

## 1. Overview of the Cyprus IP Box Regime

Cyprus offers a highly attractive IP regime, fully aligned with OECD BEPS action 5 and EU requirements (Nexus Approach). The regime provides significant tax efficiency for companies deriving income from qualifying intellectual property.

Under the regime, 80% of the qualifying profits generated from eligible IP assets are treated as tax deductible, resulting in a substantially reduced effective tax rate.

With the Cyprus corporate income tax rate at 15% (applicable from 2026 onwards), the effective tax rate on qualifying IP income can be reduced to as low as approximately 3%, subject to the application of the nexus formula.

### The Nexus Approach

According to the “nexus approach”, there should be **sufficient substance** and an **essential nexus between the expenses, the IP assets and the related IP income** in order to benefit from a patent box regime.

Under the nexus approach, the application of an IP regime is directly linked to the level of Research and Development (R&D) activities carried out by the taxpayer.

In simple terms the tax benefit is proportionate to

- The R&D expenditure and
- The extent to which such activities are performed by the Cyprus entity or **outsourced to unrelated** parties

### Qualifying profits

The following formula has been introduced to determine the qualifying profits that can benefit from an IP regime under BEPS: The Nexus Approach Formula

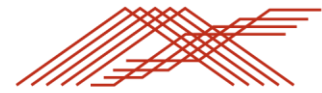
$$\text{Overall IP Income } x \frac{(\text{Qualifying expenditure} + \text{Up-lift expenditure})}{\text{Total expenditure}}$$

### Qualifying Assets

Assets acquired, developed or exploited by a person in the course of carrying on a business and which constitutes intellectual property, **other than marketing related** intellectual property associated with promotion (marketing) and which is the result of research and development activities

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## The nexus approach restrict qualifying IP Assets to

- Patents
- Copyrighted software and
- Other intangible assets which are legally protected and cover
  - utility models, intangible assets that grant protection to plants and genetic material, orphan drug designations, extensions of patent protections
  - as well as IP assets that are non-obvious, useful and novel and from which the income of a taxpayer does not exceed, in a 5 year period, €7.500.000,00 per annum (€50.000.000,00 for taxpayers forming part of a Group).

**Qualifying expenditure, excludes the R&D costs of outsourcing to related parties, contrary to the cost of outsourcing to unrelated parties** which are considered as part of ‘qualifying expenditure’.

In addition, the amendments provide for a maximum 30% up-lift of “qualifying expenditure”, thus allowing qualified taxpayers to include all or part of non-qualifying R&D costs to be included as part of the “qualifying expenditure”.

**Qualifying expenditure includes but is not limited** to salary and wages, direct costs, general expenses and commission associated with R&D activities and R&D expenditure outsourced to unrelated parties. It does not include the acquisition cost of a specific intangible asset, interest paid or payable, costs that are not associated with a specific qualified asset and expenditure relating to the acquisition or construction of immovable property.

## Qualifying income

Qualifying income includes

- Royalties or other amounts in relation to the use of the Qualifying IP Asset
- License fee for the grant of license to exploit the benefits of the Qualifying IP Asset
- IP Income embedded in the sale of the product, service or the use of the process directly related with the Qualifying IP Asset
- Insurance compensation in relation to the Qualifying IP

Capital gains on the sale of the IP are excluded.

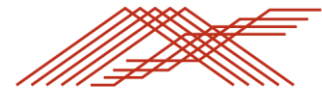
## Tax benefit

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.

In case of loss, only 20% of this loss can be surrendered to other group companies or be carried forward to subsequent years.

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## Additional deduction for the R&D expenditure

**Additional Deduction (Super Deduction) – 20% for Scientific research and research & development (R&D) expenditures incurred up to 2030, Including capital expenditures.**

### IP Box regime example

- The company has developed software that meets the criteria to be considered a qualifying intangible asset.
- In 2025, the company earns total income of €10,000,000 from royalties (e.g. licensing fees) received from customers using its software.
- Qualifying expenditures for 2025 amounted to €900,000 (e.g. direct costs, salaries, etc.).
- The company outsourced certain research and development activities to a related party for an amount of €400,000 (Non-Qualifying Expenditure).

