



## Cyprus as a Tax Haven

**For Prelims:** [Tax haven](#), [Double Taxation Avoidance Agreement](#), India's Tax Treaty with Cyprus, Tax evasion

**For Mains:** Concerns and Implications of Cyprus being used as a tax haven,

**Source:** [IE](#)

### Why in News?

The recent **Cyprus Confidential investigation** has brought to light a complex web of financial activities involving offshore entities in [Cyprus](#) and their connection to wealthy individuals in India.

- This global offshore investigation, conducted in collaboration with the [International Consortium of Investigative Journalists \(ICIJ\)](#), exposes the use of **Cyprus as a tax haven** by the rich and powerful from around the world.

### Note:

- A tax haven is generally an **offshore country** that offers foreign individuals and businesses **little or no tax liability** in a politically and economically static environment.
- An offshore company is incorporated in a jurisdiction other than its home country.
  - The main purpose of setting up an offshore company is to take advantage of the **favourable tax laws or economic environment** in a foreign country.

### What Tax Benefits Does Cyprus as a Tax Haven Offer?

- **Corporate Taxation:**
  - Offshore companies and offshore branches managed and controlled from **Cyprus are taxed at 4.25%**.
  - Offshore branches managed from abroad and offshore partnerships enjoy total exemption from tax.
- **Withholding Tax and Dividends:**
  - Cyprus imposes **no withholding tax** on dividends.
  - Beneficial owners of offshore entities or branches are not liable for additional tax on dividends or profits.
- **Capital Gains and Estate Duty:**
  - No capital gains tax is payable on the sale or transfer of shares in an offshore entity.
  - Inheritance of shares in an offshore company is exempt from estate duty.
- **Import Duty Exemptions:**
  - No import duty on the purchase of cars, office, or household equipment for foreign

employees.

- **Anonymity and Confidentiality:**

- Cyprus ensures the anonymity of the beneficial owners of offshore entities.
- Offshore trusts in Cyprus do not need to be registered with any government or authority, ensuring confidentiality.

- **Offshore Trusts:**

- Offshore trusts are trusts whose property and income are outside Cyprus, and even the settlor and beneficiaries are not permanent residents of Cyprus.
  - **Offshore trusts in Cyprus are exempt from estate duty** if the trustee is Cypriot.
  - No tax on the income and gains generated by offshore trusts.
- The trust need **not be registered with any government** or other authority, and confidentiality is enshrined in the new law.

## What is India's Tax Treaty with Cyprus?

- **Before 2013:**

- **Exemption from Capital Gains Tax**

- India and Cyprus had a tax treaty **exempting investors from capital gains** tax upon exit.
  - Zero taxation on capital gains in both countries made **Cyprus a favoured destination** for equity investments in India.
- Cyprus offered a low 4.5% withholding tax, enhancing its attractiveness for individuals and businesses.
  - Withholding tax served as a means to ensure tax compliance by non-residents, applicable to payments made to non-resident individuals.
  - Payees were responsible for deducting tax, deposited with the government at rates defined by the Income-tax Act, 1961, or the **Double Taxation Avoidance Agreement (DTAA)**, whichever was lower.

### Note:

- A DTAA is a tax treaty signed **between two or more countries**. Its key objective is that taxpayers in these countries **can avoid being taxed twice for the same income**.
  - A DTAA applies in cases where a taxpayer resides in one country and earns income in another.
- DTAA's can either be comprehensive to cover all sources of income or be limited to certain areas such as taxing income from shipping, air transport, inheritance, etc.
- **Since 2013:**
  - India designated Cyprus as a **Notified Jurisdictional Area (NJA)** on November 1, 2013, under Section 94A of the Income-tax Act.
    - NJA status resulted in consequences such as a higher withholding tax rate (30%) for payments to entities in Cyprus.
  - Transactions with entities in NJA became subject to Indian **transfer pricing regulations**.
    - Transfer pricing is the **setting of the price for goods and services sold between controlled (or related) legal entities** (may be situated in different countries) within an enterprise.
- **Since 2016:**
  - In 2016, a revised **DTAA** with Cyprus was signed, clarifying the rescission of the NJA status with retrospective effect from 2013.
  - The new DTAA introduced for **source-based taxation of capital gains** from the alienation of shares.
    - Alienation refers to the **voluntary sale/ transfer or relinquishment of the asset by the owner**.
  - A **grandfathering clause** protected investments made before April 1, 2017, allowing taxation of capital gains in the country of the taxpayer's residence.
- **Analysis and Implications:**

- The phased evolution reflects the dynamic nature of India's tax arrangements with Cyprus.
  - The move towards source-based taxation aligns with global efforts to curb **tax evasion** and ensure fair revenue distribution.
  - Increased scrutiny on tax-related matters globally, as evidenced by offshore investigations, influenced India's approach to tax treaties.
  - The **grandfathering clause** aimed to provide continuity and stability for investments made before significant policy changes.
- **Legality of Indian Companies in Cyprus:**
  - **It is not illegal** to establish an offshore company in Cyprus.
  - India has DTAA's with several countries, including Cyprus, which offer low tax rates.
    - Companies use their **tax residency certificates** in such countries to enjoy tax benefits that are available legally.
    - These jurisdictions are generally characterised by lax regulatory oversight and airtight secrecy laws.

## How do Investors use Cyprus as a Tax Haven?

- In Cyprus **money laundering** is facilitated by channelling funds through multiple networks of **shell companies**.
  - A shell company is a firm that **does not conduct any operations** in the economy, but it is formally registered, incorporated, or **legally organized in the economy**.
- Cyprus has a high level of **banking secrecy and does not exchange** information on financial accounts with other countries automatically.
  - This aids the investors in **hiding assets and income** from authorities and creditors.
- Furthermore, investors **may influence politics and policy-making** through strategic donations and lobbying practices.

## How can India Curb the Use of Cyprus as a Tax Haven?

- **Strengthening Compliance Mechanism:** India can counter the use of Cyprus as a tax haven by strengthening the enforcement and compliance mechanisms, and ensuring that the **tax authorities have adequate resources and powers to detect**, investigate, and prosecute the cases of tax evasion and **avoidance**.
- **Accountability Measures:** India should enhance the **transparency and accountability of the offshore entities**, and requiring them to disclose their beneficial owners, directors, and financial activities.
  - India can also impose **withholding taxes and anti-avoidance measures** on payments made to Cypriot entities or individuals.
- **Robust Legislations:** India can address the abuse of tax treaties by enacting and implementing robust laws. This involves expanding the scope and coverage of these laws and ensuring their effective implementation and monitoring.
- **Promotion of Ethical Behaviour:** There should be promotion and incentive for the **ethical and responsible behaviour of the taxpayers**, and encouraging them to pay their fair share of taxes and contribute to the national development.

## Key Facts About Cyprus

- Cyprus is an island country in the **Eastern Mediterranean Sea**, with an area of about 9,251 square kilometers.
- It is the **third-largest and third-most populous island in the Mediterranean**, with a population of about 1.2 million people.
- **Capital:** Nicosia
- Cyprus has been a member of the **European Union** since 2004.
- Cyprus has a pleasant Mediterranean climate, with hot summers and mild winters.
- Cyprus is physically divided with the **southern part ruled by the internationally-recognised government and the northern part controlled by Turkey**.

PDF Refernece URL: <https://www.drishtias.com/printpdf/cyprus-as-a-tax-haven>

