Wolters Kluwer

GLOBAL TAX WEEKLY
a closer look

ISSUE 213 | DECEMBER 8, 2016

SUBJECTS TRANSFER PRICING INTELLECTUAL PROPERTY VAT, GST AND SALES TAX CORPORATE TAXATION INDIVIDUAL TAXATION REAL ESTATE AND PROPERTY TAXES INTERNATIONAL FISCAL GOVERNANCE BUDGETS COMPLIANCE OFFSHORE

SECTORS MANUFACTURING RETAIL/WHOLESALE INSURANCE BANKS/FINANCIAL INSTITUTIONS RESTAURANTS/FOOD SERVICE CONSTRUCTION AEROSPACE ENERGY AUTOMOTIVE MINING AND MINERALS ENTERTAINMENT AND MEDIA OIL AND GAS

COUNTRIES AND REGIONS EUROPE AUSTRIA BELGIUM BULGARIA CYPRUS CZECH REPUBLIC DENMARK ESTONIA FINLAND FRANCE GERMANY GREECE HUNGARY IRELAND ITALY LATVIA LITHUANIA LUXEMBOURG MALTA NETHERLANDS POLAND PORTUGAL ROMANIA SLOVAKIA SLOVENIA SPAIN SWEDEN SWITZERLAND UNITED KINGDOM EMERGING MARKETS ARGENTINA BRAZIL CHILE CHINA INDIA ISRAEL MEXICO RUSSIA SOUTH AFRICA SOUTH KOREA TAIWAN VIETNAM CENTRAL AND EASTERN EUROPE ARMENIA AZERBAIJAN BOSNIA CROATIA FAROE ISLANDS GEORGIA KAZAKHSTAN MONTENEGRO NORWAY SERBIA TURKEY UKRAINE UZBEKISTAN ASIA-PAC AUSTRALIA BANGLADESH BRUNEI HONG KONG INDONESIA JAPAN MALAYSIA NEW ZEALAND PAKISTAN PHILIPPINES SINGAPORE THAILAND AMERICAS BOLIVIA CANADA COLOMBIA COSTA RICA ECUADOR EL SALVADOR GUATEMALA PANAMA PERU PUERTO RICO URUGUAY UNITED STATES VENEZUELA MIDDLE EAST ALGERIA BAHRAIN BOTSWANA DUBAI EGYPT ETHIOPIA EQUATORIAL GUINEA IRAQ KUWAIT MOROCCO NIGERIA OMAN QATAR SAUDI ARABIA TUNISIA LOW-TAX JURISDICTIONS ANDORRA ARUBA BAHAMAS BARBADOS BELIZE BERMUDA BRITISH VIRGIN ISLANDS CAYMAN ISLANDS COOK ISLANDS CURACAO GIBRALTAR GUERNSEY ISLE OF MAN JERSEY LABUAN LIECHTENSTEIN MAURITIUS MONACO TURKS AND CAICOS ISLANDS VANUATU

Signature Of The Revised Double Taxation Agreement Between Cyprus And India

by Philippos Aristotelous, Andreas Neocleous & Co. LLC

The revised double taxation agreement (DTA) between Cyprus and India was signed on November 18 in Nicosia. The signature of the agreement marks a significant milestone in the restoration of normal tax relations between the two countries, which were severely disrupted when the Indian authorities in 2013 designated Cyprus as a notified jurisdictional area under Section 94A of the Indian Income-tax Act, 1961, imposing additional bureaucratic burdens on Cyprus companies investing in India.

As was widely expected following similar changes to India's double tax agreements with Mauritius and Singapore, the new agreement provides for source-based taxation of gains from the alienation of shares. However, investments undertaken before April 1, 2017, are grandfathered, with taxation rights over gains on the disposal of such shares at any future date remaining solely with the state of residence of the seller.

The new agreement closely follows the 2010 OECD Model Convention, with only minor modifications, and a protocol appended to the agreement clarifies certain of the provisions. The key provisions of the DTA and protocol are analyzed in the following paragraphs.

