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Trend and Pattern of Indian Overseas Direct Investments to Tax Haven Countries

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Abstract

The present study explores and analyse the flow of Indian Overseas Direct Investment in to tax haven and nontax haven countries. The researcher compares the flow of Indian Overseas Direct Investment in tax haven countries with non-tax haven countries for the period of 2008-2017. The study finds that a steady increase in Indian Overseas Direct Investment flow to tax haven countries and every year between 50 to 70 per cent of Indian Overseas Direct Investment is flows to tax haven countries.

Key words: tax haven countries, non-tax haven countries, overseas direct investment

Introduction

Indian Overseas Direct Investments encourage the economic cooperation between India and foreign countries. Also it will result in transfer of technology and skills, access to new markets, employment generation and efficient utilization of resources available in India and foreign countries. It helps to integrate the Indian economy with other parts of the world. MNCs invest in foreign countries to earn more income through the use of business opportunities available there. Tax haven countries play a substantial role in the world foreign direct investment movement. The IMF coordinated investment survey states that in 2010 tax haven countries Bermuda, Barbados and the British virgin islands were received more FDIs than Japan or Germany. According to K.C. Fung, Alicia Garcia-Herrero (2012) Chinese investment attracted to large economies but corrupt and poor countries, whereas India is attracted to small and rich economies with efficient administration. First post.com (march, 19, 2014) states that more than 50% of India's outbound FDI are in tax havens such as Panama, Cyprus, Netherlands, Mauritius, British virgin islands etc. Reports published by Department

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of Economic Affair shows that many tax haven countries are top in the list of Indian Overseas Direct Investment attracting countries.

This paper attempts to identify the trend and patterns of overseas direct investment to tax haven countries over last decade. Researcher use the data provided by World Bank and RBI to analyse the trend and pattern of overseas direct to tax haven countries. The study period is 10 years from 2008 to 2017 and the analysis will helps to identify basic trend of overseas direct investment flow and its distribution between tax haven and non-tax haven countries.

The rest of this paper is structured as follows. In the next section includes an overview of tax haven countries and overseas direct investment and followed by the review of literature on overseas direct investment and tax havens. Then in subsequent sections consist of objectives of the study, data, and the overall methodology of the research. Next section presents the results and explains FDI inflow trend from tax haven. In last section we conclude.

Theory and review of literature

Tax haven countries

Tax haven countries are the territories or jurisdictions, where low or no tax at all or tax system is favour for a particular type of transactions. Examples of such tax havens include Ireland, Luxembourg, Singapore, Caribbean islands, Mauritius etc... Offshore financial centres are countries that “Provide financial services to non-residents on a scale that is incommensurate with the size and the financing of its domestic economy” (Zorome, 2007). In terms of GDP, market size, resource availability, tax haven countries are not an attractive place for investment. Dhammika Dharmapala, et al. (2009) identified that 15 % countries in the world are tax havens and these countries are small and wealthy. Also found that governance index is significant and quantitatively large association with the likelihood of being a tax haven. Tax havens countries are low-tax jurisdictions which offer investors the opportunities for tax avoidance (Mihir, Fritz Foley and James 2006). Majority of authors concludes that a tax haven is a country associated with offering low rates of taxation to non-residents, providing some degree of privacy to its offshore investors or offering easy legal procedures for incorporation and establishment of local subsidiaries. Eugenia Ramona Mara (2015) found that merely the Low tax rate is not enough to become tax haven but the

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percentage of service in GDP is important factor to become a tax haven. Normally economy of tax havens are more depends on the financial service sectors and generating income through the fee charged from these multinationals for financial service.

Overseas Direct Investment and Tax Haven Country

Reserve Bank of India defines Indian Overseas Direct Investment as "Investment either under the automatic route or the approval route, by way of contribution to the capital or subscription to the memorandum of foreign entity or by way of purchase of existing shares of a foreign entity, signifying a long term interest in the foreign entity".

Many multinationals direct Foreign Direct Investment (FDI) through a third country which has a favourable tax treaty network with ultimate receiving country. Such treaty helps the MNCs to avoid withholding taxes in investing countries (Weyzig, F. 2013). India has entered into tax treaties with many countries to promote bilateral investment by eliminating the problem of double taxation and bring a better stable tax law. Indian MNCs are investing the countries such as Mauritius, Luxembourg, and Singapore etc. to take advantages from such treaty. There has been a perceptible shift in Indian Overseas Direct Investment destination in last decade or so. The IMF investment survey states that in 2010 the British Virgin Islands were the second largest investor in to China. It shows that the tax haven countries are important player in receiving and investing FDI. Though these countries are small in GDP, geographical area, natural resource, the quantity of inflow and outflow in tax havens are large as invest from developed countries.

