New tax treaty with Cyprus puts ambiguity to rest in realty sector

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The amended tax treaty provides India the right to tax capital gains on the sale of shares by a Cyprus company.

BENGALURU | MUMBAI: With India and Cyprus revising their tax treaty, clarity has emerged on the tax liability on investments that have flowed into real-estate projects in the country through Cyprus.

A substantial amount of investments into the real estate sector in India had come through the Cyprus route. After the government in November 2013 notified Cyprus as a non-cooperative jurisdiction over tax matters, concerns had risen over the applicability of exemption from capital gains tax for existing deals.

The amended tax treaty provides India the right to tax capital gains on the sale of shares by a Cyprus company. However, what comes as a major relief is that investments made prior to April 1, 2017, will not be liable to capital gains tax in India.

"Over the last few years, much of the private equity investment in the real estate sector was made from Cyprus. Ever since the Indian government notified Cyprus as a jurisdiction not exchanging adequate information, the investors had to face the brunt of higher tax withholding at 30% and continuing uncertainty on the Treaty benefits," said Abhishek Goenka, partner-tax & regulatory services, at PwC.

Formal signing of a new treaty puts the ambiguity to rest, Goenka said. "With the specific grandfathering of investments made up to March 31, 2017, capital gains exemption will now be available on all existing investments. This will be a huge relief and will benefit investors who are in many cases battling to get their base capital itself returned."

Under the grandfathering clause, an old rule that was replaced would continue to be applicable on existing cases, even as the new one takes care of future instances.

"The revised treaty will allow better exchange of information; this is a positive development and will strengthen the economic link between India and Cyprus," said Rubi Arya, vice chairman of private equity firm Milestone Capital Advisors. "The grandfathering clause is a relief to existing Cyprus investors who were anxious and were not clear on the taxation of capital gains made on investment in shares of Indian companies."

The revised agreement will replace the existing agreement signed in June 1994 with Cyprus, which has a reputation as a tax haven. Given that the real estate sector was struggling with an economic downturn, unsold inventory and stalled projects over the past few years, the concerns over additional cash burden of higher withholding tax had further impacted both developers and investors.

According to Goenka, there is no mention in the official statement whether the withholding tax rate on interest has been reduced to the 7.5% prescribed in the new Mauritius treaty.

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