Revised double tax agreement between Cyprus and India published

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Corporate Tax, Cyprus

Introduction

The revised double tax agreement between Cyprus and India, which was signed on November 18 2016, has now been published in the *Government Gazette*.

The new agreement closely follows the 2010 Organisation for Economic Cooperation and Development (OECD) Model Tax Convention, with only minor modifications, and the protocol to the agreement clarifies a number of provisions.

Key features

Taxes covered

The double tax agreement covers all taxes on income levied by either country or by any of the country's sub-divisions or local authorities, including taxes on capital appreciation and on gains from the alienation of movable or immovable property. The agreement applies to income tax, including any surcharge, in India and income tax, corporate income tax, special contribution for defence tax and capital gains tax in Cyprus.

Residence

Article 4 of the double tax agreement reproduces the provisions of the OECD Model Tax Convention regarding residence verbatim, with the 'tie-break' criteria for determining residence for individuals who are resident in both countries being, in descending order, the individual's:

- permanent home and centre of vital interests; and
- country of habitual residence and nationality.

If neither criterion is decisive, residence will be settled by mutual agreement between the two countries' tax authorities.

For legal persons, the place of residence is the place where 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 double tax agreement, which deals with permanent establishment, also closely follows the OECD Model Tax Convention.

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

An enterprise will be deemed to have a permanent establishment if it has a representative in the territory of a country that habitually conducts any of the following activities on the enterprise's behalf:

- concluding contracts;
- maintaining stock from which it regularly delivers goods or merchandise; or
- securing orders.

As in the OECD Model Tax Convention, the double tax agreement provides that an independent broker or agent that 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 Tax Convention, income from immovable property may be taxed in the territory of the country where the property is situated.

Business profits
Article 7 of the double tax agreement follows the principles outlined in the corresponding article of the OECD Model Tax Convention, 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 conducts 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 and royalties are disregarded when determining the profits of a permanent establishment.

International shipping and transport
Profits 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 which 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 are taxable 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% of the gross dividend. There is no minimum shareholding threshold.

Article 1 of the protocol to the agreement stipulates that dividends paid by Indian companies are exempt from tax pursuant to Section 10(34) of the Income Tax Act 1961 and that, so long as this remains the case, there will be no withholding tax from dividends paid by an Indian company to its shareholders.

Similarly, there is no withholding tax on dividends paid overseas from Cyprus.

Interest
Interest arising in one country and paid to a resident of the other is taxable 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% of the gross interest. The usual anti-avoidance provisions restrict 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.

As no withholding tax is levied on interest paid overseas from Cyprus, the effective rate for Cyprus is nil.

Royalties
Royalties and fees for technical services arising in one country and paid to a resident of the other are taxable in the country of origin. If the beneficial owner of the royalties is a resident of the other country, the tax may not exceed 10% 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 in the other, or from the disposal of immovable or movable property associated with a permanent establishment in the other, are taxable by the country in which the immovable property or the permanent establishment is situated. Similarly, gains from the disposal of company shares which derive their value (directly or indirectly) principally from immovable property situated in one country are taxable in that country. Gains from the disposal of other shares are taxable in the country in which the company issuing the shares is resident. However, Article 2 of the protocol to the agreement makes an exception for shares acquired before April 1 2017. Gains from the disposal of shares acquired before that date are taxable only in the country in which the disponor is resident.

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

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.

Exchange of information
The exchange of information article reproduces Article 26 of the OECD Model Tax Convention almost verbatim. It adds a provision enabling a recipient of information to use it for purposes other 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 to the agreement makes clear that neither country is obliged to carry out measures at variance with its laws, administrative practices or public policy regarding the collection of taxes. In this respect, Cyprus's Assessment and Collection of Taxes Law provides robust safeguards against abuse of the information exchange provisions by requiring the country that requests information to fulfil rigorous specified procedures to demonstrate the foreseeable relevance of the information to the request. A request must be more than an 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. This means that the authorities requesting the information must have a strong case before making the request.

Requests for exchange of information are dealt with by a specialist unit and the 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 collection of taxes

The double tax agreement reproduces the corresponding article of the OECD Model Tax 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 take effect from the beginning of the following tax year. The tax year follows the calendar year in Cyprus and begins on April 1 in India.

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 be given only after the agreement has been in force for five years.

Comment

India is one of the world's largest and fastest growing economies. The signature of the agreement marks a significant milestone in the restoration of tax relations between the two countries and provides new 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 a similar footing to Mauritius and Singapore in this regard.

For further information on this topic please contact Philippos Aristotelous at Andreas Neocleous & Co LLC by telephone (+357 25 110 000) or email (aristotelous@neocleous.com). The Andreas Neocleous & Co LLC website can be accessed at www.neocleous.com.

Philippos Aristotelous