Objectives

1. To explain the concept of tax haven countries
2. To study the trend of India overseas direct investment to tax haven countries under the study period
3. To compare the trend and pattern of Indian Overseas Direct Investment to tax haven countries to non-tax haven countries

Data and methodology

This study uses the overseas direct investment made by Indian companies for last ten years from 2008 to 2017. Researcher collected data from Reserve Bank of India. FDI investment includes equity, loans and guarantee issued. For detailed analysis researcher

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selected top 16 Indian Overseas Direct Investment receiving countries. Out of the selected 16 countries, 9 are tax haven and 6 are non-tax haven countries. Mauritius, Singapore, Cyprus, Netherlands, Switzerland, Hong Kong, British virgin island, Cayman island, panama are the tax haven countries and U.S., United Kingdom, UAE, Mozambique, Russia, Australia are the non-tax haven countries. Indian Overseas Direct Investments data for 16 countries for the period of 2008 to 2017 are used for analysis. Present study descriptive in nature and processed data shown in graphs and charts.

Sample selection

Table 1

Tax Haven Countries	**Non-tax Haven Countries**
Mauritius	U.S.A
Singapore	United Kingdom
Cyprus	UAE
Netherlands	Mozambique
Switzerland	Russia
Hong Kong	Australia
British virgin island	
Cayman island	
panama	

First we listed out all countries receiving the Indian Overseas Direct Investment. Total 158 countries are receiving the FDI from India. Few countries have received largest share of Indian Overseas Direct Investment. These 15 countries have received 91.15% of overseas direct investment in last ten years. Out of these 15 countries 9 countries are identified as tax haven and 6 countries as non-tax haven countries. These countries are classified into tax haven and non-tax haven countries as per classification done by OECD (2000), IMF and James R. Hines (1994).

Results and discussion

The overseas investment total flows are presented in chart 1. Indian MNCs are invested in 158 countries during the study period. The amounts of overseas direct investments were at top in 2010 with the 40510.857 Million U.S $. FDI outflows started to decrease drastically in the year 2010. After 16.22 per cent decrease in 2011, outflow fell further 24 per cent in 2012. This decline may be the reflection of the weak economic performance of global economy and consistent with the findings of World Investment Report that FDI flows

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reduced in almost all major economies. In 2012 it showed a recovery but again declined in 2015.

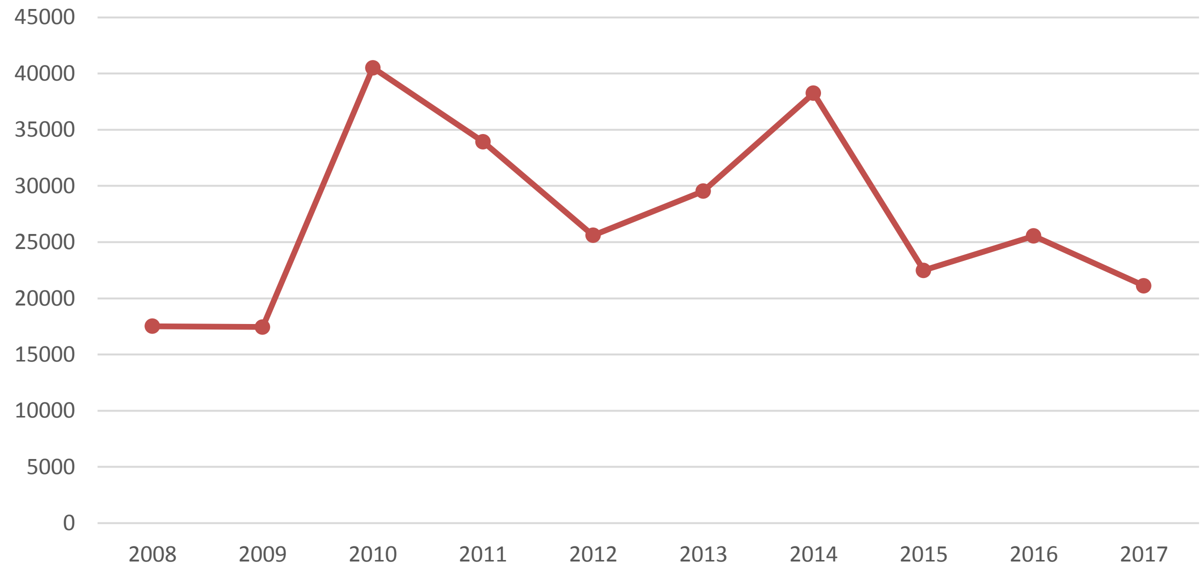

Chart 1: total Indian Overseas Direct Investment for the period of 2007 to 2017
Source: Authors calculation base on RBI data

