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Building Economic Integration of India with ASEAN: A Policy Option as Double Taxation Avoidance Agreement

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Abstract:*There is no more important global economic public policy today than that of economic integration. It builds economic co-operation through the transfer of new technologies, capital, process products and fair trade practice, and as such provide a strong impetus to economic development. But Increasing integration between the economies and the steady growth of globalisation has some potential to lead to greater opportunities for tax evasion and avoidance. Tax co-operation is the key of successive economic integration between countries and Double Taxation Avoidance Agreement (DTAA) is a means of tax co-operation and creates hurdles for tax evasion and avoidance. This paper assesses the impact of double taxation avoidance agreement on economic integration and multinational activity.*

I. INTRODUCTION

Economic integration refers to trade unification by the reduction or elimination of tariff and nontariff barriers to the flow of goods, services, factors of production and the co-ordination of monetary and fiscal policies between a group of nations. It is an arrangement in which countries agree to co-ordinate their trade, fiscal, and monetary policies. The past two decades have witnessed a growing trend towards economic integration where national borders have diminished in importance, and capital, firms, and labour have become more mobile internationally.

Now, economic integration become a pervasive phenomenon due to the emergence of trade and investment agreements which shaping the global economic environment. Economic integration among developing countries is also a part of a wider strategy to promote not only equitable growth but also increase competition, reduce private

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transaction costs, enable firms to exploit economies of scale, encourage inward foreign investment and facilitate macroeconomic policy co-ordination. But Increasing integration between the economies and the steady growth of globalisation has some potential to lead to greater opportunities for tax evasion and avoidance.

Taxation has the potential to either be a facilitator or an impediment to greater integration and economic growth within countries. Taxation is a key factor in many considerations made by businesses in making investment decisions; other factors such as transparency, supply chains, labour force and markets are clearly important to investment decisions. The Several studies and researches indicate that the tax related impediments to integration are more important in a generic effect than any specific impediments to integration impacting on economic development. Tax co-operation is the key of successive economic integration between countries and Double Taxation Avoidance Agreement (DTAA) is a means of tax co-operation and creates hurdles for tax evasion and avoidance.

ASEAN (Association of South-East Asian Nation) comprises economic grouping of 10 Asian tiger countries i.e. Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Vietnam, Laos, Myanmar and Cambodia for economic growth and nation building. In the era of globalisation, India continued to expand its political and economic relations with ASEAN. India became a sectoral dialogue partner of ASEAN in 1992 and full dialogue partner in 1995. India also became an active participant of the ASEAN Regional Forum (ARF) since 1996. India and ASEAN have been holding summit-level meetings on an annual basis since 2002. The Framework Agreement for Comprehensive Economic Cooperation, signed in 2005, is proved the economic engagement of India with ASEAN. However, India's trade and investment with ASEAN is not as much developed as possible due to some generic considerations. The paper assesses what is reason behind this and how to strengthen the economic integration of India with ASEAN.

II. OBJECTIVES OF THE STUDY

- To study the role of DTAA in economic integration for potential of taxpayers and MNCs.
- To examine the tax competitiveness of India with ASEAN and its impact on economic growth.
- To study the impact of economic integration on equilibrium tax rate and profits shifting.
- To examine whether there are specific tax impediments to the integration and how to remove them.

III. RESEARCH METHODOLOGY

The present study is analytical in nature and based upon secondary source of data where in India and ASEAN member countries have been covered. DTAA, Corporate Tax and Withholding Tax are taken as Explanatory Variable and Economic Integration and Growth is Dependent Variable. Correlation, Regression and Ratio analysis were used to evaluate the determinants of economic integration between the countries. The study presents the significance of economic integration and objective of the study which covered, "what is DTAA and why it is needed for economic integration?" The study also deals with corporate tax competitiveness of India with selected ASEAN countries and its impact on economic growth. The main problem associated with increasing economic integration is avoidance of taxation in Asian continent. The study discusses generic taxation issues that act as impediments to integration, including those associated with double taxation. The study concludes with several recommendations and also suggests some measures designed to facilitate greater cooperation on taxation issues.

IV. SIGNIFICANCE OF THE STUDY

Globalisation, Recession and financial crisis are regularly encouraging the cooperation between the countries. Several ASEAN Member Countries (AMCs) also offer more favourable DTA provisions to the Asian neighbor countries than they offer to other countries. The absence of a comprehensive DTA network within Asian region means that the double taxation and tax evasion and avoidance remain largely unresolved and the affairs of economic integration will become increasingly difficult to sustain over the longer term without DTAA. The study provides information about DTAA and tax competition in terms of potential to greater economic integration of India with ASEAN which would lead to remove tax impediments in the way of comprehensive DTA network and brings the greater economic cooperation and integration between India and ASEAN and also with other neighbour countries.

