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Cyprus Confidential investigation

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Why is in news? Secrecy and no tax — reason why Indians look at Cyprus

Over the last decade, a series of investigations based on data leaks of service providers and banks operating in tax haven jurisdictions have helped governments go after tax evaders.

Examples: Offshore leaks (2013); Swiss leaks (2015); Panama Papers (2016); Paradise Papers (2017); Mauritius leaks (2019); FinCEN Files (2020); Pandora papers (2021); Cyprus Confidential (2023).

Cyprus Confidential:

The Cyprus Confidential investigation reveals that entities with offshore residency were controlled from India, and instructions for financial transactions in these entities are given by individuals in India.

Cyprus Confidential is a **global offshore investigation** of 3.6 million documents in English and Greek, which lays bare a **paper trail of companies incorporated in the tax haven of Cyprus** by the **rich and powerful from around the world**.

The investigation, carried out in **partnership with the International Consortium of Investigative Journalists (ICIJ)**, involves more than 270 journalists from more than 60 media houses in 55 countries and territories.

The data trove comprises documents from six offshore service providers in Cyprus

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The data trove comprises documents from six offshore service providers in Cyprus.

Besides information on Indian investors who became Cypriot nationals under the **country's Golden Passport scheme**, it also has documents relating to entities set up by leading business houses to take advantage of the liberal tax regime in the island country in the Eastern Mediterranean.

What does the India investigation show?

The investigation attempts to **lift the veil of secrecy for government and regulatory agencies**.

The documents reveal how entities with offshore residency were controlled from India, and instructions for financial transactions in these entities are given by individuals in India.

Setting up offshore entities in Cyprus:

It is **not illegal to set up an offshore company** in Cyprus.

India has **double-taxation avoidance agreements** (DTAAs) 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.

Double Taxation Avoidance Agreement (DTAA):

DTAA is a tax treaty **between two or more countries**, including India, designed to **prevent taxpayers from being taxed twice on the same income**—once in the source country and again in the residence country.

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It aims to **eliminate or reduce the instances of double taxation**, providing clarity on tax liabilities for individuals and businesses operating in multiple countries.

India's tax treaty with Cyprus:

India's tax arrangement with Cyprus has had **three distinct phases** over the last two decades.

Prior to 2013:

India and Cyprus had a **tax treaty offering investors exemption from capital gains tax** at the time of exit.

Incidentally, **Cyprus too didn't tax capital gains**. Thus, investors paid zero tax on gains made from their equity investment in India.

Cyprus also had a **low 4.5 per cent withholding tax**, and was hence a favoured destination for individuals/businesses to set up entities and invest in India.

Withholding tax: It is an effective way to **ensure tax compliance by non-residents** who may be subject to different tax regulations than residents. It is applicable **in case of payments done to non-resident individuals**. It is the payee's responsibility to deduct tax when depositing the payment in the account of the NRI.

The payee deposits the deducted withholding tax with the government, and the tax rate is decided as prescribed in the **Income-tax Act, 1961, or Double Taxation Avoidance (DTA) Agreement**, whichever is lower.

Since 2013:

On November 1, 2013, India **included Cyprus in a list of countries that refrained from sharing or exchanging valuable tax-related information**.

In technical terms, it was categorised as a **Notified Jurisdictional Area (NJA)** under Section 94A of the Income-tax Act.

NJA countries face consequences such as a higher withholding tax rate of 30 per cent for payments received by entities registered there.

Further, transactions with entities in NJA are subjected to Indian transfer pricing regulations.

Revised DTAA in 2016:

A revised **Double taxation Avoidance Agreement (DTAA)** was signed with Cyprus on December 14, 2016.

India rescinded Cyprus as NJA, and subsequently clarified that the rescission was with retrospective effect from November 1, 2013.

The text of the new DTAA provides for **source-based taxation of capital gains** arising from alienation of shares. **Alienation** refers to voluntary sale/ transfer or relinquishment of the asset by the owner.

Further, a **grandfathering clause** has been provided for investments made prior to April 1, 2017. This allowed for **capital gains to be taxed** in the country of which the **taxpayer is resident**.

These changes are consistent with those brought about by the renegotiated India-Mauritius tax treaty, i.e., source-based taxation of capital gains and a grandfathering clause.

Tax benefits does Cyprus offer:

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Offshore companies and offshore branches managed and controlled from Cyprus are taxed at 4.25 per cent, and offshore branches **managed and controlled from abroad** and **offshore partnerships** are **totally exempt from tax**.

There is **no withholding tax on dividends**, and the beneficial owners of offshore entities or branches are **not liable to an additional tax on dividends or profits** over the amount paid by the respective legal entities.

No capital gains tax is payable on the sale or transfer of shares in an offshore entity.

No estate duty is payable on the inheritance of shares in an offshore company.

There is **no import duty** on the purchase of cars, office or household equipment for foreign employees.

It also **assures anonymity of the beneficial owners** of offshore entities.