Chart2 depicts the trend of overseas investment flows to tax haven and non-tax haven countries. Overseas direct investments outflows to tax haven countries are higher than flows to non-tax haven countries in all ten years. The trend in outflow to non-tax haven is less sensitive to total outflow while outflow to tax haven countries are highly sensitive to change in total outflow.

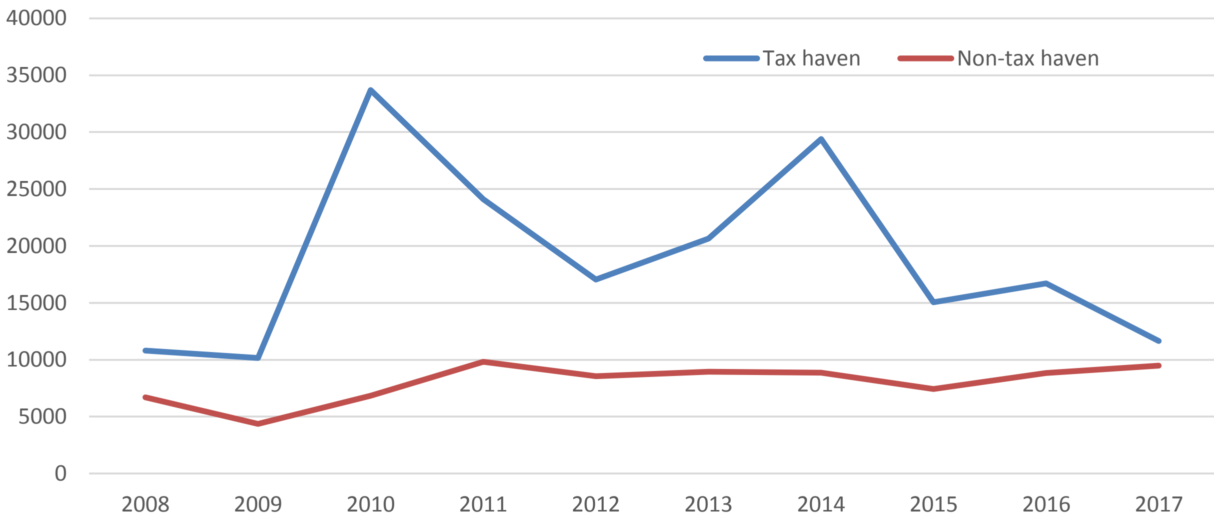

Chart2: Flow of Indian Overseas Investments to tax haven and non-tax haven countries
Source: Authors calculation base on RBI data

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Since 2008 Overseas Direct Investments has started slowly increasing because of the relaxations in overseas investment rules in FEMA act 2000. Overseas Direct Investments by India increased in the year 2007 and reached in 2010 with investment of $ 33686 million. The well foreign exchange reserve position results in relaxation of the capital controls and simplification of the procedures for outward investments from India. There was a decline in overseas direct investment in 2011-12 and 2012-13. This decline can attributes to the global financial crisis that reduced the risk taking capacity of firms investing in foreign countries. In 2014 India showed signs of recovery but in 2015 again started to decline. In 2016 the overseas direct investment increased to 16720.2 $US.