What is DTAA and Why it is Needed for Economic Integration

The DTT (Double Taxation Treaty) network is the most important element of the international tax regime, i.e., the generally applicable rules governing income taxation of cross-border transactions. DTTs are generally entitled convention between countries for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. Bilateral tax treaties are an important method of international tax cooperation.

Table 1: Tax Laibilities of International Assessee

Status of the Assessee	Investment in home country	Investment in Source country
Resident	Yes	Maybe
Non-resident	Maybe	No

Double taxation refers to taxation by two or more countries of the same income, asset or transaction, for example (Table-1) income paid by an entity of one country to a resident of a different country. Often Source Countries have the right to tax all incomes earned their whether residents and non-residents and Home Countries have the right to tax worldwide income of their residents.

Table 2: Tax Liability of World-Wide Income

USA's Company invests in India Double taxation	Source Country	Home Country		Total
		Local	World wide	
Income (in lakh)	10	20	30	30
Tax rate	30%	40%	40%	
Tax	3		12	15

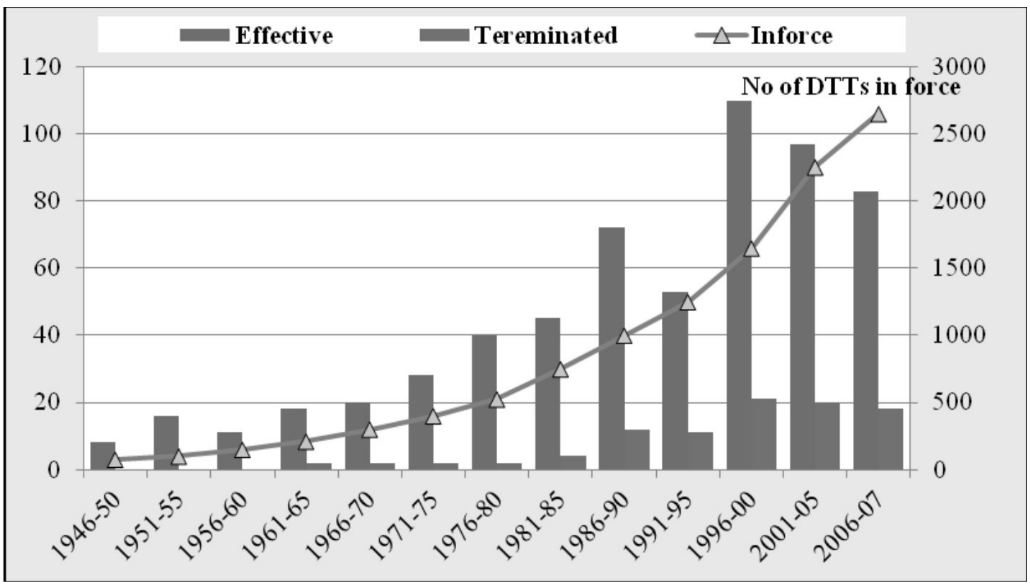
Soppose the USA's company earned income is 10 Lakh in India (Table-2) and the tax rate is 40% in USA and 30% in India. The taxpayer would pay 3 lakh taxes in India and then pay 4 lakh taxes in USA. The total tax on this income would be 70% or 7 lakh. To illustrate other aspects, it will assume that the person also has 20 lakh incomes in USA and pays another 8 lakh taxes on this. So he pays a total tax of 15 lakh on a total income of 30 lakh. If the USA's company had invested only in USA, he could have, perhaps, earned all 30 lakh of his income in USA and he would have paid taxes of only 12 lakh. Instead, thanks to double taxation, he is paying 15 lakh. This is because the income of 10 lakh is being taxed twice: once in India and once in USA. Therefore, Double taxation is hinders for investing abroad. For free mobility of capital and labour, countries come with an agreement to avoid this double taxation through tax credit and tax exemptions i.e. Double Taxation Avoidance Agreements.

