Introduction to accounting and tax for startups

Stelios Spiliotis and Antigoni Hadjiargyrou

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Seminar Agenda

Session 1: Introduction to accounting

- Definition of accounting and the reasons that accounting is important
- Basic principes of accounting for Startups
- What is an accounting software and how to decide which accounting software to use
- Basic accounting concepts
- Introduction to accounting and IFRS standards
- Main Accounting Reports for a Startup
- Accounting and Reporting Requirements of Cyprus Companies

Seminar Agenda

Session 2: Introduction to tax and company registrar requirements

- Corporation tax requirements
- VAT/VIES requirements
- Payroll taxes
- Other taxes(defence and GESY)
- Company law requirements

Session 3: Tax benefits and schemes applicable for startups, investors and employees

- Summary of tax benefits and incentives for companies, employees and investors
- Intellectual Property regime
- Notional Interest Deduction
- Tax benefits for investing in innovative SMEs

Share knowledge and experience

-Corporation tax reporting and payments
-VAT/VIES reporting and payment
-Payroll taxes
-Defence contribution
-GESY
-Company registrar filings
- Update UBO register

-Explain principles of accounting and the main accounting concepts

-Understand the accounting, reporting and tax reporting requirements and deadlines for submission of reports and payments for a legal entity in Cyprus

- Summarize tax benefits and incentives for companies, employees and investors

- Present Intellectual Property regime

- Present Notional Interest Deduction

Presenters' introduction

Stelios Spiliotis (FCA)
-Partner and Co-founder of Sagehill Partners
-21 years of experience in the area of accounting, audit, tax and financial advisory
-Current Member of ISA Panel of ICAEW
-Lecturer at University of Cyprus and expert tutor in Global training
-Member of Audit Committee(ICPAC) – 4 years

Antigoni Hadjiargyrou (FCCA)
-Assistant Manager in Audit and Assurance at Sagehill Partners
-17 years of audit experience

Session 1: Introduction to accounting

What is Accounting?

Accounting serves as the financial backbone of any business. It involves systematically collecting, organizing, and interpreting financial data to provide insights into the financial health and performance of a company.

Why accounting is important?

Keeping a Record: Detection and Prevention of Fraud

Accounting maintains a comprehensive record of financial transactions, ensuring transparency and accountability within the organization. This record-keeping not only helps in understanding the financial status but also serves as a deterrent against fraudulent activities.

Budget Planning

Budgeting is the process of setting financial goals and allocating resources to achieve them. Accounting provides historical financial data and insights into revenue and expenses, enabling businesses to create realistic budgets.

Why accounting is important? (Continued)

Assisting Decision Making

Accounting information forms the basis for strategic decision-making within an organization. Managers rely on financial reports and analysis provided by accountants to evaluate performance, identify trends, and assess the financial implications of various alternatives.

Statutory Compliance

Businesses are subject to various laws and regulations governing financial reporting and taxation. Accounting ensures compliance with these legal requirements by accurately recording and reporting financial transactions.

Why accounting is important? (Continued)

Evaluating and Monitoring Business Performance

- Accounting facilitates the evaluation of a company's financial performance and health.
- Monitoring performance involves regularly assessing various aspects of a company's operations. Management accounts and key performance indicators (KPIs) play significant roles in this process.
- Management accounts are customized financial reports prepared internally for management purposes.
- Key Performance Indicators (KPIs) are specific metrics aligned with strategic goals, such as financial (profitability, liquidity), operational (efficiency, customer satisfaction), and strategic (market share, innovation).

Understanding accounting for startups

- When you're starting a business, keeping track of your money is very important. This process is called accounting.

- The difference of bookkeeping versus accounting. Bookkeeping is like the basic recording of all your business transactions—what money is going where. Accounting goes a step further by analyzing these transactions to understand your business's financial health.

Understanding accounting for startups (continued)

Financial tasks:

- Daily Bookkeeping
- Sending Invoices
- Keeping Track of Payments
- Managing Cash Flow
- Dealing with Taxes

Accounting software

All the accounting tasks involve a lot of paperwork. While some businesses still use manual methods like spread sheets and paper files, using accounting software is generally more efficient and reduces the chances of mistakes.

Accounting software has transformed business finance management by:

- Automating tasks
- Enhancing accuracy
- Enabling accessibility with cloud-based platforms
- Ensuring compliance with regulatory requirements and tax laws
- Providing robust reporting tools for generating customizable reports

How to decide which accounting software to use?

Choosing the right accounting software involves considering factors such as your business size, industry needs, budget, and desired features.

- Assess Your Needs: Determine your specific accounting requirements
- Consider Scalability: Choose software that can scale with your business as it grows
- Evaluate Ease of Use: Opt for user-friendly software that your team can quickly learn
- Check Compatibility: Ensure compatibility with your existing systems
- Review Features and Customization: Look for software that offers the features you need
- Assess Support and Training: Consider the availability of customer support, training resources
- Compare Pricing: Evaluate the pricing structure, including subscription fees, additional user costs, and any hidden fees

Popular accounting software

International accounting software

- SAP
- Sage
- QuickBooks
- Zoho
- Oracle
- Netsuite
- Microsoft Dynamic
- Wave

Simple solutions -Cyprus

- E-soft
- Intellisoft
- Powersoft

Basic accounting concepts

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The Accounting Equation: It shows the relationship between what your business owns (assets), what it owes (liabilities), and what's left over for you (owner's equity). The equation is: Assets = Liabilities + Owner's Equity.

Double-Entry Bookkeeping: To keep everything balanced, businesses use double-entry bookkeeping. This means every transaction affects at least two accounts—one account gets money (debit), and another gives money (credit).

Basic accounting concepts-Accrual Vs Cash Basis (continued)

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- Accrual accounting records income and expenses when they're earned or incurred, regardless of when the cash exchanges hands.

- Cash basis accounting, on the other hand, records transactions only when cash is received or paid out.

- For startups, accrual accounting provides a more accurate picture of financial health, reflecting revenues and expenses as they occur. However, cash basis accounting offers simplicity and may be suitable for startups with straightforward finances.

Basic accounting concepts-Revenue recognition (continued)

- Revenue recognition is a critical accounting principle that determines when a company should record revenue in its financial statements.

- Under IFRS 15, revenue recognition occurs when control of goods or services is transferred to the customer, and it's recognized at the amount to which the company expects to be entitled in exchange for those goods or services.