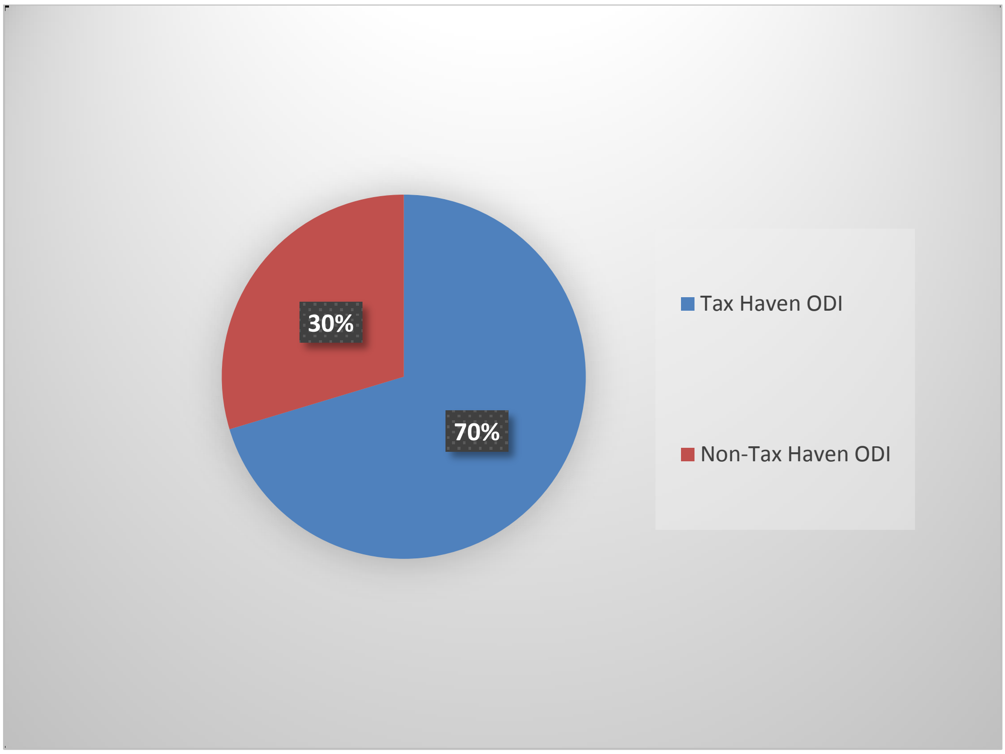

Chart 3: Indian Overseas Direct Investments to tax haven and non-tax haven
Source: Authors calculation base on RBI data

Chart 3 shows the cumulative investment of Indian overseas investment in tax have and non-tax haven countries for the period of 2008 to 2017. The chart 3 shows that 70% of total Indian Overseas Direct Investments invested in tax haven countries while in non-tax haven countries only 30%. Thus tax haven countries have a significant role in receiving Indian overseas investment. There are 40 tax haven countries and 118 non-tax haven countries, receiving the Indian Overseas Direct Investment. Even though the tax haven countries are less in numbers and in economic indicators, they receive more than half of Indian overseas investment.

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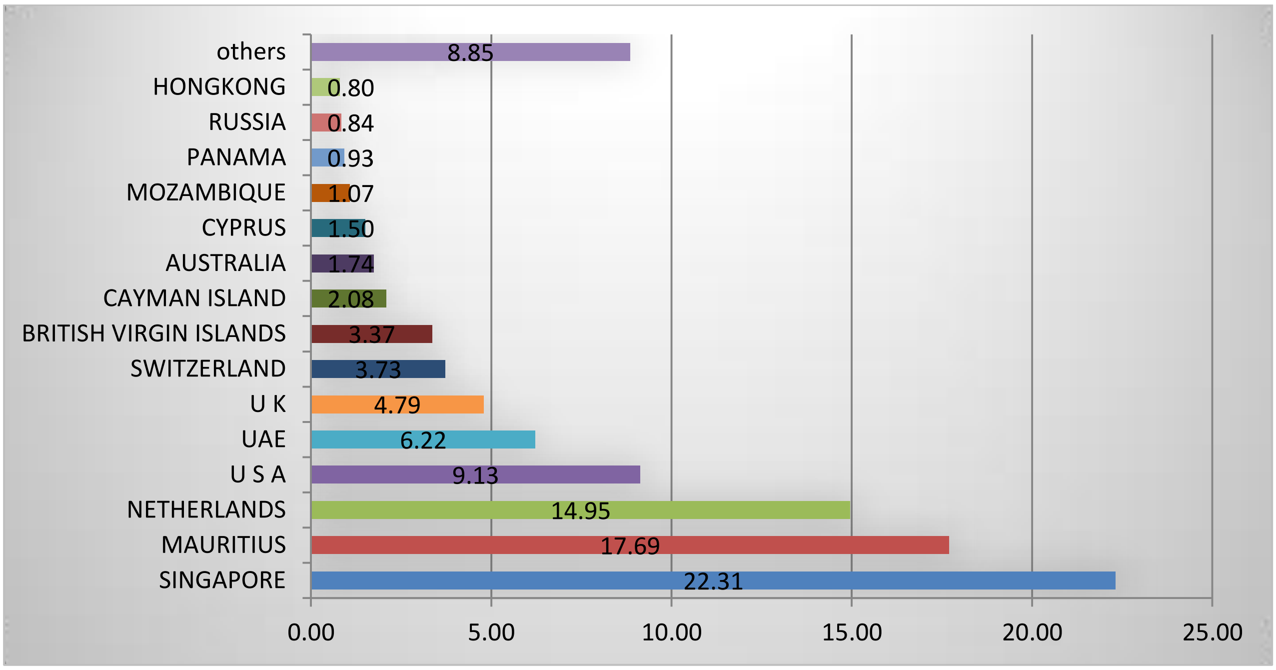