The need for double taxation agreements arose because the income generated in one country which flows to another country, in the form of business profits, dividends, interest, royalties and fees for technical services, is taxed by both countries according to their respective laws resulting in the double taxation of international income. Therefore, in order to allow ease of cross-border movement of labour, investments and international trade, governments worldwide have decided to cooperate and coordinate between two taxation regimes. These agreements between countries are called Double Taxation Treaties. Double Taxation Avoidance Agreement (DTAA) is an agreement between two countries seeking to avoid double taxation by defining the taxing rights of each country. The main objective of DTAA is to promote the free flow of international trade, international investment and international transfer of capital and technology and facilitate cross-border grouping of companies. As such, it creates a strong bridge of economic integration between two countries.

Changing Scenario of DTAA: India with ASEAN

Until the late 1960s, DTTs were mainly concluded among developed countries but, since then, an increasing number of treaties have been concluded between developed and developing countries (and, to a smaller extent, among developing countries) (Easson, 2000). By the end of the 1960s there were 322 treaties, which rose to 674 by the end of the 1970s and to 1143 by the end of the 1980s. The number of DTTs worldwide grew rapidly in the 1990s and, by 2002, there would be 2,255 DTTs worldwide. It grew to 2651 by the end of 2006. In 2008, 75 new DTTs were concluded, bringing the total to 2,805. Figure 1 illustrates the development of the annual average of new treaty conclusions, treaty terminations and the number of total treaties in force.

Figure 1: Average annual number of DTTs concerning income and capital taxation: new effective treaties, terminated treaties, and total number of treaties in force (right-hand scale), 1946-2007.



Source: IBFD (2008)

The pace of treaty conclusion has increased tremendously over the last decades: from an annual average of nearly 18 new conventions during the 1960s, to 58 DTTs per year in the 1980s, more than 80 in the 1990s, and reaching a peak with 117 newly concluded treaties in 1998.Since then, the expansion has lost some momentum, but has remained at a high average of 92 new DTTs per annum in 2004 to 2007. Noteworthy is the fact that the number of terminated treaties jumped up at the end of the 1980s. However, this cannot be interpreted as a renunciation of bilateral cooperation, since most of the terminated treaties were substituted by a renegotiated contract. Radaelli (1997) argues that these new contracts more strongly emphasize the role of tax treaties in avoiding tax evasion through transfer pricing, or guard more strictly against treaty shopping.

Table 3 showing that because of their coverage and currency, the best practice DTA coverage within ASEAN is by Indonesia, Malaysia, Singapore, Thailand and Viet Nam. India is also as bilateral treaties of these countries. By contrast, Cambodia does not have a DTA with any other AMC, while Laos and Myanmar each have only one DTA in force with another AMC. But each bilateral DTA varies in its approach and generosity.

Table 3: India and ASEAN Treaty Network Coverage and Year Effective

	Indi	**Brun**	**Comb**	**Indo**	**Laos**	**Myam**	**Mal**	**Phil**	**Sing**	**Thai**	**Viet**
Indi				1998			1973	1996	1995	1988	1997
Brun				2003					2007		
Comb											
Indo	1998	2003				N/E	1986	1995	1992	2004	2000
Laos										1998	N/E
Myam				N/E			N/E		2001	N/E	
Mal	1973			1986		N/E		1984	2007	1983	1997
Phil	1996			1995			1984		1977	1983	2004
Sing	1995	2007		1992		2001	2007	1977		1976	1993
Thai	1988			2004	1998	N/E	1983	1983	1976		1993
Viet	1997			2000	N/E		1997	2004	1993	1993	

* 'N/E' indicates DTAs signed, but not effective / not in force. ** Data of Combodia and Laos is not available

Source: International Bureau for Fiscal Documentation

ASEAN best DTTs practice, as illustrated in table-4 by Indonesia, Singapore and Viet Nam, is to have an extensive, modern bilateral treaty network with other AMCs. The absence of a treaty can also create uncertainty, fails to provide 'tie-breaker' rules to establish the tax jurisdiction and leads to inconsistent – usually inadequate - approaches to taxation and tax relief.

Table 4: India and ASEAN Treaty Network Coverage Summary

Indi	**Brun**	**Comb**	**Indo**	**Laos**	**Myam**	**Mal**	**Phil**	**Sing**	**Thai**	**Viet**
More extensive newer treaty network	Very limited old treaty network	No treaty network	More extensive newer treaty network	Very limited newer treaty network	Limited newer treaty network	Extensive older treaty network	Extensive older treaty network	Extensive newer treaty network	Extensive older treaty network	More extensive newer treaty network

Corporate Tax Competitiveness of India with ASEAN and Economic Growth

DTAA brings tax competitiveness among the treaties/countries because government shaping their tax system accordance with other integrated member countries and moreover, attracting FDI, MNCs and foreign aids. The increased importance of MNCs in the world economy poses at least two challenges to the design of corporate taxation in the global economy. The first pertains to the division of the tax base of MNCs among the jurisdictions where MNCs have some ongoing activity. The second problem is the profit shifting activities of MNCs to low tax jurisdictions. It creates tax competitiveness among the countries as providing tax incentives and reducing the tax rate. The African, Asian and Central Eastern Europe countries rely on tax holiday and import duty exemptions, while industrial Western Europe countries allow investment allowances or accelerated depreciation (Table-5).

