India - Cyprus DTAA

Why in news?

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- Nearly three months after the Cabinet's approval to the signing of the revised double tax avoidance agreement (DTAA) with Cyprus, India has now signed the new pact with the island nation, which is a popular tax haven.
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- It was signed in Nicosia by High Commissioner of India to Cyprus and the Minister of Finance of Cyprus.
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- Similar agreements have been signed with Mauritius and Singapore.
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What are the provisions of the agreement?

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- The protocol for the revised agreement will replace the existing agreement signed in June 1994.
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- The new DTAA provides for **source-based taxation of capital gains** arising from alienation of shares, instead of residence-based taxation provided under the existing DTAA.
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- However, a grandfathering clause i.e exemption clause has been provided for investments made prior to April 1, 2017, in respect of which capital gains would continue to be taxed in the country where the taxpayer is a resident.
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- The treaty also expands the scope of the permanent establishments to allow for source-based taxation of business income.
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- It reduces the tax rate on royalty in the country from which payments are made to 10 per cent from the existing rate of 15 per cent, in line with the tax rate under Indian tax laws.
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- It updates the text of other provisions in accordance with the international standards and consistent policy of India in respect of tax treaties.
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- The new DTAA will come into force after the completion of necessary internal procedures in both countries and is expected to be set in motion in India in respect of income derived in fiscal years beginning on or after April 1, 2017, according to an official release on Friday.
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What is the significance of the deal?

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- Cyprus is the seventh top country from which India gets maximum FDI inflow.
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- But it was the only country to have been **blacklisted by India as a non-cooperative jurisdiction**, due to lack of effective exchange of information.
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- India and Cyprus had entered into a tax treaty in 1994, and are obliged to exchange information. On November 2013, the Finance Ministry had notified Cyprus as a non-cooperative jurisdiction following failed discussions to secure the desired level of cooperation.
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- The new pact provides for assistance between the two countries for collection of taxes. It also updates the provisions related to exchange of information to accepted international standards, which will enable exchange of banking information and allow its use for purposes other than taxation, with the prior approval of the competent authorities of the country providing the information.
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Is any country likely to benefit as a result of the amendment?

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- Experts say the Netherlands may emerge as an alternative due the series of agreements with Cyprus, Singapore and Mauritius.
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- The India-Netherlands treaty provides that if a company based in Netherlands holds less than 10% equity in an Indian entity, it would not

attract capital gains on the sale of those shares to residents or non-residents.
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- Even if it were to own more than 10% equity in an Indian company, the treaty allows it to sell the shares to a non-resident without attracting tax.
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