

India and Cyprus have entered into a revised double taxation avoidance agreement ("Revised Treaty") which will replace the existing agreement between the government of India and government of the Republic of Cyprus ("Existing Treaty"). The Revised Treaty is yet to be notified by India. The government of India through the Central Board of Direct Taxes has issued a press release highlighting the significant amendments. The Revised Treaty will come into effect once both countries ratify it.

Below is a brief analysis of the Revised Treaty and the anticipated impact on existing and future investments between entities incorporated in India and Cyprus.

| Key Amendments | Existing Treaty | Revised Treaty |
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| Capital Gains | <p>Capital gains arising from the sale of shares/other capital assets situated in India were liable to be taxed according to the residence of the seller, i.e., under the laws of the Republic of Cyprus.</p> <p>Such capital gains were not taxable in India and were exempt from capital gains tax in Cyprus.</p> | <p>Authority to tax shifted onto the jurisdiction of the source of capital gains.</p> <p>Capital gains arising from the alienation of capital assets situated/sourced in India will be taxable in India and not in Cyprus.</p> <p>This will be effective for acquisitions made on or after 1 April 2017, i.e., if a Cypriot entity acquires shares of an Indian entity prior to 1 April 2017, then capital gains on alienating of such shares anytime thereafter will still be subject to the terms of the Existing Treaty.</p> |
| Permanent Establishment | <p>A "permanent establishment" (PE) connects the foreign entity to the source country and is used to determine the right of the source country to tax the business profits of the foreign entity that has a PE in India.</p> <p>The scope of what constitutes a PE in India was limited under the Existing Treaty and has been significantly expanded by the Revised Treaty.</p> | <p>The Revised Treaty has expanded the scope in the following ways:</p> <ul style="list-style-type: none"> • Service PE – Similar to the terms of the tax treaty between India and Mauritius, a Cypriot entity providing services in India will qualify as being a PE if it provides these services (i) through its employees or other personnel (ii) for an aggregate of 90 days within any 12 month period. • Specific Inclusions – The Revised Treaty specifically states that PE now includes a (i) sales outlet (ii) warehouse in relation to a person providing storage facilities for others (iii) farm, plantation or other place where agricultural, forestry, plantation or related activities are carried out. • Construction PE – The Revised Treaty has reduced the time period threshold for constituting a construction PE from 12 months (under the Existing Treaty) to six months. |
| Royalties and Fees for Technical Services | <p>Withholding tax applicable to royalty payments was 15%.</p> | <p>Rate has been reduced to 10% under the Revised Treaty, aligning it with the prevailing rate under Indian tax laws.</p> <p>The Revised Treaty also broadens the definition of "fees for technical services" to include "managerial services" as well.</p> |

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|---|--|--|
| Dividends and Interest | <p>The source country can tax dividends received at the following rates:</p> <ul style="list-style-type: none"> • Up to 10%, if the recipient is a company having at least 10% shareholding in the company distributing the dividends • Up to 15% in all other cases | <p>A standard rate of 10% will be applicable.</p> <p>The rate is applicable even in situations where the dividend recipient is a company that does not have at least 10% shareholding of the company distributing the dividends.</p> <p>Interest income accruing to a tax resident from another contracting state will continue to be taxed at the rate of 10%. However, Indian institutions such as the Reserve Bank of India, the Export Import Bank of India and the National Housing Bank have been specifically exempt in the Revised Treaty from paying tax in Cyprus on interest income earned by them from Cyprus.</p> |
| Exchange of Information; Mutual Assistance | <p>The Existing Treaty did not contain international standards for information sharing. Furthermore, one of the main reasons to negotiate the Existing Treaty with Cyprus was the lack of exchange of information (see discussion below).</p> | <p>The Revised Treaty updates the exchange of information covenants between the contracting states to reflect international standards.</p> <p>It enables exchange of banking information and permits use of information for purposes other than taxation, with prior approval from the competent authorities of the country providing such information.</p> <p>Also provides for a specific article for assistance between India and Cyprus in relation to the collection of taxes.</p> |

Cyprus – No Longer a “Notified Jurisdictional Area”

Negotiations on the Existing Treaty commenced in November 2013, once the government of India issued a notification stating Cyprus to be a Notified Jurisdictional Area (NJA) under Indian tax laws (“2013 Notification”). The NJA status was issued after determining that Cyprus was a “non-cooperating jurisdiction” as it failed to provide information that had been requested for according to the terms on information exchange under the Existing Treaty. As a result of the NJA status, Cypriot investors ceased to enjoy certain benefits, including:

- Transfer-pricing regulations that were inapplicable earlier were now applicable to transactions between taxpayers and persons located in Cyprus
- Deductions in respect of payments made to any financial institution in Cyprus were now denied unless the taxpayer authorised the Indian tax authorities to seek relevant information from the said financial institution, on its behalf
- Deductions in respect of any expenditure or allowance arising from transactions involving a person located in Cyprus were now denied unless the taxpayer maintained and furnished certain specified information
- The taxpayer was now required to satisfactorily explain the source of any sum received from a person located in Cyprus, failing which such sum would now be treated as income of the taxpayer
- Payments made to persons located in Cyprus were now subjected to a higher withholding tax rate of 30%

These adverse implications directly affected existing and future transactions and there was a decline in investments from Cyprus-based investors. There have been negotiations and discussions between the two contracting states regarding the 2013 Notification. In July 2016, the government of India released a press note stating that it will consider rescinding the 2013 Notification with effect from 1 November 2013.

The 2013 Notification was finally rescinded on 14 December 2016 by way of a notification issued by the Indian tax authorities (“Rescission Notification”). Unlike as indicated in the press release of July 2016, the Rescission Notification does not rescind the 2013 Notification retrospectively. The Rescission Notification rescinds the 2013 Notification prospectively from 14 December 2016, i.e., Cyprus is no longer a NJA with effect from 14 December 2016. Accordingly, transactions that were carried out between the 2013 Notification and Rescission Notification are not impacted by this.

Impact on Foreign Investment in India

While Cypriot entities making strategic investments in India will now have to factor in capital gains tax at the time of alienating these investments, the grandfathering provisions are likely to prevent a significant impact on such strategic investments.

The Rescission Notification puts an end to the uncertainty around Cyprus' NJA status. Coupled with the Revised Treaty, there is now sufficient clarity and certainty on the treatment of capital gains earned by the tax residents of both countries. These measures are in line with the [amendments](#) carried out to the tax treaty between India and Mauritius recently, which makes India's international tax regime predictable. This stability and predictability is likely to increase foreign investment into India from Cyprus and with increased focus of sharing information and cooperation between the two countries, it is also likely to bring in transparency and prevent round tripping of funds by Indian taxpayers.

Contacts



Biswajit Chatterjee

Partner, Corporate
Co-chair, India Practice
T +65 6922 8664
E biswajit.chatterjee@squirepb.com



Kaustubh George

Senior Associate
T +65 6922 8658
E kaustubh.george@squirepb.com



Anandee Banerji

Associate
T +65 6922 8677
E anandee.banerji@squirepb.com

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