Table 5: Types of Tax Incentives used by Different Regions

Region/Major incentives	Africa	Asia	Latin America and Caribbean	Central and Eastern Europe	Western Europe	Other Countries	Total
Countries No.	23	17	12	25	20	6	103
Tax holidays	16	13	8	19	7	4	67
Accelerated depreciation	12	8	6	6	10	5	47
Investment allowances	4	5	9	3	5	-	26
Import duty exemption	15	13	11	13	7	4	63
Duty drawback	10	8	10	12	6	3	49

Source: UNCTAD, world investment report 2001, 2004, 2009.

Tax incentives have generated considerable debate about whether governments have offered unreasonably large incentives to entice those firms to invest in their area. In recent years, the governments have to deal with this new dimension in the design of their national tax policy. In contrast, some emerging counties are not providing as much incentives as industrial countries because of cost associated with tax incentives i.e. negative impact on fiscal revenue, cost of compliance, possibilities of suspicious behaviour of tax administration and companies.

In fact, the globalization causes a question on the sustainability of the current corporate taxation systems. Many Asian countries seem to try to attract FDI and to compete with other countries to offer incentives to FDI. It is clearly evident from the table-6 that in India the corporate tax rate is higher as compared to Singapore, Vietnam, Malaysia and Indonesia among ASEAN countries. High corporate tax rate in India is a drag on the flow of FDI.

Table 6: Comparative Statutory Corporate Tax Rates (effective rate) in ASEAN

Tax Rate / Countries	1991 - 92	1996 - 97	1998 - 99	2000 - 01	2003 - 04	2006 - 07	2008 - 09	2010 - 11
India	-	35	35	38.5	33	33.66	33.99	33.22
Indonesia	-	30	30	30	30	30	28	25
Singapore	31	27	26	25.5	22	20	18	17
Thailand	30	30	30	30	30	30	30	30
Philippines	35	35	34	32	32	35	30	30
Malaysia	-	30	28	28	28	27	26	25
Vietnam	-	35	35	32.5	32	28	25	25

Source: KPMG's Corporate Tax Rates Survey-from 2006 to 2011.

Note: Data of Brunei, Cambodia, Myanmar and Laos is not available.

In order to make ASEAN as an attractive investment destination, income tax rates in ASEAN have been going down consistently as seen in the table forcing same impact on other Asian countries. Singapore is often cited as the leading example of countries that continue to reduce corporate income tax rates and introduce various tax incentives to attract and keep global investments. Effective tax rates as one of the lowest in the world and the general "business friendliness" of Singapore are the two important factors contributing to the economic growth and foreign investment. It seems from tax competition in this region, corporate income tax rate will be further reduced.

Table 7: Main Aspects of Corporate Taxation in India and Selected ASEAN Countries 2010-11

Country	**Tax basis**	**Main rate**	**Specific rate (business tax)**	**Period for deducting losses**
India	Net world-wide income for domestic company. Other than domestic company.	30% + SC-10% EC-3% 40% + SC-2.5% EC-3%	MAT-10% & Dividend Distribution Tax-18% Tax Exemption for certain companies	For 8 years business loss plus unabsorbed depreciation
Indonesia	Adjusted accounting profit	25%	10% for Below Rs. 25 million, 15% for Rs.25-50 million.	5 to 10 year for certain business
Singapore	Chargeable income	4.5% less than $ 10000, 9% More than $ 10000, 17% more than $ 300000	No tax on capital gain. Dividend allow to tax credit.	Indefinitely subject to certain conditions
Thailand	adjusted accounting profit	30%	Alternative option, Not specific rate	5 years
Philippines	Net world-wide income For domestic corporations. Net Philippine-source income for resident foreign corporations	30%	15% branch profits tax of foreign companies. Dividends are exempt in the hands of individual.	3 Years from any source
Malaysia	adjusted accounting profit	25%	40% for petroleum companies.	Indefinite time
Vietnam	Based on annual turnover	25%	50% for businesses conducting petroleum rare and precious natural resources.	6 years
Brunei	Net Profit of Business	23.5%	No Tax on Capital Gain, Dividend, Pioneer companies, Expansion of estbs. companies	Indefinite period
Cambodia	Net profit + other income	20%	5% for insurance activities	5 Year
Myanmar	Income of Company	30%	No dividend tax and 5% capital gain tax	3Year
Laos	Net Profits	35%	20 % for registered under foreign investment law	Indefinite year

