



Key highlights of the revised tax treaty between India and Cyprus

The Finance Act, 2011 introduced Section 94A in the Income-tax Act, 1961 (the Act) as an anti-avoidance measure with effect from 1 June 2011. As per Section 94A(1) of the Act, the central government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify by notification in the Official Gazette, such country or territory as a Notified Jurisdictional Area (NJA) in relation to transactions entered into by the taxpayer with any person in such notified country or territory.

Since Cyprus has not been providing the information requested by the Indian tax authorities under the exchange of information provisions of the tax treaty, the Central Board of Direct Taxes (CBDT), through a notification¹, notified Cyprus as an NJA under Section 94A of the Act.

The India-Cyprus tax treaty (tax treaty) signed in 1994 provides that both countries would exchange information as is necessary for carrying out the provisions of the tax treaty or those of the domestic laws of each country in particular for the prevention of fraud or evasion of taxes. As per the tax treaty, there are certain streams of income, which are either taxed at 'Nil' or a 'concessional rate' in India.

Subsequently, CBDT issued a press release² to finalise the new tax treaty, wherein all pending issues, including taxation of capital gains, were discussed. It was stated that India will consider rescinding the notification effective from 1 November 2013, under Section 94A of the Act.

In August 2016, the Union Cabinet of India has issued a press release³ approving revised tax treaty and protocol. It was stated that capital gains will be taxed in India for entities resident in Cyprus subject to double taxation relief. In other words, India will have the right to tax capital gains arising in India.

Recently, CBDT has issued a press release⁴ stating that India has signed a revised tax treaty with Cyprus along with its Protocol. The Cyprus government has issued the revised tax treaty, and the key aspects are summarised as follows:

Particulars	Existing tax treaty	Revised tax treaty
Title		The title only covers taxes on income. Levy of taxes on 'capital' has been removed.
Taxes covered	Applies to taxes on income and capital.	Applies to taxes on income.
General definitions	<ul style="list-style-type: none"> Defines company to mean only body corporate or any entity which is treated as company or body corporate under tax laws in force in the respective contracting state. 	<ul style="list-style-type: none"> The 'company' has been defined to mean any body corporate or any entity that is treated as a body corporate for tax

¹ Notification No. 86/2013, dated 1 November 2013

² CBDT press release, dated 1 July 2016

³ PIB release, dated 24 August 2016

⁴ CBDT press release, dated 18 November 2016

	<ul style="list-style-type: none"> • For any transport to fall within the definition of 'International traffic' the ship or aircraft should be registered and have the headquarters (i.e. effective management) in a contracting state. • The term 'fiscal year' is the same as defined under Section 3 of the Act. • As regards the application of the tax treaty by a contracting state, any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the law of that state concerning the taxes to which this tax treaty applies. 	<p>purpose.</p> <ul style="list-style-type: none"> • For any transport to fall within the definition of 'International traffic' the ship or aircraft is not required to be registered and having the headquarters (i.e. effective management) in a contracting state. • The term 'enterprise' applies to the carrying on of any business. • The term fiscal year has been now defined as fiscal year beginning on the 1 day of April. Reference to Section 3 of the Act has been removed. • Additionally, it has been provided that any meaning under the applicable tax laws of a state will prevail over a meaning given to the term under other laws of that state shall apply.
Resident	<ul style="list-style-type: none"> • The term 'resident of contracting state' does not include a person who is liable to tax in that state in respect only of income from sources in that state or on capital situated therein. 	<ul style="list-style-type: none"> • The term 'resident of contracting state' has been amended to remove the word 'capital situated therein'. In other words exclusion of a person who is liable to tax in that state on capital situated therein has been removed. • It also provides that in case of a person other than individual if the state in which the person's place of effective management situated cannot be determined, then the competent authorities of the contracting states shall settle the question by mutual agreement within two years from the date of invocation of Mutual Agreement Procedure (MAP). • The resident now specifically includes any political subdivision or local authority thereof.
Permanent Establishment (PE)		<ul style="list-style-type: none"> • The following has been added to the illustrative list of PE in clause 2 of Article 5 of the tax treaty: <ul style="list-style-type: none"> ➤ A sales outlet ➤ A warehouse in relation to a person providing storage facilities for others; ➤ A farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on.