Basic accounting concepts- Matching principle (continued)

- Matching expenses with revenue to accurately reflect profitability.
- This principle is based on the accrual basis of accounting, which records revenues and expenses when they are earned or incurred, regardless of when the cash actually changes hands.
- **Timing of Recognition:** Expenses are recognized in the same period as the revenues they help generate, regardless of when the cash transactions occur.
- **Expense Recognition:** Expenses are matched with the revenues they help to generate.
- **Accurate Profitability Reporting:** By matching expenses with the revenues they generate, the income statement provides a more accurate depiction of the company's profitability for a given period.

Accounting and IFRS standards

- Businesses are obligated to comply with designated accounting standards. In Cyprus, this entails adherence to International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS).

- IFRS and IAS were developed by the International Accounting Standards Board (IASB) to create consistency and comparability in financial reporting across different industries and regions.

- The relevant body overseeing the adoption and implementation of these standards in Cyprus is the Institute of Certified Public Accountants of Cyprus (ICPAC).

Key accounting reports

Recording transactions and sorting them into different categories is just the beginning of accounting. The next step is organizing this data into useful reports for investors, creditors, and analysts who want to understand how well the startup is doing. Plus, these reports are legally required to ensure transparency and make things easier for everyone involved.

Key accounting reports (continued)

Balance Sheet:

- This report shows what your business owns (assets), what it owes (liabilities), and what's left for you (owner's equity) at a specific date.

Income Statement:

- It is also known as the profit and loss statement,

- This report tells you how financially successful your startup has been over a certain period. It breaks down your revenues (money coming in) and expenses (money going out) to calculate your net income.

Key accounting reports (continued)

Cash Flow Statement:

- This report tracks the money flowing into and out of your business. It complements the income statement and balance sheet by showing three main types of activities:
  - Operating activities: Money from sales, taxes, salaries, etc.
  - Financing activities: Loans, dividends, stock sales, etc.
  - Investing activities: Purchases of property, stocks, bonds, etc.

Statement of changes in Equity:

- This statement summarizes changes in the owner's investments, withdrawals, and the business's profits and losses.

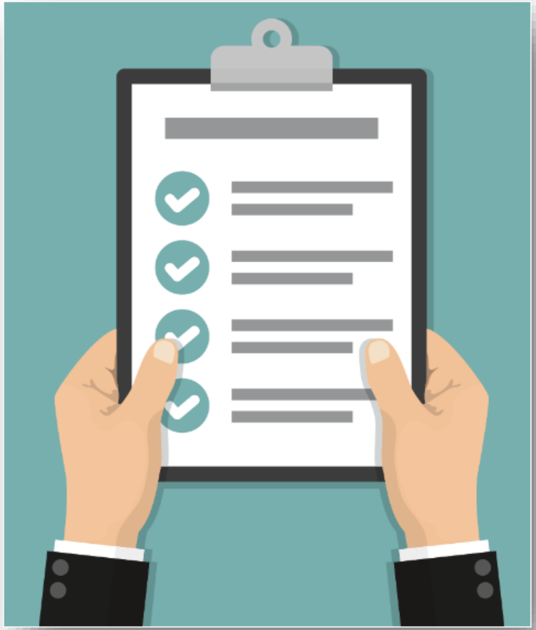
Who will assume the role of accountant in a start-up?

- In a startup, the accountant role may be fulfilled by the founder or a dedicated accounting professional hired specifically for financial management tasks.

- Alternatively, startups may opt to outsource accounting functions to external accounting firms or utilize accounting software for basic bookkeeping tasks.

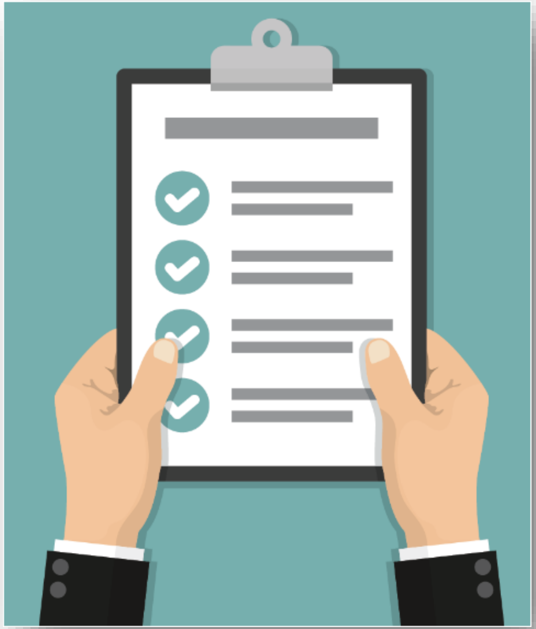
Accounting and Reporting Requirements of Cyprus Companies

Every company established in Cyprus, regardless of its scale, industry, or inception date, is mandated by the Cyprus Companies Law (Cap.113) to maintain accurate accounting records and supporting documentation.



Accounting and Reporting Requirements of Cyprus Companies- Bookkeeping requirements

To adhere to legislative standards, company management must ensure the following:



Location of Records: All accounting records and relevant documents should be securely kept at the Registered Office of the Company.

Timely Updates: Records must be regularly updated, ensuring that entries are made no later than four months after the occurrence of a transaction.

Accessibility for Review: Authorities may request to review these records, necessitating the company's prompt cooperation within typically two working weeks.

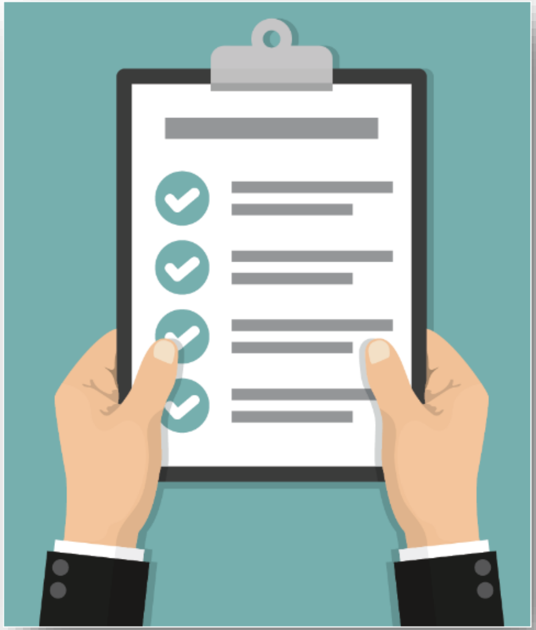
Accounting and Reporting Requirements of Cyprus Companies- Bookkeeping requirements (continued)

To adhere to legislative standards, company management must ensure the following:

Retention Period: Records must be preserved for a minimum of six years following the end of the respective financial year

Language of Accounting Records:

- Accounting records are usually in Greek or English, the country's official languages.
- The choice depends on the business owner's preference, transaction language, and primary users' linguistic background.
- Some businesses prepare statements in both languages for wider accessibility.



