



Extended tax benefits for investing in innovative SMEs

Introduction

The innovation and entrepreneurship culture in Cyprus has been significantly enhanced over the last few years. From classroom curriculums, makerspaces and start-up accelerators to pitching events, innovation-centered festivals, competitions and awards, the culture is booming. This, coupled with the continuous effort of the Cyprus government to attract business and investments, has led to a growing startup ecosystem.

As innovation and entrepreneurship is key for increasing productivity and economic growth, the Cyprus government recently announced an action plan to attract international (especially innovative) businesses to the island.

One of the planned actions that has already taken place, is the extension (until **30 June 2024**) of the tax incentive already provided in [Article 9A](#) of the Cyprus Income Tax Law ('ITL') for investments in innovative small and medium-sized enterprises ('SME's). This incentive was introduced in Cyprus legislation back in 2017 and was effective until 30 June 2021.

In this article, we briefly analyse the main provisions of this scheme.

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.

Who benefits?

A qualifying investor is an individual who is independent to the investee SME (corporates are not eligible). Existing shareholders therefore do not qualify, unless they were founders upon incorporation.

Moreover, the qualifying investor must make a “risk-finance investment”, i.e. equity, quasi-equity, loan or a combination. Both initial and follow-on investments are eligible (the latter subject to conditions).

The investment can be made either directly, or through an investment fund or an alternative trading platform, as defined in [Article 9A](#) of the ITL. A **minimum holding period of three years applies**, otherwise the Commissioner of Taxation may disallow the tax deduction.

What is an innovative SME?

A qualifying innovative SME must be an unlisted enterprise, operating within the Republic of Cyprus, with a business plan for investment. This could be:

- not-yet-operating in any market, or
- operating in any market for less than seven years, or
- requiring an initial investment to launch a new product or enter a new geographical market which, according to its business plan, would provide more than 50% of its average turnover in the preceding five years.

Innovative SMEs must also align with the SME definition as per [EU Regulation 651/2014](#), the key conditions of which are an employee headcount of less than 250 persons and an annual turnover of up to €50m and/or a balance sheet total of up to €43m.

To obtain a certificate of ‘innovative SME’ status, it is necessary to receive a statement by an independent auditor, which confirms that research and development (R&D) expenses (including capitalised) represent more than 10% of the enterprise’s total operating expenditure in at least one out of the three years preceding the year in which investment is made.

In the case of enterprises with no financial history, the above R&D threshold may be validated through the enterprise’s business plan.

The law provides that upon receipt of a complete application, a response shall be provided within one month.

It is important to note that an enterprise will automatically lose its innovative SME status if, at any time, the total amount of the risk-finance investment received exceeds €15 million.

What are the tax incentives available for innovative SMEs?

Certified innovative SMEs enjoy a corporate tax deduction for scientific research expenditure or R&D expenditure, if incurred for the use and benefit of the business. Any such expenditure that is of a capital nature may be deducted from taxable income equally in the year incurred and in the following five years (i.e. over a total of six years), unless it falls under an asset class for which a different useful economic life (capital allowance rate) is provided.



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