	<ul style="list-style-type: none"> • Construction PE is constituted only where such site, project or activities continues for a period of more than twelve months. • Service PE clause does not exist. • The term PE shall be deemed not to include the following: <ul style="list-style-type: none"> ➤ the use of facilities solely for the purpose of storage, display or <u>delivery</u> of goods or merchandise belonging to the enterprise; ➤ the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or <u>delivery</u>; • The person other than an agent of independent status shall constitute an agency PE if he is acting on behalf of an enterprise and has, and habitually exercises, in a contracting state an authority to conclude contracts on behalf of the enterprise. 	<ul style="list-style-type: none"> • The threshold for Construction PE has been reduced to six months. • A new Service PE clause has been introduced whereby furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only where activities of that nature continue (for the same or connected project) within the country for a period or periods aggregating more than 90 days within any 12 month period shall constitute a PE in India. • The word 'delivery' has been removed from the exclusions of PE. • Exclusions provided for maintenance of fixed place of business solely for the purpose of advertising, for the supply of information or for scientific research, being activities solely of a preparatory or auxiliary character in the trade or business of the enterprise removed. • Additional exclusion from PE is provided in case fixed place of business is maintained solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character. • The criteria for the constitution of an agency PE has been amended. Accordingly, the person other than an agent of independent status shall constitute an agency PE if: <ul style="list-style-type: none"> ➤ He is acting on behalf of an enterprise and has, and habitually exercises, in a contracting state an authority to conclude contracts in the name of the enterprise; ➤ Has no such authority, but habitually maintains in the first-mentioned state a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the
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	<ul style="list-style-type: none"> • Insurance PE clause does not exist. 	<p>enterprise;</p> <ul style="list-style-type: none"> ➤ Habitually secures orders in the first-mentioned state, wholly or almost wholly for the enterprise itself. • Insurance PE clause has been introduced under the revised tax treaty. An insurance enterprise (except in regard to re-insurance) shall be deemed to have PE in India if it collects premiums in the territory of that other state or insures risks situated therein through a person other than an agent of an independent status.
Income from immovable property	The income from immovable property specifically covers income from agriculture or forestry.	No specific mention to cover agriculture and forestry.
Business profits	<ul style="list-style-type: none"> • There is a force of attraction rule under the tax treaty. Accordingly, the business profits of the enterprise may be taxed if it is attributable to the following: <ul style="list-style-type: none"> ➤ The PE ➤ Sales in that other state of goods or merchandise of the same or similar kind as those sold through that PE or ➤ Other business activities carried on in that other state of the same or similar kind as those effected through that PE. • There was no clause on the allowability of head office expenditure. 	<p>The revised tax treaty has removed the 'force of attraction' rule. Accordingly, the business profits of an enterprise may be taxed in the other state but only so much of them as is attributable to that PE.</p> <ul style="list-style-type: none"> • No deduction shall be allowed in respect of amounts⁵, if any, paid (other than reimbursement of actual expenses) by the PE to the head office or any of its other offices, by way of interest on money lent to the PE. <p>Similarly, no account shall be taken, in the determination of the profits of a PE, of amounts charged⁵ (other than reimbursement of actual expenses) by the PE to the head office or any of its other offices, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.</p>
Dividends	<ul style="list-style-type: none"> • If the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed: <ul style="list-style-type: none"> ➤ 10 per cent of the gross amount of the dividends if the beneficial owner is a company which owns at least ten per 	<ul style="list-style-type: none"> • The rate of dividend in source state shall not exceed 10 per cent. The rate of 15 per cent has been removed.