Session 2: Introduction to tax and company registrar requirements

Tax compliance- main requirements and deadlines

- Income/corporation tax
- VAT/ VIES
- Payroll taxes (social insurance and other contributions
- Other taxes (i.e. special contribution for defence, GESY, Capital gains tax)

Tax compliance- Corporation tax

In Cyprus, the corporation tax rate is set at 12.5%.

The main income tax requirements are the following:

- Companies are required to be registered with tax authorities and obtain tax identification number (ie TIC)
- Submit annual tax return (TD4) every year
- Deadlines: Typically within 15 months from the end of the financial year.
- Penalties:
    - Late submission/payment may incur fines and interest charges.
    - Penalty of €100 is imposed for late submission of tax return (TD4) to the Tax authorities.
- There also deadlines for payment of provisional tax (31/7-1st instalment, 31/12-2nd instalment) .A final balancing payment must be made on or before 1 August of the following year on a self-assessment basis to bring the total payments of tax to the total actually due according to the tax return.

Tax compliance- Corporation tax (continued)

- Government websites: Cyprus Tax Department: www.mof.gov.cy/tax
- Tax submission procedures are facilitated through Taxisnet, an online platform designed for electronic tax filing and administration. https://taxisnet.mof.gov.cy/login.jsp
- The Tax portal provides a comprehensive overview of tax payments and obligations for businesses operating in Cyprus. Through this portal, companies can access information regarding their tax liabilities and view payment history. https://taxportal.mof.gov.cy/Account/Login

Tax compliance- VAT/VIES

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- Most companies in Cyprus must register with the State VAT Department and obtain a VAT number. The standard tax rate is 19%.

For VAT/VIES the main requirements / reports to be submitted are:

- Submit periodic VAT returns, and if applicable, VIES (VAT Information Exchange System) statements for intra-community transactions. A Cyprus company selling to an EU VAT-registered counterparty needs to submit monthly VIES Statements in addition to its quarterly VAT returns.
- Deadlines: VAT returns are usually due on a quarterly basis, with specific deadlines set by the tax authorities. VIES statements are typically submitted monthly.
- Penalties: Late submission/payment of VAT returns or VIES statements may result in fines and interest charges. Late submission of VAT return €100 for each return
- Government website for VAT: https://taxforall.mof.gov.cy

Tax compliance- Payroll taxes (social insurance and other contributions)

Deadlines:

- Employers must adhere to monthly deadlines for reporting and remitting social insurance, provident fund, and income tax contributions.
- Social insurance and other contributions are payable not later than the end of the month following the month in which they relate to.
- Annual submission deadlines for summary reports to relevant authorities ensure comprehensive reporting for the tax year (TD7 Employer's return).
- Deadline for electronic submission of Employer's return (TD7) is end of fifth month following the tax year.

Penalties:

- Every employer who fails to pay the contributions within the deadline, is obliged to pay an additional charge in the range of 3% to 27%, depending on the period of delay, calculated on the amount of contributions due for payment.

Tax compliance- Payroll taxes (social insurance and other contributions) (Continued)

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Government Websites:

- Employers can find essential information and resources on payroll tax requirements, reporting procedures, and compliance guidelines on the Cyprus Tax Department website.
- The Social Insurance Services website offers access to forms, regulations, and updates related to social insurance contributions.
- Social Insurance Services:
    - www.mlsi.gov.cy/mlsi/sid/sidv2.nsf/index_en/index_en?OpenDocument
    - https://www.pay.sid.mlsi.gov.cy/SisWeb/index.jsp

Tax compliance- Other taxes (ie special contribution for defence, GESY)

Special Defence is imposed on dividend income, ‘passive’ interest income and ‘passive’ rental income earned by companies tax resident in Cyprus and by individuals who are both Cyprus tax resident and Cyprus domiciled.

Deadlines:

- End of each month: For Cyprus sourced interest and dividends, Special Contribution for Defence due is withheld at source and is payable at the end of the month following the month in which they were paid.

- End of each semester: For Cyprus sourced rental income where the tenant is a Cyprus company, partnership, the state or local authority, Special Contribution for Defence on rental income is withheld at source and should be paid in two tranches, by 30 June (on rental income withheld during January – June) and 31 December (on rental income withheld during July – December).

Tax compliance- Other taxes (ie special contribution for defence, GESY)

Deadlines(Continued):

- End of each semester: Payment of Special Contribution for Defence for the six months of the year on rents if such tax is not withheld at source by tenant and on dividends or interest from sources outside Cyprus.

GESY (General Healthcare System):

- GESY contributions are mandatory for individuals and employers to fund the general healthcare system in Cyprus.
- Deadlines: GESY contributions are typically deducted from employees' salaries on a monthly basis and remitted to the relevant authorities.

Tax compliance- Other taxes: Capital Gain tax

- Capital gains tax is applied on the profit from the sale of immovable property in Cyprus, including land, buildings, and shares in companies holding immovable property.

- Deadlines: Tax liabilities arising from capital gains are typically due upon the transfer of the property or shares, with specific reporting and payment deadlines set by the tax authorities.

- Penalties: Failure to meet tax filing and payment deadlines may result in penalties, fines, or interest charges imposed by the tax authorities.

Company law requirements – Annual report and financial statements filing

Annual Reporting and Meetings

Every year, companies are obligated to:

- Annual Report Preparation: Prepare and file an Annual Return (HE32 Form) with the Registrar of Companies, containing essential company information such as registered address, shareholder details, directorship, and secretaryship.
- Approval Process: The Annual Report must be approved at the annual meeting of shareholders (AGM) and submitted to the Registrar within 28 days of its compilation.
- Financial Statements Filing: Financial statements for the previous year should be filed along with the annual return for the current year. For instance, if a company was incorporated on January 1, 2023, it has 18 months to file its first annual financial statements by July 1, 2024. Subsequent filings are required annually thereafter.

