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# Tax incentives for start-ups

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Innovation and entrepreneurship are heavily sought after by countries looking to ameliorate and modernise their economies. Cyprus is no different in this respect and has prioritised creating a vibrant landscape which addresses the needs of start-ups and their investors. The defining features of the Cypriot system are its IP box regime, notional interest deduction (NID), alternative investment funds (AIFs) and various tax incentives which can be coupled with research and development and innovation.

**IP box regime**

Cyprus's IP box regime complies with Organisation for Economic Cooperation and Development guidance and EU standards while simultaneously providing attractive prospects for companies in the technology sector. This includes start-ups, which can benefit from tax allowances on a range of qualifying assets (eg, patents, copyright, computer software and other intangible assets). The IP box regime provides for up to 80% of qualifying profits to be exempt from tax. Effectively, the aforementioned profits, calculated through the nexus fraction, are treated as deductible expenses. Capital expenditure on intellectual property is also written off over five years. Coupled with a corporate income tax rate of 12.5% and other supportive legislation, this means that a start-up may potentially benefit from an effective tax rate of as low as 2.5%. The IP box regime's benefits are maximised if a start-up develops its qualifying assets in-house.

**NID**

In addition to the IP box regime and its competitive tax system, Cyprus has also introduced an NID by amending Article 9B of the Income Tax Law. In simple terms, the NID is equal to new equity (paid up share capital or share premium) multiplied by the applicable reference rate. The NID is limited to 80% of the taxable profit generated by new equity. The policy objective behind the amendment was to balance the bias towards debt financing by enhancing the benefits of equity financing. Debt financing is tax-deductible, while the same cannot usually be said of equity financing. Start-ups can take advantage of the NID and are therefore encouraged to deleverage and increase their financial robustness via an enhanced equity base. In turn, this offers them greater flexibility and substance.

The Cypriot government has also sought to attract investors by revising certain tax incentives regarding investments in innovative businesses. In 2016 the Income Tax Law was amended through Article 9A to allow investors to deduct from their taxable income costs associated with investments into "innovative small and medium-sized enterprises". This benefit is subject to a 50% limitation on an investor's taxable income and may not exceed €150,000 a year. However, if an investment exceeds this limit, the remaining sum may be carried forward for five years.

**AIFs**

Investors may also benefit from AIFs and the NID by capitalising on the considerable tax deductions which are available. AIFs in Cyprus have a simple application process with low set-up and maintenance costs. There are no restrictions on the type of investments that may be funded. Further, there is no withholding tax on dividend distributions to foreign investors and services provided by investment and fund managers are not subject to value added tax. Combined with the NID and investment benefits for innovative businesses, AIFs may prove to be an interesting investment vehicle in the Cypriot start-up landscape. Their attractiveness to a burgeoning venture capital market is magnified by the fact that they may be structured as umbrella funds covering diverse investment strategies and sub-funds.

**Comment**

A good understanding of tax law will help to streamline start-ups while granting them more financial robustness, substance and flexibility.

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