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PHOTO: AFP

Revisiting the S'pore-India Double Taxation Avoidance Agreement

Singapore, being India's largest trade and investment partner in Asean, has additional bargaining power over other tax havens and should expect a fair renegotiation. **BY RAMKISHEN S RAJAN AND SASIDARAN GOPALAN**

FOREIGN direct investment (FDI) inflows into India have been growing robustly since the 2000s, reaching a new high of US\$55 billion in 2015-2016 or about 2.7 per cent of India's GDP. An examination of the breakdown of these inflows of FDI into India by source country reveals that the combination of Mauritius, Cyprus, Singapore and Netherlands constitute about 60 per cent of overall FDI equity inflows on a cumulative basis over the period 2000 to 2016. Among these countries, Mauritius has traditionally been the dominant source country, accounting for about one-third of India's FDI equity inflows, with Singapore constituting another 16 per cent over the same period. In 2015-2016, Singapore surpassed Mauritius as the single largest source of FDI into India, with almost 35 per cent of FDI equity inflows into India originating from Singapore as against just over 20 percent from Mauritius.

All the four countries mentioned above impose very low-to-negligible capital gains taxes domestically and have in place Double Taxation Avoidance Agreements (DTAAs) with India. The DTAAs have traditionally implied that there will be exemptions to capital gains taxes for investments from these countries which in turn have facilitated their role as important sources of FDI into India. However, over the years, the DTAAs have also given rise to widespread concerns in India that they may have been misused by several Indian companies and individuals to avoid domestic taxation and instead engage in round-tripping of funds back to India or trans-shipping of funds from third countries, not unlike what was done historically in Hong Kong vis-a-vis China.

However, it is not altogether appropriate for India to have lumped Singapore with tax havens such as Mauritius and Cyprus. Singapore has for long been an established bone fide international financial centre and a regional headquarters for several firms undertaking significant business activities in the rest of Asia.

While the Singapore-India DTAA came into force in 1994, it received an impetus when it was revised as part of the landmark Comprehensive Economic Cooperation Agreement (CECA) in 2005. In 2011, when India became concerned about tax loopholes in the DTAA, Singapore was the first country to be willing to agree to a "Limit of Benefit" (LOB) provision which was expected to prevent "treaty shopping" – a major tax leakage source – and restrict the misuse of the DTAA by third-country investors. It reflected Singapore's confidence that most firms were primarily using Singapore as

a hub to invest in India and elsewhere rather than as a means of tax avoidance.

The CECA has widened the nature of engagement with Singapore on several key fronts, including trade in goods, services and investment flows. On the investment front, closer connectivity between the two countries have resulted in Singapore emerging as a key off-shore hub for Indian corporates. To date, there are about 6,000 Indian firms registered in Singapore that use it as their regional base and headquarters to tap the larger Asia-Pacific region.

On the trade front, the expansion has been particularly significant since 2005, with bilateral trade jumping from about US\$7 billion in 2004-05 to about US\$15 billion in 2015-16. Singapore is India's largest trade and investment partner in the Asean region. Nearly 30 per cent of India's overall exports to the Asean group of countries from 2015-16 was destined for Singapore. Thus, the economic relationship between the two countries is highly robust and is not just about tax exemption issues.

In contrast, although the DTAA with Mauritius was signed in 1983, it has been the subject of a variety of controversies ever since and the path to renegotiating the DTAA to plug the possible loopholes has been riddled with difficulties. After 33 years, the DTAA with the country was finally amended on May 10, 2016, with the key changes including an introduction of capital gains taxation at source from April 1, 2017, incorporation of an LOB, as well as updating the information exchange between the countries. Similarly, the DTAA with Cyprus was revised in November 2016, replacing its original one signed in 1994.

SINGAPORE-INDIA DTAA: VICTIM OF COLLATERAL DAMAGE?

A significant collateral damage of the revised DTAA with Mauritius in particular was its impact on India's DTAA with Singapore, as the capital gains tax exemption under the Singapore DTAA was "co-terminus" with the exemption of capital gains tax under the Mauritius DTAA. This implied that a revision to the DTAA with Singapore was unavoidable to some extent. Consequently, on Dec 30, 2016, the DTAA with Singapore was revised by signing a "Third Protocol" that is closely (although not fully) aligned with the Mauritius DTAA.

The "Third Protocol" allows for source-based taxation of capital gains arising from transfer of shares from April 1, 2017, while allowing grandfathering of investments made before the effective date of imple-

mentation, subject to the LOB clause as per the earlier protocol agreed on in 2005. The amendment also allows a transition period of two years, similar to the Mauritius treaty, with any capital gains accruing during this period to be taxed at 50 per cent of the domestic tax rate subject to LOB fulfillment. However, the withholding tax on interest payments remains at 15 per cent for Singapore which compares unfavourably to 7.5 per cent offered to Mauritius.

As much as it is true that the tax treaty between Singapore and India had a provision that any changes in the Mauritius treaty would automatically apply to the one with Singapore, the Republic is certainly within its rights to be dissatisfied with repeated renegotiations. It was also rather inopportune that the timing of the DTAA renegotiations with Singapore coincided with the demonetisation initiative in India.

Speaking at a "demonetisation report-card" press conference on Dec 29, 2016, the Indian finance minister remarked that "... since there have been efforts by the government of India to eliminate black money and its users in India, where it can, revisiting of this treaty was important" seeming to refer to the reworking of the Singapore DTAA. This seemed to give a probably unintended but unfortunate impression that Singapore was a part of the Indian government's anti-corruption drive.

Singapore has shown abundant good faith by being willing to be part of this renegotiation process. This is testimony indeed of Singapore's long-standing warm and deep economic and geo-political ties with India. If there is a silver lining for Singapore, one could also argue that the renegotiation of the India-Singapore DTAA was, in fact, preferable for the Republic now as it removed some uncertainty of possible retroactive changes that might be imposed by India later, which has remained a possibility with non-treaty countries.

Regardless, India would, however, do well to realise that too frequent renegotiations on previous agreements could adversely impact its reliability as an economic partner and may even nullify the effectiveness of its economic agreements with other countries as they engender uncertainty and may lack credible commitments.

■ Ramkishan S Rajan is professor of economics at ESSEC Business School, Asia-Pacific in Singapore. Sasidaran Gopalan is a research fellow at Asia Competitiveness Institute, Lee Kuan Yew School of Public Policy, National University of Singapore. Views expressed are personal.