Table 7 exhibits the comparative position of corporate taxation in 2010-11 in selected ASEAN countries. It is evident from the table that Singapore and Malaysia are the most preferred places for MNCs and foreign investors. It is because of the fact that the main corporate tax rates are comparatively lower and the losses can be carried forward for an indefinite period of time. However, basis of tax varies in these countries. It is also clear from the table that rates of tax in India are the highest and harsher to foreign companies. Further, loses can be carried forwarded only to a limited period of 8 years. Even Indonesia and Vietnam is better to India so for as the rates of tax are concerned. Tax competitiveness for attracting MNCs and FDI among this region brings significant economic growth.

As the desire to attract investment from outside the region, different AMCs are in different DTA bargaining positions, especially on withholding tax rates. Best practice within ASEAN is offered by those countries that have implemented unilateral measures to reduce or eliminate double taxation, including the foreign-source income exemptions offered by Brunei, Malaysia and Singapore. This approach is consistent with global best practice.

Table 8: AMCs Withholding Tax Best Practice within ASEAN and Non-ASEAN

States	Lowest withholding tax rates (ASEAN states)	Lowest withholding tax rates (Non-ASEAN states)	With India
Indi	Malaysia: D-10%, I-10%, R-10%	Mauritius: D-5%, I-NIL, R-15%	
Brun	Indonesia: D-15%, I-15%, R-15% (n.b.: Non-treaty rate: D-0%, I-20%, R-0%)	United Kingdom: D-0%, I-20%, R-0% (same as non-treaty rate)	
Comb	No DTA ratified Non-treaty rate: D-14%, I-14%, R-14%	No DTAs ratified Non-treaty rate: D-14%, I-14%, R-14%	No DTAs ratified Non-treaty rate: D-14%, I-14%, R-14%
Indo	Singapore: D-15/10%, I-10%, R-15%	United Arab Emirates: D-10%,I-5%, R-5%	D-10%, I-10%, R-15%.
Laos	Viet Nam: D-10%, I-10%, R-10%	China: D-5%, I-5/10%, R-5/10%	
Myam	Singapore: D-0%, I-8/10%, R-10/15%	United Kingdom: D-0%, I-20%, R-0%	
Mal	Myanmar/Viet Nam: D-0%, I-10%, R-10%	Bahrain: D-0%, I-5%, R-8%	D-10%, I-10%, R-10%.
Phil	Thailand, Indonesia: D-15/20%, I-0/10/15%, R-15/25%	China, Israel: D-10/15%, I-0/10%, R-10/15%	D-15%, I-10%, R-15%.
Sing	Malaysia: D-5/10%, I-10%,R-15%	Mauritius: D-0%, I-0%, R-0%	D-10%, I-10%, R-10%
Thai	Laos: D-15%, I-10/15%, R-15%	France: D-15/20%, I-3/10%, R-5/15%	D-15%, I-10%, R-15%.
Viet	Singapore: D-0/10%, I-5/7/12.5%, R-5/15%	Netherlands: D-5/7/15%, I-0/7%, R-5/10/15%	D-10%, I-10%, R-10%

D= Dividend Withholding Tax, I = Interest Withholding Tax, R = Royalty Withholding Tax

Source: International Burea u for Fiscal Documentation

The table 8 clearly indicates that the withholding tax rates within ASEAN is high as compare to Non-ASEAN also it is in Indian case resulting limited economic integration within ASEAN and India with ASEAN.