Taxes Covered

The agreement covers all taxes on income levied by either country or by any of its subdivisions or local authorities, including taxes on capital appreciation and on gains from the alienation of movable or immovable property. The specific taxes to which it applies are, in the case of India, income tax, including any surcharge; and, in the case of Cyprus, income tax, corporate income tax, Special Contribution for Defence (commonly referred to as SDC tax), and capital gains tax.

The agreement will also apply to any identical or substantially similar taxes that are imposed in future in addition to, or in place of, existing taxes.

Residence

Article 4 of the DTA reproduces the provisions of the OECD Model regarding residence verbatim, with the "tie-break" criteria for determining residence for individuals who are resident in both countries being permanent home and center of vital interests, country of habitual residence, and nationality, in descending order. If none of these is decisive, residence is to be settled by mutual agreement between the two countries' tax authorities.

For legal persons the place of residence is the place in which the effective management of the enterprise is situated. If this cannot be determined, the issue will be settled by mutual agreement.

Permanent Establishment

Article 5 of the DTA, which deals with permanent establishment, also reproduces the provisions of the OECD Model verbatim, with the same list of ancillary activities that *prima facie* do not give rise to a permanent establishment as appears in the OECD Model, including storage and display of goods, maintenance of stocks for processing by a third country, a purchasing or information-gathering facility, or a facility for preparatory or auxiliary purposes.

A building site, a construction, assembly or installation project or a supervisory or consultancy activity connected with it will be deemed to be a permanent establishment if it lasts for more than six months. A permanent establishment will also arise when an enterprise provides services, including consultancy services, through employees or other personnel which continue for more than 90 days within any 12-month period. An insurance enterprise of one country will, except in regard to re-insurance, be deemed to have a permanent establishment in the other country if it collects premiums or insures risks there through a person other than an agent of independent status.

If an enterprise has a representative in the territory of a country who has, and habitually exercises, authority to conclude contracts in the name of the enterprise, or who habitually maintains a stock from which he regularly delivers goods or merchandise on behalf of the enterprise, or habitually secures orders for the enterprise, the enterprise concerned is deemed to have a permanent establishment in respect of any activities which the person undertakes for it.

As in the OECD Model, the DTA provides that an independent broker or agent who represents the enterprise in the ordinary course of business will not be caught by this provision. Particular care needs to be taken regarding the issuing of general powers of attorney so as not to risk unintentionally creating a permanent establishment, with potential adverse consequences.

Income From Immovable Property

As in the OECD Model, income from immovable property may be taxed in the territory of the country where the property is situated.

Business Profits

Article 7 of the DTA follows the principles contained in the corresponding article of the OECD Model, but includes a number of amplifications and clarifications.

The profits of an enterprise are taxable only by the country in which it is resident unless it carries on business in the other country through a permanent establishment there, in which case the profit attributable to the permanent establishment may be taxed by the country in which it is located.

Intra-group management charges, interest, royalties and the like are disregarded for the purpose of determining the profits of a permanent establishment.

International Shipping And Transport

Profits of an enterprise from the operation of ships or aircraft in international traffic (including interest directly related to such operations and income from containers, trailers and related equipment) are taxable only by the country in whose territory the enterprise is resident. Income from the use of containers, trailers and related equipment entirely within a country may be taxed in that country.

Dividends

Dividends paid by a resident of one country to a resident of the other country may be taxed in the country in which the company paying the dividends is resident. However, if the beneficial owner of the dividends is a resident of the other country, the tax may not exceed 10 percent of the gross dividend. There is no minimum shareholding threshold.

Article 1 of the protocol makes clear that dividends paid by Indian companies are currently exempt from tax by virtue of Section 10 (34) of the Income-tax Act, 1961 and that, so long as this continues to be the case, there will be no withholding tax from dividends paid by an Indian company to its shareholders.

Similarly, there are no withholding taxes on dividends in Cyprus.

Interest

Interest arising in one country and paid to a resident of the other may be taxed in the country of origin. If the beneficial owner of the interest is a resident of the other country, the tax may not exceed 10 percent of the gross interest. There are the usual anti-avoidance provisions restricting relief to arm's length interest in transactions between related parties.