Company law requirements – Update UBO register

- The UBO register is a record of the Ultimate Beneficial Owners of companies, trusts, and other legal entities, maintained by the Registrar of Companies in Cyprus.
- UBOs are individuals who ultimately own or control a company, either directly or indirectly, and whose details must be disclosed for transparency and anti-money laundering purposes.
- Changes in UBO register: Companies are required to identify and register their UBO and within 45 days update the register with any changes to UBO information.
- Annual confirmation of UBO details: During the period from 1st October to 31st December of each calendar year, an Entity must confirm electronically, to the Registrar its beneficial owners.
- Failure to maintain an accurate and updated UBO register may result in a fine of €200 and a further fine of €100 for each day of continuation of the violation with a maximum total fine of €20,000, or legal consequences for the company and its officers.

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Session 3: Tax benefits and schemes applicable for startups, investors and employees

Companies- Tax benefits and incentives

- Corporate tax rate: 12.5% (One of the lowest in the EU)
- Attractive and expanding double tax treaty network (over 65 countries)
- Advanced tax ruling practice offering safety and predictability of investments
- Intellectual Property regime
- Notional interest deduction
- No tax on foreign exchange gains
- No withholding tax on outgoing dividend, interest, or royalty payments
- Audiovisual industry incentives
    - Audio visual tax exemption
    - Investments in audiovisual infrastructure and technological equipment
- Dividend income is exempt (subject to conditions)

Investors – tax incentives and schemes

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- Non-domiciled tax resident individuals income from dividends, interest and rental income are exempt from income tax and SDC

Non-domiciled individuals are exempt from tax on dividend , rental and interest income except for certain General Health System ("GeSY") contributions of 2.65% which is capped to a maximum revenue of EUR 180.000 (Maximum tax: EUR 4.770)

Domiciled tax resident individual

Type of Income	Income Tax	SDC
Dividends	Exempt	Taxable -17%
Interest	Exempt	Taxable -30%
Rental Income	Taxable (Normal rates)	Taxable at 3% on 75% of gross income

Non Domiciled tax resident individual

Type of Income	Income Tax	SDC
Dividends	Exempt	Exempt
Interest	Exempt	Exempt
Rental Income	Taxable (Normal rates)	Exempt

Investors – tax incentives and schemes (continued)

- Tax benefits for investing in innovative SMEs
- No tax on disposal of shares

Employees- Tax benefits and incentives available to expatriates

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The 50% exemption rule

- Individuals who take up employment in Cyprus with an annual income in excess of €100.000 will be eligible for an exemption from taxation of 50% of their income for a period of 10 years, commencing from the year of employment.

The 20% exemption rule

- Individuals who take up employment in Cyprus and were not tax resident in Cyprus prior to commencing such employment, will be eligible for an exemption from taxation of 20% of their income or €8.550 (whichever is lower) from any employment which is exercised in Cyprus.

Overseas Pensions

- Overseas pensions are exempt from tax up to €3.420 and taxed at 5% thereafter.
- The taxpayer may opt to be taxed in the normal way, where this special mode of taxation of income results to a higher tax liability (this selection can be made from year to year).

Taxable income €	Rate
€0 - €19.500	0%
€19.501 - €28.000	20%
€28.001 - €36.300	25%
€36.301 - €60.000	30%
Over €60.000	35%

Employees- Tax benefits and incentives available to expatriates (continued)

- 100% exemption on lump sum repayments from life insurance schemes or from approved provident funds.
- No inheritance and gift taxes.
- No wealth taxes.
- No immovable property taxes.
- Capital gains from the sale of immovable property situated outside Cyprus is exempt from tax.

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Intellectual Property (IP) Regime in Cyprus

1. Introduction

- IP Box Regime is a corporate tax regime used by many countries to incentivize research and development activities by taxing revenues deriving from licenses, royalties, patents, sale or transfer of qualified IP assets differently, offering lower taxes compared to other commercial revenues.
- Cyprus is an attractive location for the establishment of an IP holding and development company, offering an efficient tax rate as well as the legal protection afforded by EU Member States and by the signatories of all major IP treaties and protocols.
- The key benefit from IP regime is that 80% of the profit earned from the use of intangible assets is deducted for tax purposes. With a Cyprus corporate tax rate of 12.5%, which is among the lowest in the EU, this can result in an effective tax rate of 2.5%.

80% of the profit earned from the use of IP is deducted for tax purposes resulting an effective tax rate of 2.5%.

2. Background

- On 14 October 2016, the House of Representatives passed amendments to the Income Tax Law in order to align the current Cyprus IP tax legislation with the provisions of Action 5 of the OECD's Base Erosion and Profit Shifting (BEPS) project.
- The Nexus fraction is used to determine the amount of qualifying profits that will give the relevant deduction to the taxpayer.
- The revised legislation includes certain transitional provisions for IP assets that have already qualified under the existing IP regime. In such cases, taxpayers will continue to benefit from the existing IP regime for a maximum of five years, after which date the new IP tax regime shall apply.

80% of the profit earned from the use of IP is deducted for tax purposes resulting an effective tax rate of 2.5%.

3.Transitional arrangements: Benefit under previous IP regime until 30 June 2021

- With a view to protect the owners of IP assets that have already qualified under the current Cyprus IP regime, transitional provisions have been introduced in the legislation.
- According to these, taxpayers benefiting from the current IP regime shall continue to apply its provisions until 30 June 2021, as long as the intangible assets in question have either generated income, or their development was completed as at 30 June 2016 and the intangible assets were acquired:
    A. prior to 2 January 2016; or
    B. either directly or indirectly from a related person during the period from 2 January 2016 to 30 June 2016, and which assets at the time of their acquisition were benefitting under the Cyprus IP regime or under a similar scheme in any other country; or
    C. from a non-related person, or were developed by the taxpayer himself during the period from 2 January 2016 to 30 June 2016.
- For intangible assets acquired directly or indirectly from a related person during the period from 2 January 2016 to 30 June 2016 and which do not fall under the provisions of (b) above, the transitional period extends only up to 31 December 2016. The income from IP's that qualify for the transitional provisions will include embedded income arising from the commercial use of such assets, or income from such IP assets for which only economic ownership exists.

4. Provisions of the new IP regime

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- The new IP regime complies with the provisions of the modified ‘nexus approach’, whereby for an intangible asset to qualify for the benefits of the regime, needs to have a direct link between the qualifying income and the own qualifying expenses contributing to that income.