⁵ by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of banking enterprises.

	<p>cent of the shares of the company paying the dividends; and</p> <ul style="list-style-type: none"> ➤ 15 per cent of the gross amount of the dividends in all other cases. 	
Interest	<ul style="list-style-type: none"> • Interest may be taxed in source state, the tax so charged shall not exceed 10 per cent if the recipient is the beneficial owner of the interest. 	<ul style="list-style-type: none"> • Tax rate of interest in source state shall not exceed 10 percent if the beneficial owner of the interest is a resident of the other contracting state. • Following entities are additionally exempt from tax: <ul style="list-style-type: none"> ➤ Export-Import Bank of India ➤ National Housing Bank ➤ Any other institution as may be agreed upon from time to time between the competent authorities of the contracting states through the exchange of letters.
Royalties and Fees for Technical Services (FTS)	<ul style="list-style-type: none"> • If the recipient is the beneficial owner of the royalties or Fees for Included Services (FIS) the tax so charged shall not exceed 15 per cent of the gross amount of the royalties or FIS. • The term royalty and FIS includes payment or credits. • The term royalty has been defined to mean payments or credits, whether periodical or not, and however described or computed, to the extent to which they are made as consideration for : <ol style="list-style-type: none"> (a) the use of, or the right to use any copyright, patent, design or model, plan, secret formula or process, trade mark or other like property or right; (b) the use of, or the right to use, any industrial, commercial or scientific equipment; (c) the supply of scientific, technical, industrial or commercial knowledge or information; (d) the use of, or the right to use : <ol style="list-style-type: none"> (i) motion picture films; (ii) films or video tapes for use in connection with television; or 	<ul style="list-style-type: none"> • The term FIS has been replaced by the term FTS. • The tax rate of royalties and FTS in the source state is reduced to 10 percent from 15 per cent. • The term royalty has been amended to include payment only. • The definition of the term 'royalty' has been amended as follows: <p>The term 'royalties' means payment of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films or films or tapes used for television or radio broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. The term 'royalties' will not include income for the use of, or the right to use aircrafts and ships.</p>

	<ul style="list-style-type: none"> (iii) tapes for use in connection with radio broadcasting; or (iv) total or partial forbearance in respect of the use or supply of any property or right referred to in this paragraph. <ul style="list-style-type: none"> • The term FIS has been defined to mean payments or credits, whether periodical or not, and however described or computed, to the extent to which they are made as consideration for: <ul style="list-style-type: none"> (a) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right⁶, any such equipment⁷, or any such knowledge or information⁸; (b) rendering of any technical or consultancy services (including the provision of technical or other personnel) if such services make available technical knowledge, experience, skill, know-how or process or consist of the development and transfer of a technical plan or technical design. <ul style="list-style-type: none"> • Technical fees are separately dealt in Article 13 of the tax treaty. 	<ul style="list-style-type: none"> • The term 'FTS' has been amended as follows: <p>'FTS' means payments of any kind as consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel.</p> <p>Further, the 'make available' clause has been removed from the term FTS.</p> • Additionally, provides that royalties or FTS do not arise in one of the contracting states, and the royalties relate to the use of, or the right to use, the right or property, or the FTS relate to services performed, in one of the contracting states, the royalties or FTS shall be deemed to arise in that contracting state. • This article is deleted in the revised tax treaty, and FTS is merged in the above article.
Capital gains	<ul style="list-style-type: none"> • Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the contracting state in which the place of effective management of the enterprise is situated. 	<ul style="list-style-type: none"> • The clause relating to alienation of ship and aircraft amended to provide that gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the contracting state of which the alienator is a resident. • A new clause has been inserted to provide that gains from the alienation of shares of the capital stock of a company

⁶ The use of, or the right to use any copyright, patent, design or model, plan, secret formula or process, trade mark or other like property or right

⁷ The use of, or the right to use, any industrial, commercial or scientific equipment

