

Under the new Cyprus IP box, a qualifying taxpayer is a taxpayer

resident in Cyprus, a Cyprus permanent establishment (PE), or a foreign PE subject to tax in Cyprus.

Maintaining accounting books and records

According to the Regulations, qualifying taxpayers that wish to claim deductions under the new Cyprus IP box must keep accounting books and records of income and expenditures for each item of IP.

The takeaway

The Regulations provide multinational enterprises doing business in Cyprus with a new tax-efficient IP box that is fully aligned with the OECD's BEPS Action 5 report.

The modified-nexus approach requires the claimant taxpayer to hold

qualifying IP rights, undertake R&D activities either itself directly or through a taxable foreign PE or third-party outsourcing, and have qualifying IP profits.

The new Cyprus IP box strengthens Cyprus's position as a jurisdiction for R&D and IP management as taxpayers may benefit from the preferential tax regime within the internationally agreed framework of the BEPS Action 5 report.

Cyprus' geographical location, common-law framework, and full EU membership, coupled with the fact that Cyprus offers a highly educated workforce, well-developed IT infrastructure and R&D centers and highly-regarded universities, make Cyprus an excellent choice for the centralization and management of R&D and IP.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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