India-Cyprus DTAA and its significance:

It allows Cyprus — which has a low tax regime — to be used as a jurisdiction for tax planning.

Many foreign investors set up their investment firms in Cyprus to invest in India to benefit from the DTAA.

Cyprus is **now an alternative to Mauritius for setting up an offshore entity** for investment in India.

As dividends paid out from India will be subject to withholding tax, no taxation will arise in Cyprus as this will be adjusted or credited against the 4.25 per cent tax in Cyprus.

Offshore Trusts in Cyprus:

As per Cyprus International Trust Law, offshore trusts are trusts whose **property and income are outside Cyprus** and even the **settlor and beneficiaries are not permanent residents** of Cyprus.

If the **trustee is a Cypriot**, the offshore trust is exempt from estate duty, and does not have to pay any tax on the income and gains.

The trust **need not be registered with any government or other authority**, and confidentiality is enshrined in the new law.

In other words, the trust **allows businesspersons to avoid tax** that would have otherwise been paid by the settlor had she/ he remitted the income arising from overseas operations, to the country of residence.

Limitations of Indian DTAA: A DTAA **does not stop the I-T department from denying tax treaty benefits** if it is established that a company has been inserted as the owner of shares in India at the time of disposal of the shares to a third party, **solely with a view to avoid tax**.

Tax haven country:

A tax haven is a country or location with **extremely low “effective” tax rates for overseas investors**.

Tax havens **do not typically require residency or business presence** for individuals and businesses to benefit from their tax policies.

A list of some of the **popular tax haven countries** includes the Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands, Hong Kong, Mauritius, Lichtenstein, Monaco, Panama, St. Kitts, and Nevis.

Characteristics of Tax Haven:

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Tax havens also **share only a limited amount of financial data** with foreign tax authorities, if any at all.

Tax havens **encourage foreign depositors** by offering tax advantages to corporations and the wealthy.

Depositing money in a tax haven is legal as long as the depositor pays the taxes required by the home jurisdiction.

Tax havens may also be **used illegally to hide money from tax authorities** at home.

Offshore Tax Haven:

From the viewpoint of an Indian, “offshore” is **anywhere outside the Indian jurisdiction**.

Offshore tax havens benefit from the capital their countries draw into their economies. The funds flow in from individuals and businesses with accounts at banks and other financial institutions.

Tax Haven Criteria by OECD:

The Organization for Economic Co-operation and Development (OECD) outlines four crucial criteria to assess if a jurisdiction qualifies as a tax haven:

Imposition of no or minimal taxes.

Lack of transparency.

Presence of laws or practices hindering effective information exchange for tax purposes.

Absence of a requirement for substantial economic activity.

Golden passport:

Golden Passport scheme or Citizenship by investment scheme is a scheme in which the person gets “golden passport” or “cash-for-passports”.

Golden passport refers to a facility offered by some countries whereby foreigners can get citizenship status by making a significant investment or by buying a house in that country.

For Indians, and businesspeople in particular, having a passport that is higher up in the pecking order can help in ease of business.

Example:

Recently, the European Commission has proposed suspending a visa-free travel arrangement with Vanuatu due to concerns about the Pacific nation’s controversial “golden passports” scheme.

The citizenship-by-investment (CBI) programs allow foreign nationals to **purchase Vanuatu citizenship for US\$130,000** in a process that typically takes just over a month, without ever setting foot in the country.

Other important terms:

Tax Evasion:

Tax evasion is the **illegal practice of not paying owed taxes** to the government through fraudulent means, such as underreporting income, utilizing offshore accounts, or inflating deductions to decrease tax liability.

Automatic Exchange of Information:

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It was introduced to **combat offshore tax evasion by wealthy individuals**, promoting transparency and information sharing among countries.

Base Erosion and Profit Shifting (BEPS):

BEPS, **coined by OECD**, refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations, thus eroding the tax base of the higher-tax jurisdictions.

Shell Company:

A shell company is a business entity **without active business operations** or significant assets.

Often, it **exists only on paper** and is used for various financial purposes, including reducing tax liability, avoiding regulations, or conducting financial transactions anonymously.

P-Notes (Participatory Notes):

Participatory Notes are financial instruments **used by investors to invest in Indian securities without direct registration** with regulatory authorities.

They are issued by registered foreign institutional investors (FII) to overseas investors, providing an indirect route to participate in the Indian stock market, especially in the context of international finance and taxation.

Round tripping:

Round tripping is a financial practice where **funds are routed**, often **through a series of transactions or intermediary entities**, to conceal the original source of the funds.

This can involve **sending money offshore and then bringing it back through a complex route** to make it appear as if it's a legitimate investment.

Conclusion:

The India-Cyprus offshore connection is a complex landscape with legal tax planning, secrecy, and regulatory challenges. The Cyprus Confidential investigation has brought these nuances to light, prompting scrutiny and raising questions about the intricacies of offshore financial activities.