- In brief, an amount equal to 80% of the qualifying profits earned from qualifying intangible assets are allowed as a tax-deductible expense.

$$QP = OI \; x \; \frac{QE+UE}{OE}$$

Where:
QP= Qualifying Profit
OI= Overall Income
QE= Qualifying Expenditure
UE= Uplift Expenditure
OE= Overall Expenditure

4. Provisions of the new IP regime(continued)

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Qualifying intangible assets

- As per the amended legislation, “qualifying intangible asset” is defined as an asset which was acquired, developed or exploited by a person within the course of carrying out his business (with the exception of intellectual property related to marketing), which is the result of research and development (R&D) activities, and which includes intangible assets for which only economic ownership exists.
- Qualifying intangible assets comprise of:
  - a) patents, as defined in the Patents Law,
  - b) Copyrighted software computer programs and
  - c) other IP assets which are legally protected and fall within one of the following categories:
    - I. utility models, intellectual property assets which provide protection to plants and genetic material, orphan drug designations and extensions of protections for patents
    - II. non-obvious, useful and novel, where the person utilizing them in furtherance of a business does not generate annual gross revenues in excess of €7,500,000 from all intangible assets (€50,000,000 in case of a group of companies), which are certified as such by an appropriate authority, in Cyprus or abroad

4. Provisions of the new IP regime(continued)

- **Qualifying intangible assets- examples**
    - Copyrights, which may take any of the following forms: Literary works, Dramatic works, Musical works, Scientific Works, Artistic works, Sound recordings, Films, Broadcasts, Published editions, Databases, Publications, Software programmes;
    - Patented inventions;
    - Trademarks (and service marks), designs and models that are used or applied on products

- The definition of qualifying intangible assets specifically **excludes** business names, brands, trademarks, image rights and other intellectual property rights used for the marketing of products and services.

- Registrable IPs need not be registered in Cyprus to benefit from IP regime

4. Provisions of the new IP regime(continued)

Qualifying persons

- Qualifying persons include Cyprus tax resident taxpayers, tax resident Permanent Establishments (PEs) of non-tax resident persons as well as foreign PEs that are subject to tax in Cyprus.

Qualifying profit

- Qualifying profit (QP) is defined as the proportion of the overall income (OI) derived from the qualifying asset, corresponding to the fraction of the qualifying expenditure (QE) plus the uplift expenditure (UE) over the overall expenditure (OE) incurred for the qualifying intangible asset.

$$QP = OI \times \frac{QE+UE}{OE}$$

Where:
QP= Qualifying Profit
OI= Overall Income
QE= Qualifying Expenditure
UE= Uplift Expenditure
OE= Overall Expenditure

5. The Nexus approach

- The nexus approach is used to determine the amount of qualifying profits that will give the relevant deduction to the taxpayer.
- For the purpose of calculating the taxable profit, 80% of the qualifying profit derived from qualifying intangible assets is treated as a deductible expense. For each tax year, the taxpayer may elect to waive this allowance, either in part or in whole.
- Where the calculation of qualifying profits results in a loss, **only 20%** of this loss can be surrendered to other group companies or be carried forward to subsequent years.

$$QP = OI \; x \; \frac{QE+UE}{OE}$$

Where:
QP= Qualifying Profit
OI= Overall Income
QE= Qualifying Expenditure
UE= Uplift Expenditure
OE= Overall Expenditure

5. The Nexus approach (Continued)

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Overall Income (OI)

- Overall income is defined as the gross income earned from qualifying intangible assets during the tax year, minus any direct costs incurred for generating the income.
- Overall income includes, but is not limited to:
    - royalties or other amounts resulting from the use of qualifying intangible assets
    - license income for the operation of qualifying intangible assets
    - any amount received from insurance or as compensation in relation to qualifying intangible assets
    - income from the disposal of qualifying intangible assets(if considered of trading nature, excluding profits of a capital nature)
    - embedded income of qualifying intangible assets arising from the sale of products or services, or from the use of procedures that are directly related to the assets
- For the purpose of calculating overall income, the following direct costs are deducted:
    - all costs incurred, either directly or indirectly, wholly and exclusively for the purpose of earning the income from qualifying intangible assets
    - capital allowances of the asset
    - notional interest on equity contributed to finance the development of the assets (being a notional interest tax deduction allowed by Cyprus tax provisions)

5. The Nexus approach (Continued)

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Qualifying Expenditure (QE)

- Qualifying expenditure for qualifying intangible assets is defined as the sum of all (i.e. cumulative) R&D costs incurred during any given tax year wholly and exclusively for the development, improvement or creation of qualifying intangible assets, and which costs are directly related to such assets.

- Qualifying expenditure includes, but is not limited to:
    - wages and salaries
    - direct costs
    - general expenses relating to installations used for R&D
    - commission expenses associated with R&D activities
    - costs associated with R&D that has been outsourced to non-related persons

$$QP = OI \ x \ \frac{QE+UE}{OE}$$

Where:
QP= Qualifying Profit
OI= Overall Income
QE= Qualifying Expenditure
UE= Uplift Expenditure
OE= Overall Expenditure

-Avoid expenses from related companies
-Use subcontractors

QE,UE and OE are **cumulative** expenses, not the current year

5. The Nexus approach (Continued)

Qualifying Expenditure (QE) (Continued)

- Qualifying expenditure does not include:
  - costs for acquisition of intangible assets
  - interest paid or payable
  - costs for acquisition or construction of immovable property
  - amounts paid or payable directly or indirectly to a related person to conduct R&D activities, regardless of whether such amounts relate to cost sharing agreements
  - costs which cannot be proved directly connected to a specific qualifying intangible asset
- Any expenditure for R&D that has been outsourced to non-related parties, as well as any expenses of a general nature for R&D which cannot be allocated to the qualifying expenditure of a specific qualifying intangible asset, can be apportioned pro rata to the qualifying intangible assets.

$$QP = OI \times \frac{QE+UE}{OE}$$

Where:
QP= Qualifying Profit
OI= Overall Income
QE= Qualifying Expenditure
UE= Uplift Expenditure
OE= Overall Expenditure

5. The Nexus approach (Continued)

Uplift Expenditure (UE)

- An uplift expenditure is added to the qualifying expenditure, which will be equal to the lower of:
    I. 30% of the qualifying expenditure; and
    II. the overall((ie cumulative) cost of acquisition of the qualifying intangible assets, plus the overall cost((ie cumulative) of outsourcing to related parties of any R&D activities in relation to such assets.