Table 9: India and ASEAN Withholding Tax Rate Summary

Indi	**Brun**	**Comb**	**Indo**	**Laos**	**Myam**	**Mal**	**Phil**	**Sing**	**Thai**	**Viet**
Moderate for ASEAN and low for non-ASEAN	High- both for ASEAN and non-ASEAN	High- both for ASEAN and non-ASEAN	Moderate for ASEAN and low for non-ASEAN	Moderate both for ASEAN and non-ASEAN	Moderate for ASEAN and low for non-ASEAN	Moderate for ASEAN and low for non-ASEAN	High- both for ASEAN and Non-ASEAN	Moderate for ASEAN and low for non-ASEAN	High for ASEAN and low for non-ASEAN	Low for ASEAN and moderate for non-ASEAN

Generic Taxation Issues That Act as Impediments to Integration

1. Tax Competition: Globalisation and competition for foreign direct investment are likely to make economic integrations progressively more difficult to manage. The issue therefore becomes when, rather than whether, these issues will be addressed by ASEAN.
2. Limited Double Tax Agreements Between AMCs: The study found that while many AMCs have extensive regional bilateral treaty networks, e.g. Malaysia, Singapore and Viet Nam, and some AMCs have very limited treaty networks, e.g. Brunei, Cambodia, Laos and Myanmar. But no one AMC has a comprehensive network across the entire region. The absence of a comprehensive Double Tax Agreement (DTA) relationship across ASEAN was identified as an impediment to regional economic integration and development in terms of increasing business tax costs, imposing administrative burdens and creating cost uncertainty. The average ASEAN DTA is between 10 and 15 years old. This may also be considered an impediment to cross border investment because fiscal and regulatory reform, economic and technological changes and lowering withholding tax rates have been occurred.
3. High Intra-ASEAN Withholding Tax Rates Compare to Non-ASEAN: The treatment of income and capital flows between AMCs (i.e. intra-ASEAN) is often not as favourable as the treatment between AMCs and non-ASEAN countries because of 'high' withholding taxes. The impact of this inconsistent treatment is to make income and capital flows between AMCs and countries outside ASEAN more advantageous than intra-ASEAN.
4. Lack of Full Relief: Each AMC imposes conditions on access to and eligibility for tax relief provided through foreign tax credits or exemption relief. The conditions can often mean that the relief is unavailable like:-
   - Some AMCs offer no relief (Myanmar).
   - Tax credits can't offset and carried backward or forwards to other years (Philippines).

- Foreign losses are not taken into account in the computation of the maximum credit (Indonesia).
- The relief is effectively limited to a very small number of countries (Brunei).
- When a difficulty is arises to define multiple classes of income, this act to deny relief or add administrative complexity where different tax rate is applicable on specified income (India).

5. Inconsistent Definitions/Treatment: Where two countries do not share a common definition then access to double tax relief may not be possible at all, especially where the DTA is silent on the matter or one is absent, thereby raising the prospect of double taxation without any relief being permitted.

V. FINDING AND CONCLUSION

The ASEAN and Indian economy is increasingly opening to investment opportunities and removing trade barriers for international players resulting in increasing trends in economic cooperation, inflows in FDI and Industrial growth.

- Economic integration increases the potential for taxpayers to structure transactions to maximise any advantage from the different ASEAN tax arrangements.
- Role of DTAA and corporate tax incentives are important factors to attract international investors and economy for integration that resulted tax competitiveness among the countries.
- Increased economic integration forces government to reduce tax rates. Where corporate tax rates have been reduced while the tax base has been broadened, are optimal responses to the increased presence of multinationals.
- Economic integration under tax competition affects equilibrium tax rates, transfer prices and national welfare. At the same time, the transfer price can be used either as a profit shifting device or as a strategic trade instrument.

However, tax competitiveness for attracting MNCs among this region brings significant economic growth as the tax rate on companies was gradually reduced there was positive impact on FDI inflow, capital flow and industrial growth and as such economic cooperation.

Recommendations for Consideration to Remove Impediments of Economic Integration

- Use Separate Accounting (SA) as a foundation for their corporate tax system. Under this system accountants and tax authorities try to identify the exact receipts and expenditures attributable to the corporation's activities in each country.
- A multilateral tax treaty would be the optimum solution as an appropriate mechanism for the convergence of the tax regimes. A treaty would provide for consistency within south east region that would enhance the attractiveness of

the region as a destination for foreign direct investment.

- There should be the equality of tax treatment within the south east region. Non-discrimination among these nationals would be likely to encourage integration of AMC economies, including the priority sectors where incentives are available.
- ASEAN and India should give consideration to adopt Most Favoured Nation arrangements internally. Therefore they would be obliged to offer all other AMCs the same treaty terms as any negotiated with any non ASEAN countries.
- Countries should adopt a regime of maximum withholding tax rates for dividends, interest and royalties and considers a timetable for phased reductions for withholding taxes between the region, possibly leading to their eventual abolition.
- ASEAN adopts a system of flow-through provisions for treaty negotiations with non-ASEAN countries that would facilitate negotiations by one or more AMCs on behalf of ASEAN.

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