### Calculations

OI=Overall Income	= €10.000.000
<b>QE=Qualifying Expenditure</b>	<b>= €900.000</b>
OE=Overall Expenditure	= €900.000 + €400.000 = €1.300.000
UE=Up-lift Expenditure	= €270.000
(the lower of €400.000 or 30%×€900.000=€270.000)	

### Applying the Nexus formula

$$\begin{aligned} & (900.000+270.000)/1.300.000 \times 10.000.000 = \\ & \quad 90\% \quad \times 10.000.000 = €9.000.000 \\ \text{Discount} & = 80\% \times \text{QP} = 80\% \times €9.000.000 = €7.200.000 \\ \text{Income tax without the IP Regime tax} & = 15\% \times €10.000.000 = €1.500.000 \\ \text{Final real Income tax} & = 15\% \times (€10.000.000 - €7.200.000) = €420.000 \\ \text{Effective tax rate} & = €420.000 / €10.000.000 = 4.2\% \text{ (compared to 15\% corporate tax)} \end{aligned}$$

If under the above example all the outsource activities were **with unrelated parties** then the income tax in the example is revised as below.

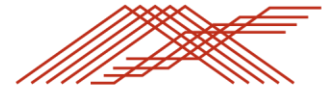
OI=Overall Income	= €10.000.000
<b>QE=Qualifying Expenditure</b>	<b>= €1.300.000</b>
OE=Overall Expenditure	= €900.000 + €400.000 = €1.300.000

### Applying the Nexus formula

$$\begin{aligned} & (900.000+400.000)/1.300.000 \times 10.000.000 = \\ & \quad 100\% \quad \times 10.000.000 = €10.000.000 \\ \text{Discount} & = 80\% \times \text{QP} = 80\% \times €10.000.000 = €8.000.000 \\ \text{Income tax without the IP Regime tax} & = 15\% \times €10.000.000 = €1.500.000 \\ \text{Final real Income tax} & = 15\% \times (€10.000.000 - €8.000.000) = €300.000 \\ \text{Effective tax rate} & = €300.000 / €10.000.000 = 3\% \text{ (compared to 15\% corporate tax)} \end{aligned}$$

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## Substance Requirements

To benefit from the IP Box regime, **adequate substance** must be demonstrated in Cyprus, including:

### 1. Management and Control from Cyprus

This is the most critical element for Cyprus tax residency.

- Majority of directors should be Cyprus tax residents
  - Board meetings should be held physically in Cyprus
  - Key strategic decisions must be taken in Cyprus
  - Maintain proper minutes and resolutions locally
2. Development, enhancement, maintenance, protection, and exploitation (DEMPE functions) performed locally
3. Physical presence (office and infrastructure)
- Registered office (this is also required from Cyprus registrar)
  - Physical office
  - Use serviced offices or lease office
  - Consider telephone line, website, Email domain, Office equipment

Only Registered office is weak under substance tests

4. Qualified personnel and operational presence
5. Outsource activities could be exercised from abroad
6. Consider Cyprus Bank account

## 2. Cyprus Company incorporation

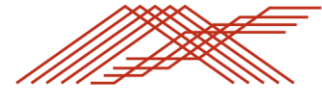
### 2.1 Company incorporation process

The incorporation process typically includes:

- Approval of company name
- Preparation of incorporation documents
- Registration with the Registrar of Companies
- Tax registration (Income Tax, VAT if applicable)
- Bank account opening

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## 2.2 Annual Compliance Requirements

Cyprus companies are required to:

- Maintain proper accounting records
- Prepare audited financial statements annually
- Submit annual tax returns
- File annual returns with the Registrar
- Maintain transfer pricing documentation (where applicable)

## 2.3. Tax and operational filings

- VAT registration and quarterly filings (if applicable)
- Payroll administration and social insurance compliance (if employees are engaged)
- Corporate tax filings and provisional tax payments

## 3. Why Cyprus

Cyprus remains a preferred jurisdiction for IP structuring due to:

- EU membership and OECD compliance
- Attractive IP Box regime (effective tax rate ~3%)
- Competitive corporate tax rate (15%)
- Extensive double tax treaty network
- Cost-effective substance compared to other EU jurisdictions
- Strong legal and regulatory framework based on English common law
- Experienced professional services ecosystem

Maria Shiaka

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