Interest paid to local and national government bodies and national banks is exempt from these provisions.

Royalties

Royalties and fees for technical services arising in one country and paid to a resident of the other may be taxed in the country of origin. If the beneficial owner of the income is a resident of the other country, the tax may not exceed 10 percent of the gross amount. As with interest, relief is restricted to arm's length amounts where transactions involve related parties.

Capital Gains

Gains derived by a resident of one country from the disposal of immovable property situated in the territory of the other, or from the disposal of immovable or movable property associated with a permanent establishment situated in the other, may be taxed by the country in which the immovable property or the permanent establishment is situated.

Similarly, gains from the disposal of shares in a company which derive their value (whether directly or indirectly) principally from immovable property situated in one country may be taxed in that country. Gains from the disposal of other shares may be taxed in the country in which the company issuing the shares is resident. However, Article 2 of the protocol makes an exception from these provisions for shares acquired prior to April 1, 2017. Gains from the disposal of shares acquired at any time prior to that date are taxable only in the country in which the disponor is resident.

Gains derived from the disposal of all other property (including ships or aircraft operated in international traffic) are taxable only by the country of residence of the disponor.

Offshore Activities

Unlike most of Cyprus's recent DTAs, the Cyprus–India agreement has no article dealing specifically with offshore activities. However, the provision giving rise to a permanent establishment when an enterprise provides services, including consultancy services, which continue for more than 90 days within any 12-month period will have a similar effect.

Elimination Of Double Taxation

Elimination of double taxation is achieved by the credit method. The credit is limited to the amount of tax that would be payable on the income concerned in the country of residence.

Non-Discrimination

The DTA reproduces the corresponding article of the OECD Model verbatim.

Mutual Agreement Procedure

The DTA follows the corresponding provisions of the OECD Model, but does not include any reference to arbitration to settle issues that cannot otherwise be resolved. Instead, it provides for the setting-up of a joint commission to determine such issues.

Exchange Of Information

The exchange of information article reproduces Article 26 of the OECD Model Convention almost verbatim. It adds a provision enabling a recipient of information to use it for other purposes than those specified on condition that the laws of both countries permit such use and the competent authority of the country providing the information agrees.

Article 4 of the protocol makes clear that neither country is obliged to carry out measures at variance with its laws, administrative practices, or public policy with respect to the collection of its own taxes. In this regard, it is important to note that Cyprus's Assessment and Collection of Taxes Law provides robust safeguards against abuse of any information exchange provisions by requiring the country that requests information to fulfill rigorous specified procedures to demonstrate the foreseeable relevance of the information to the request.

A request must be much more than a brief email containing the name and identifying information of the individual concerned. Rather, a detailed case must be made, with the criteria set out in a formal, reasoned document. In effect, this means that the authorities requesting the information must already have a strong case even before they request the information.

Requests for exchange of information are dealt with by a specialist unit, and informal exchange of information between tax officers bypassing the competent authority is prohibited. As a final safeguard, the written consent of the Attorney General must be obtained before any information is released to an overseas tax authority.

Assistance In The Collection Of Taxes

The DTA reproduces the corresponding article of the OECD Model Convention almost verbatim. It adds a provision making clear that the agreement does not give either country access to the courts of the other.

Entry Into Force And Termination

The agreement will enter into force when the two governments inform one another that the requisite constitutional procedures have been completed. Its provisions will have effect from the beginning of the following tax year. In Cyprus, the tax year is the calendar year, and in India, it is the year beginning April 1.

Termination of the agreement will require written notice by either country given at least six months before the end of any calendar year, whereupon the agreement will cease to have effect from the beginning of the following tax year. Notice may only be given after the agreement has been in force for five years.

Conclusion

India is among the world's largest and fastest-growing economies, and the signature of the agreement and the restoration of normal tax relations provide great opportunities for both trade and investment. While the revised agreement no longer provides exemption from capital gains tax on investments made after April 1, 2017, it places Cyprus on no less advantageous a footing than Mauritius and Singapore in this regard, Furthermore, by bringing to an end the notified jurisdictional area designation, it will eliminate the bureaucratic burdens that this imposed.