

Tax incentives for investments in Cypriot innovative SMEs

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Introduction

The Cyprus Income Tax Law ("the Law") provides for tax incentives for Cypriot tax resident individuals investing in innovative small and medium-sized enterprises ("SMEs"). The provisions granting the incentives were originally introduced in Section 9A of the Law on 1 January 2017 for a period of 3 years (up to 31st December 2020) and were subsequently extended up to 30 June 2021.

The Cyprus Parliament voted on the 10th March 2022 for a further extension of the aforementioned incentives until 30 June 2024. The amendment to the legislation was published in the Official Gazette on 18 March 2022.

The aim of the incentives is to boost entrepreneurship and innovation, support start-ups in developing innovative products and services, as well as strengthen the Cyprus entrepreneurial ecosystem.

Tax incentives

The said tax incentives provide that "**qualifying investors**" who make "**risk-finance investments**" in "**innovative SMEs**" may deduct the costs of such investments from their taxable income, subject to the following conditions/ limitations:

- The allowable tax deduction cannot exceed 50% of the investor's taxable income in the year in which the investment is made, as calculated before the deduction, but after allowing deductions for life insurance premiums and contributions to provident and other approved funds.
- Any remaining investment cost not claimed as tax deductible can be carried forward and claimed in the following five years, subject to the aforementioned 50% restriction.
- The total deductible amount cannot exceed €150,000 per year.

There is a minimum holding period of three years; otherwise, the Commissioner of Taxation may disallow the tax deduction. In addition, the Commissioner may refuse the deduction in cases where actions are taken with the intention to obtain the relevant deductions and to circumvent any provisions of Article 9A of the Law.

Qualifying investors

For the purpose of Article 9A of the Law, "qualifying investors" are individuals who are independent from the enterprise in which they are investing. An investor is deemed to be independent if he/she is not an existing shareholder of the enterprise, unless he/she was one of the founders of the enterprise upon its establishment.

The investments can be carried out either directly, or indirectly via an investment fund or through an alternative trading platform. Any remaining investment cost not claimed as tax deductible can

be carried forward and claimed in the following five years, subject to the aforementioned 50% restriction.

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Risk-finance investment

Risk-finance investments in innovative SMEs are defined as equity investments, quasi-equity investments, loans (including finance leases), guarantees, or a mix thereof. A risk-finance investment may be the initial investment in the enterprise, or a "follow-up" investment.

Innovative SME

Article 9A of the Law defines an SME as "innovative" if it meets the following conditions:

- Its operations are situated in Cyprus; and
- At the time of the investment, it is an unlisted SME (unless it is listed on an alternative trading platform) that has a business plan for its risk-finance investment and fulfils at least one of the following conditions:
 - It has not been operating in any market; or
 - It has been operating in any market for less than seven years following its first commercial sale; or
 - It requires an initial risk-finance investment which, based on a business plan prepared in view of entering a new product offering or a new geographical market, is higher than 50% of its average annual turnover in the preceding five years; and
- It has been approved by the Cyprus Ministry of Finance or other authority as a qualifying innovative SME.

It is noted that a business will stop being considered a qualifying innovative SME if, at any time, the total amount of risk-finance investment received reaches €15 million, which is the maximum permissible amount set in the relevant EU Commission Regulation.

NOTES

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. Totalserve Management Ltd will be glad to assist you in this respect. Please do not hesitate to contact us.