⁸ The supply of scientific, technical, industrial or commercial knowledge or information

		<p>the property of which consists directly or indirectly principally of immovable property situated in a contracting state may be taxed in that state.</p> <ul style="list-style-type: none"> • Further, gains from the alienation of shares other than those mentioned above in a company which is a resident of a contracting state may be taxed in that state. • As per the Protocol to the tax treaty, a grandfathering clause would be provided for shares acquired prior to 1 April 2017, in respect of which capital gains would be taxed in the country of which taxpayer is a resident. Accordingly, gains from the alienation of shares that have been acquired at any time prior to the 1 April 2017 shall be taxable only in the contracting state of which the alienator is a resident. However, it will not apply to gains from the alienation of shares that have been acquired on or after the 1 April 2017.
Shipping and air transport	<ul style="list-style-type: none"> • Profits derived by an enterprise which is registered and having the headquarters (i.e., effective management) in a contracting state from the operation by that enterprise of ships or aircraft in international traffic shall be taxable only in that state. • Profits from the operation of ships or aircraft in international traffic was defined to mean profits derived by an enterprise from transportation by sea or air respectively of passengers, mail, livestock or goods carried on by the owners or lessees or charterers of ships or aircraft including the sale of tickets for such transportation on behalf of other enterprise, other activity directly connected with such transportation, and the rental of ships or aircraft incidental to any activity directly connected with such transportation. • Interest on funds connected with the operation of ships or aircraft in international traffic shall be regarded as profits derived from the operation of such ships or aircraft, and the provisions of Article 11 (Interest) shall not apply in relation to such interest. 	<ul style="list-style-type: none"> • The criteria of registration and headquarters have been removed. Accordingly, profits derived by an enterprise of a contracting state from the operation of ships or aircraft in international traffic shall be taxable only in that state • The term profits for the purpose of shipping and air transport has been amended. Accordingly, profits from only the operation of ships or aircraft in international traffic shall include profits derived from the rental of ships or aircraft on a full time (time or voyage basis) or bareboat basis. • The exception is provided for the taxability of profits from the use, maintenance, or rental of containers for the transport of goods or merchandise solely between places within the other contracting state. • The amended tax treaty refers to interest on funds connected directly with the operation of ships or aircraft in international traffic shall be regarded as profits derived from the operation of such ships or aircraft, and the provisions of

	<ul style="list-style-type: none"> Gains derived from the alienation of ships, aircraft or containers owned and operated by the enterprise, the income from which is taxable only in that state, shall be taxed only in that state. 	<p>Article 11 (interest) shall not apply in relation to such interest.</p> <ul style="list-style-type: none"> Gains derived from the alienation of ships, aircraft or containers owned and operated by the enterprise are covered under 'capital gains'. It shall be taxable only in the contracting state in which the alienator is a resident (Article 13 clause).
Independent personal services	<ul style="list-style-type: none"> There is no rolling period concept under the tax treaty. The income derived in respect of professional services or other independent services inter-alia of a similar character shall be taxable in source state if his stay in other contracting state is for a period or periods amounting to or exceeding in the aggregate 183 days in the relevant financial year. 	<ul style="list-style-type: none"> The revised tax treaty has introduced the rolling period concept i.e. for a period or periods amounting to or exceeding in the aggregate 183 days in any 12 month period commencing or ending in the fiscal year concerned.
Dependent personal services	<ul style="list-style-type: none"> There is no rolling period concept under the tax treaty. The remuneration derived by a resident shall be taxable in source state only if the recipient is present in the other state for a period or periods amounting to or exceeding in the aggregate 183 days in the relevant fiscal year. In case the remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic by an enterprise shall be taxable only in the contracting state in which the place of effective management of the enterprise is situated. 	<ul style="list-style-type: none"> The revised tax treaty has introduced the rolling period concept i.e. the remuneration derived in respect of an employment exercised in the other contracting state shall be taxable in source state only if the recipient is present in the other state for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned. The revised tax treaty has removed the place of effective management criteria. Therefore, the remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic, by an enterprise of a contracting state shall be taxed in that state.
Other income	<ul style="list-style-type: none"> Notwithstanding the other provisions of this Article, items of income of a resident of a contracting state not dealt with in the foregoing Articles of the tax treaty and arising in the other contracting state may also be taxed in that other state. 	<ul style="list-style-type: none"> This clause has been removed in the revised tax treaty. The revised tax treaty listed certain specified income for taxability in source state. Accordingly, if a resident of a contracting state derives income from sources within the other contracting state in the form of lotteries, crossword puzzles, races including horse races, card games and other games of any sort or gambling or betting of any nature whatsoever, such income may be taxed in the other contracting state.