Overall Expenditure (OE)

- Overall expenditure relating to qualified intangible assets is defined as the sum of:
    - the total (ie cumulative) qualifying expenditure; and
    - the total (ie cumulative) cost of acquisition of the qualifying assets, plus
    - the total (ie cumulative) cost of outsourcing to related parties of any R&D activities in relation to these intangible assets, incurred during any tax year.

$$QP = OI \times \frac{QE+UE}{OE}$$

Where:
QP= Qualifying Profit
OI= Overall Income
QE= Qualifying Expenditure
UE= Uplift Expenditure
OE= Overall Expenditure

6. Other considerations

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Accounting records

- Persons claiming benefits under the new regime are obliged to maintain proper books of account, as well as records of income and expenses for each intangible asset.

Losses from the qualifying assets

- Where the calculation of qualifying profits results in a loss, only 20% of this loss may be carried forward or group relieved.

Disposal of an IP

- When an IP asset is disposed, an accounting profit/loss may arise. As long as the disposal is considered as a capital nature transaction, the accounting gain/loss should be exempt from tax in Cyprus. Where the disposal is considered as a trading nature transaction, the accounting gain/loss should be taxable.
- Up to 31 December 2019, upon the disposal of an IP asset, the taxpayer would also be obliged to prepare a balancing statement to calculate the taxable gain/loss as follows: Disposal proceeds less tax written down value of the asset (TWDV), whereby TWDV is the cost of the IP asset less accumulated capital allowances claimed.

6. Other considerations (continued)

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Disposal of an IP (continued)

- On 17 July 2020, the Cypriot House of Representatives approved a bill amending Section 9(1)(l) of the Income Tax Law which introduced a number of changes with respect to the tax treatment of intangible assets. Specifically, if disposal of intangible assets is a capital nature transaction, then the resulting capital gain should not be taxable. The changes became effective from 1 January 2020 and the obligation to prepare a balancing statement upon a transfer or sale of an intangible asset is abolished.

Capital allowances

- All intangible assets (excluding goodwill), irrespective of whether they are qualifying assets or not, are eligible for tax amortisation (capital allowances) over their useful economic life with a maximum of 20 years.

- The taxpayer has the option not to claim capital allowances in a given year. Moreover, capital allowances that have not been claimed in a year are claimed over the remaining useful life of the asset.

7. Illustrative examples
8. Comparison between countries applying IP regime

Illustrative examples

- In Appendix 1 and 2, there are example illustrating how the new IP regime.

Comparison between countries applying IP regime

- As presented in Appendix 3 below, Cyprus has one of the most attractive IP regimes since it provides an effective tax rate of 2.5% on income earned from IP assets. The comparable rate in its nearest competitors, Belgium at 4.44%, Hungary at 4.5% and Luxembourg at 5.2%, is twice that amount, followed by Netherlands at 7%, France at 10% and United Kingdom at 10% who seem to be behind Netherlands but far behind Cyprus.
- Cyprus IP Regime also applies to a wider range of income compared to other similar European scheme, most of which restrict benefits to income from patents and supplementary patent certificates. While IP Box Regime schemes of Belgium, Hungary, Luxembourg, Netherlands and United Kingdom offer partial exemption of gains on disposal, the exemptions become less attractive for IP holders than those offered by the Cyprus scheme, due to their limitations on qualifying assets and less deduction rates.

7. Illustrative example 1

- A Cyprus Company who is engaged in the production of mobile applications has developed a game application. The development took place in January 2019 and is expected to be finished by December 2019.The game was launched early 2020.

- The Company incurred the following income/expenses for the specific game-Refer to next Slide

Appendix 1: Application of new IP regime in mobile's application industry

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Profit& loss for the year	2019	2020	2021	2022	2023	2024
	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's
Revenues-royalties	-	8,000	9,000	9,000	9,000	9,000
Direct costs						
R&D outsourced- related party	100					
R&D outsourced- subsidiary company	500					
R&D outsourced- non-related party	1,000					
Wages of developers	1,000	700	100	100	100	100
Amortization		1,500	1,500	1,500	500	-
Operational and other expenses						
Office rent	150	150	150	150	150	150
Marketing,selling and distribution		500	1,000	1,000	1,000	1,000
Aministration expenses		300				
Interest expense	30	30	30	30	30	30
FX loss		5	5	5	5	5
Profit/(loss) before tax	**- 2,780**	**4,815**	**6,215**	**6,215**	**7,215**	**7,715**

Capitalised expenses						
	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's
Acquisition cost	**100**					
Development cost- third party	4,800					
Development costs-related parties	100					
Expenses capitalised	5,000					
Amortization		1,500	1,500	1,500	500	
Capital allowances		1,000	1,000	1,000	1,000	1,000

	2019	2020	2021	2022	2023	2024
OVERALL INCOME(OI)	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**
Profit before tax	- 2,780	4,815	6,215	6,215	7,215	7,715
Add amortization	-	1,500	1,500	1,500	500	-
Less capital allowances	-	- 1,000	- 1,000	- 1,000	- 1,000	- 1,000
FX loss	-	5	5	5	5	5
Less Notional interest deduction (If any)						
TOTAL	- 2,780	5,320	6,720	6,720	6,720	6,720

	2019	2020	2021	2022	2023	2024
QALIFYING EXPENDITURE(QA)	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**
Expenses capitalised- external parties	4,800	4,800	4,800	4,800	4,800	4,800
Wages of developers	1,000	1,700	1,800	1,900	2,000	2,100
R&D outsourced to a non-related company	1,000	1,000	1,000	1,000	1,000	1,000
Office rent	150	300	450	600	750	900
TOTAL	**6,950**	**7,800**	**8,050**	**8,300**	**8,550**	**8,800**

	2019	2020	2021	2022	2023	2024
UPLIFT EXPENDITURE	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**
Lower of:						
(i)30% of qualifying expenditure	2,085	2,340	2,415	2,490	2,565	2,640
(ii)Total acquisition cost of the QA and any R&D costs outsourced to related parties	800	800	800	800	800	800
	800	**800**	**800**	**800**	**800**	**800**

	2019	2020	2021	2022	2023	2024
OVERALL EPXENDITURE(OE)	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**	**€ 000's**
Qualifying expenditure (QE)	6,950	7,800	8,050	8,300	8,550	8,800
Total acquisition cost of the QA and any R&D costs outsourced - all years	800	800	800	800	800	800
TOTAL	**7,750**	**8,600**	**8,850**	**9,100**	**9,350**	**9,600**

	- 2,780	5,320	6,720	6,720	6,720	6,720
Qualifying profit (QP) = OI*(QE+UE))/OE						
80% exemption	**- 2,224**	**4,256**	**5,376**	**5,376**	**5,376**	**5,376**