Chart4: Indian Overseas Direct Investment to top fifteen countries
Source: Authors calculation based on RBI data

Chart 4 presents the cumulative amount of Indian Overseas Direct Investment to top 15 countries and country's share for the study period. Singapore, Mauritius, Netherlands, U.S.A and UAE are in top five leading countries. First three countries are tax haven countries as per OECD (Organisation for Economic Co-operation and Development) tax haven classification. More interestingly the tax haven countries such as Switzerland, British Virgin Islands, Cayman islands, cypress panama and Hong Kong are included in top fifteen countries which are receiving Indian overseas investment. Singapore which is the top in list received 24% of overseas direct investments for the period of 2008-2010. Then Mauritius, Netherlands, USA and UAE received 19%, 16%,10% and 7 % respectively.

Discussion

An efficient governance system in host countries is found to attract higher overseas direct investments flows from India. (Alicia Garcia-Herrero, Sumedh Deorukhkar, 2014) . Investment to tax haven countries is motivated by low rate of tax and high governance strength (Murali D. R. Chari, Şenay Açıkgöz, 2015). Thus The Indian Overseas Direct Investments to tax haven countries might drives by the low tax rate and high governance index. FEMA act 2000 liberalised overseas direct investment process and restrictions and enables the MNCs to make huge investments in foreign countries.

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The notable change in Indian Overseas Direct Investments during the year 2000 to 2014 is the shift in geographical destination. While U.S and U.K was the attractive destination for India's overseas direct investments before 2000(Chaudhry, D., Tomar, P., & Joshi, P. 2018.), from 2007 to 2017 largest receivers are Singapore and Mauritius which accounted for 22.31% and 17.69% respectively. Both Singapore and Mauritius are the tax haven countries. Other tax havens such as Netherlands, British Virgin Islands, Switzerland, Cayman Island, Hong Kong, Cyprus, Panama, Jersey, Ireland etc. are also included top15 Indian Overseas Direct Investments receiving countries. It shows that the Indian companies are preferring tax haven countries for their overseas direct investment. But the ultimate destination of investments may be different for these overseas direct investments. The increased flow of investment to tax haven countries may be due to low tax rates, high governance index and large tax treaty networks. India has double tax avoidance agreements with all tax haven countries. Some of the provisions in the double tax avoidance agreements facilitate the multinationals to escape from tax liability in both countries. Also multinationals can shift profits to tax haven countries through transfer pricing, debt financing etc. Registering intangible assets in tax havens and selling it to subsidiaries in non-tax haven countries at inflated price is the common method of shifting profiting. Best example is Microsoft which have registered their research and development (R&D) units and patents in Ireland (Simpson (2005). Thus investing in tax haven subsidiary is an important strategy in international tax planning.

Conclusion

The study analyse the recent trend and pattern of Indian Overseas Direct Investment made to tax haven countries. In the last 20 years there is a significant increase in Indian Overseas Direct Investment due to the policy made by government of India. The present study found that Indian Overseas Direct Investment showed a steady increase over last two decades and every year about 50 per cent to 70 per cent of overseas direct investment is flows to tax haven countries. Tax haven countries such as Singapore, Mauritius and Netherlands are the countries which attracts substantial amount of overseas direct investment for last decades. During 2009 to 2011 Indian overseas investments was highest forever, but there has been a slowdown in 2012 and 2013. After a recovery in 2014, again the overseas direct investments declined continuously for 3 years since 2015. This study results are consistent with the statement of "early period overseas investments were directed to resource rich countries such as Australia, UAE, and Sudan, in the latter half, overseas investments was channelled into

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countries providing higher tax benefits such as Mauritius, Singapore, British virgin islands, and the Netherlands" (India brand equity foundation).

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