Non-discrimination	—	<ul style="list-style-type: none"> • The revised tax treaty has amended the non-discrimination clause. It provides that nationals of a contracting state shall not be subjected in the other contracting state to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other state in the same circumstances, <u>in particular with respect to residence</u>, are or may be subjected. This provision shall also apply to persons who are not residents of one or both of the contracting states. • Interest, royalties and other disbursements paid by an enterprise of a contracting state to a resident of the other contracting state shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned state. Similarly, any debts of an enterprise of a contracting state to a resident of the other contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.
Exchange of information	—	<ul style="list-style-type: none"> • The revised tax treaty has updated the exchange of information article as per international standards. It will enable the exchange of banking information and allow the use of such information for purposes other than taxation with the prior approval of the competent authorities of the country providing the information.
Assistance in collection of taxes	This article does not exist in the tax treaty.	The revised tax treaty has introduced a new article namely 'Assistance in Collection of Taxes'. This article will help in assisting each other for collecting revenue claims.
Entry into force		<ul style="list-style-type: none"> • With respect to taxes withheld at source, for amounts paid or credited on or after 1 April of the fiscal year next following that in which the tax treaty enters into force; and • With respect to taxes on income for any fiscal year beginning on or after 1 April of the fiscal year next following that in which the tax treaty enters into force.

Our comments

The issue with respect to the constitutional validity of Section 94A of the Act has been debated before courts⁹. The courts observed that the challenge to the constitutional validity of Section 94A(1) of the Act is without any merit. It is not correct that once a tax treaty is entered into, the Parliament loses the power conferred by the Constitution, to make a law. Accordingly, the constitutional validity of Section 94A of the Act was upheld by the courts.

Now the tax treaty has been revised to provide for source based taxation of capital gains arising from the alienation of shares, instead of residence based taxation provided under the existing tax treaty. However, a grandfathering clause has been provided for shares acquired prior to 1 April 2017, in respect of which capital gains would continue to be taxed in the country of which taxpayer is a resident. The revised tax treaty provides that dividend distributed by an Indian company is exempt from tax under the Act. Accordingly, even though the tax treaty provides for withholding tax rate of 10 per cent, so long as the present system of taxation of dividends in India continues, there will be no withholding tax from dividends paid by an Indian company to its shareholders.

The revised tax treaty has widened the scope of construction PE, agency PE, etc. Further, service PE has been included within its ambit. The tax rate of royalty and FTS has been reduced, which will help to boost technology and intellectual rights. However, the scope of FTS has been widened by removing 'make available' clause. The other income article is narrowed down to tax payment specified in the source state.

In furtherance to the agenda of non-adversarial tax regime with a focus on more exchange of information alongwith certainty, clarity, and reduced litigation, the government has revised the tax treaty. However, the notification dated 1 November 2013 has not been rescinded so far. Withdrawal of the notification will help to protect the interest of genuine investors from Cyprus who want to invest in India.

⁹ Expo Gulf Ltd v. UOI [2016] 274 CTR 390 (Uttarakhand), T. Rajkumar, v. UOI [2016] 383 ITR 385 (Mad)

www.kpmg.com/in

Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytila, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

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