Appendix 1: Application of new IP regime in mobile's application industry(continued)

Tax computation	2019	2020	2021	2022	2023	2024
	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's
Profit/(loss) before taxation	- 2,780	4,815	6,215	6,215	7,215	7,715
Adjustments for						
Amortization	-	1,500	1,500	1,500	500	-
FX loss	-	5	5	5	5	5
Capital allowances	-	- 1,000	- 1,000	- 1,000	- 1,000	- 1,000
Taxable profit/(loss)	- 2,780	5,320	6,720	6,720	6,720	6,720
Exemption- IP regime		**- 4,256**	**- 5,376**	**- 5,376**	**- 5,376**	**- 5,376**
Restriction of losses	**2,224**					
Utilization of losses		- 556	-	-		
Taxable profit/(loss)	- 556	508	1,344	1,344	1,344	1,344
Loss carried forward	- 556	-	-			
Tax @12,5%		**64**	**168**	**168**	**168**	**168**
Effective tax rate		**1.2%**	**2.5%**	**2.5%**	**2.5%**	**2.5%**

Effective
tax rate
2.5%

Appendix 2: Example

We set a numerical example to demonstrate how, under the new IP regime, one would reach the QP stage on which 80% notional deduction would be applied.

The major factors considered are the following:

- whether the asset was internally developed or whether it was acquired, and
- whether R&D costs were outsourced to related parties or to third parties.

The following cases will be examined:
Case 1:The asset was developed or improved internally, with R&D costs being undertaken by the company itself.
Case 2: The asset was acquired, with subsequent R&D costs for improvements of the asset being were outsourced to non-related parties.
Case 3: The asset was acquired, with subsequent R&D costs for improvements being outsourced to related parties.
For the purposes of the examples, the Figures shown on Table 1 are used.

Results
The results for calculation of the Qualifying Profit(QP) an and the tax benefit of up to 80% as a notional deduction are presented on Table 2.
Case 1: Taxable profit will be decreased by €800,000 notional expense – 2.5% effective corporate tax rate
Case 2: Taxable profit will be decreased by €416,000 notional expense – 7.3% effective corporate tax rate
Case 3: No notional expense applies – 12.5% effective corporate tax rate

Table 1	**Case 1**	**Case 2**	**Case 3**
Overall Income (OI) from qualifying IP	**€ 1,000,000**	**€ 1,000,000**	**€ 1,000,000**
Cost of acquisition of asset	N/A	€ 300,000	€ 300,000
R&D costs, incurred internally	€ 500,000	N/A	N/A
R&D costs, outsourced to non-related parties	N/A	€ 200,000	N/A
R&D costs, outsourced to related parties	N/A	N/A	€ 200,000
Overall Expenditure (OE)	**€ 500,000**	**€ 500,000**	**€ 500,000**
R&D costs, incurred internally	€ 500,000	N/A	N/A
R&D costs, outsourced to non-related parties	N/A	€ 200,000	N/A
Qualifying Expenditure (QE)	**€ 500,000**	**€ 200,000**	**N/A**
30% of the qualifying expenditure	€ 150,000	€ 60,000	0
Total cost of acquisition + cost of outsourcing to related parties	0	€ 300,000	€ 500,000
Uplift Expenditure (UE)	**0**	**€60,000**	**0**
30% of the qualifying expenditure	€ 150,000	€ 60,000	0
Total cost of acquisition + cost of outsourcing to related parties	0	€ 300,000	€ 500,000

Table 2	**Nexus Formula: OI* (QE+UE) /OE**	**Qualifying Profit (QP)**	**Notional Deduction (80% of QP)**
Case 1:	€1,000,000 x [(€500,000 + €0) / €500,000]	€ 1,000,000	€ 800,000
Case 2:	€1,000,000 x [(€200,000 + €60,000) / €500,000]	€ 520,000	€ 416,000
Case 3:	€1,000,000 x [(€0 + €0) / €500,000]	0	0

Appendix 3: Summary the key differences between IP regimes in various countries

Criteria	Cyprus	Belgium	Hungary	Luxembourg	Netherlands
Effective Tax Rate	2.50%	4.44%	4.50%	5.20%	7%
Qualifying IP Assets	Patents, computer software, utility models, other IP assets such as non obvious, useful or novel rights	Patents and supplementary patent certificates, copyrighted software	Patents, utility model protection, copyrighted software	Patents, trademarks, designs, domain names, models and software copyrights, brands for services for goods such as productions and marketing know-how	Self-developed intellectual property relating to patents, copyrighted software or approved R&D
Ineligible IP Assets	Business names, trademarks, image rights, marketing activities	Know-how, trademarks, designs, models, formulas and processes	Designs	Formulas, copyrights (other than software)	Trademarks, brands and acquired IP
Internally Developed or Acquired?	Internally developed and acquired intellectual property	Self-developed IP rights or acquired or licensed from third parties	Internally developed and acquired intellectual property	Internally developed and acquired intellectual property, but not IP acquired from a related party	Self-developed only
Limitations on Where R&D Takes Place	Some	Some	None	None	Some
Qualifying Revenue	Royalty, licensing fees, compensation income, trading profits from the disposal of IP, capital nature gains form the disposal not subject to any tax	Patent income	Royalties	Royalties net of costs (amortisation, R&D costs, interest)	Net income from qualifying assets
Deduction Rate	80%	85%	50%	80%	None – reduced tax rate
Overall Limit of Deduction	None	100% of pre-tax income	50% of pre-tax income	None	None
Gains on Disposal Included	Yes	No	Yes	Yes	Yes

Notional Interest Deduction

1. Background

- The Cyprus Income Tax Law (ITL) provides for a notional interest deduction (NID) from the taxable profits of businesses financing their operations through new equity, in a similar manner that companies financing their operations through debt, enjoy an (actual) interest deduction in calculating their taxable profit.
- The NID enhances the tax benefits of financing business operations through equity and offers a tax efficient alternative to debt financing.
- In November 2020, the EU Code of Conduct Group (Business Taxation) and ECOFIN confirmed that the Cyprus NID regime has been assessed as "not harmful" since its introduction as from 1 January 2015.

A taxpayer claiming NID can achieve an effective tax rate of up to 2.5%

2.Legal framework

- According to Article 9B, titled, "deduction on new equity", with effect from 1 January 2015, Cyprus tax resident companies and Cyprus permanent establishments (PEs) of non-Cyprus tax resident companies, are entitled to a notional interest deduction (NID) upon the employment of new equity in the production of taxable income.

- In 2016, the Cyprus Tax Authorities issued Circular 2016/10, providing clarifications and details regarding the application of the law as well as practical examples of calculating the NID.

A taxpayer claiming NID can achieve an effective tax rate of up to 2.5%

3.NID definition and calculation

Definition

- Notional Interest deduction(NID) is the amount deductible for the purposes of calculating the taxable profit.
- NID does not trigger any accounting entries and therefore does not affect the accounting profit.

Calculation

- The NID is equal to the new equity multiplied by the relevant reference rate and it is subject to a cap equal to 80% of the taxable profit (as calculated prior to the NID), arising from the new equity.
- As corporate profits are subject to income tax at the flat rate of 12.5%, a taxpayer claiming NID can achieve an effective tax rate of up to 2.5%.

NID= NEW EQUITY x REFERENCE RATE

***capped to 80% of taxable profit arising from the new equity**

4.New Equity

- "New Equity" is equity introduced in a company as from 1 January 2015 in the form of paid-up share capital and share premium.

- New equity includes shares of any class, including ordinary, preference, redeemable and convertible shares, paid either in cash or in kind.

- The Circular clarifies that unpaid share capital, in respect of which a corresponding claim has been recognised which gives rise or is deemed to give rise to interest which is subject to income tax, shall be considered as paid-up capital for the purposes of Article 9B of the ITL.

NID= NEW EQUITY x REFERENCE RATE

***capped to 80% of taxable profit arising from the new equity**

4. New equity (continued)

The Circular clarifies that the following may qualify as new equity:

- Loans payable and other debt instruments converted into issued share capital;
- Shareholders' credit balances converted into issued share capital;
- Non-refundable capital contributions converted into issued share capital;
- Realised reserves created after 1 January 2015 converted into issued share capital.

The Circular provides guidance in determining the level of new equity in a number of cases, including:

- A non-Cyprus tax resident company with a Cyprus PE issuing new equity;
- A non-Cyprus tax resident company transferring its tax residency to Cyprus;
- A non-Cyprus tax resident company with Cyprus PE transferring its tax residency to Cyprus; A Cyprus tax resident company or a PE of a non-Cyprus tax resident company reducing its equity, following the introduction of new equity.

5. Reference rate

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- For tax years up to and including 2019,the reference rate is calculated by adding a 3% premium to the 10-year government bond yield (as at 31 December of the prior tax year) of the country where the funds are employed, subject to a minimum rate, equal to the yield of the 10-year Cyprus government bond, plus a 3% premium.

- From tax year 2020 onwards, the reference rate is calculated by adding a 5% premium to the 10-year government bond yield (as at 31 December of the prior tax year) of the country where the funds are employed, with no minimum rate.

Why country is relevant?

Example:
I have provided a loan of $50m to a Croatian company in 2024? What the reference rate? What is the NID?

REFERENCE RATE= 5%+ 10-year bond Yield

	10 years bond yield as of 31/12/2023	NID Reference Interest Rate 2024
Albania (€)	5,418	10,418
Chile	5,478	10,478
Croatia	3,190	8,190
Cyprus	3,250	8,250
Czech Republic	3,752	8,752
Dubai (US$)	4,632	9,632
Greece	3,042	8,042
Israel(US$)	5,146	10,146
Luxembourg	2,809	7,809
Poland	5,191	10,191
Qatar(US$)	4,182	9,182
Romania	5,633	10,633
Russia	11,440	16,440

6. NID CAP calculation
7. Anti-abuse provisions

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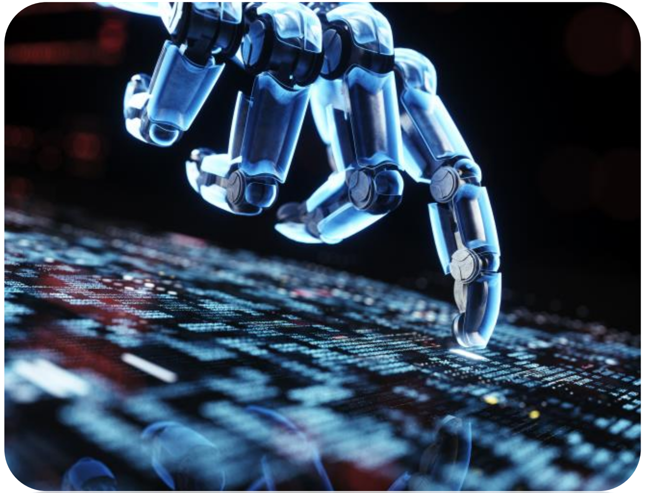
NID CAP Calculation

- **The NID is capped to 80%** of the taxable profit, generated from the new equity and calculated before allowing for the NID.
- Where a taxpayer invests the new equity in a number of different assets generating taxable income, the Circular introduces a scheduling method for the purpose of calculating the applicable NID cap.
- In this respect, taxpayers would need to determine the taxable profits generated from each asset/activity as well as to allocate new equity between the various assets/activities of the taxpayer, as follows:
  - First, identify new equity that directly financed specific assets (the 'matching concept').
  - Then allocate any remaining new equity to non-business assets and assets not generating taxable income. Finally, apply a pro-rata allocation to the remaining assets of the taxpayer.

Anti-abuse provisions

- The law provides for a number of specific anti-abuse provisions as well as a general anti-abuse provision.

Tax benefits for investing in innovative SMEs



Tax benefits for investing in innovative SMEs

Introduction

- This incentive was introduced in Cyprus legislation back in 2017, it was amended in 2022 and is currently applicable until 31 December 2026.
- The scheme is included in Article 9A of the Cyprus Income Tax Law ('ITL') and relates to investments in innovative small and medium-sized enterprises ('SME's).

What is the main tax incentive for investing in innovative SMEs?

- A qualifying individual that makes an investment in an "innovative SME" may deduct the costs of the investment from his/her taxable income, subject to the following limitations:
    - Percentage limit: The tax deduction is limited to 50% of the investor's taxable income in the year in which the investment is made.
    - Annual limit: The total deductible amount may not exceed €150,000 per year.
- Any non-deductible investment may be deducted in the five years following the year of investment, subject to the restrictions mentioned above.

Example:
An investor with taxable income in 2024 of EUR200k and it has made an eligible investment of EUR 120k.
What is the deductible amount?

Audience Q&A Session

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