2. FDI Outwards - Economy

Nearly 60% of India's outward FDI goes to 'tax havens', reflecting strategic potential of these countries. . Over half of India's outward FDI is routed through low-tax jurisdictions like Singapore and Mauritius for strategic benefits such as tax efficiency and easier global expansion. While this helps Indian firms compete globally, it raises concerns about tax revenue loss, prompting countermeasures from the government.

The Core Issue - FDI Flows to Low-Tax Jurisdictions

RBI Data Finding - A recent report by the Reserve Bank of India (RBI) reveals that a majority of India's outward Foreign Direct Investment (FDI) is being channelled into low-tax jurisdictions, commonly known as tax havens.

Key Statistics -In the fiscal year 2023–24, nearly 56% of India's outward FDI was directed to these jurisdictions.This trend intensified in the first quarter of 2024–25, with the figure rising to 63%.

Primary Destinations - The main recipient countries include Singapore, Mauritius, the UAE, the Netherlands, the U.K., and Switzerland.

Defining Key Terms

Foreign Direct Investment (FDI) - An investment made by an individual or entity from one country into a business located in another country, either by establishing new business operations or acquiring existing assets.

Outward FDI - Investments made by Indian companies into foreign enterprises (through subsidiaries, joint ventures, or acquisitions) to expand their global footprint.

Tax Haven - A country or territory characterized by very low or zero taxation, strong financial secrecy laws, and relaxed regulations, making it attractive for foreign investors seeking tax efficiency.

Reasons for Preferring Tax Havens

Indian companies route investments through these jurisdictions for several strategic advantages -

Intermediate Jurisdictions - They serve as hubs for creating Special Purpose Vehicles (SPVs), which are used to manage global operations and investments efficiently.

Tax Efficiency - It results in a lower tax liability when a company dilutes its stake in a foreign subsidiary or transfers funds between international entities.

Investor Preference - Global partners and venture capitalists often find it legally and financially simpler to invest in an Indian venture through a Singaporean or Mauritian entity rather than directly.

Regulatory Shield - It helps insulate the Indian parent company from certain domestic compliance requirements and regulatory risks.

Ease of Operations - These jurisdictions typically offer more flexible laws and faster, simpler processes for moving funds compared to India.

Fundraising Advantage - Raising capital from international markets is often easier and quicker when done through a subsidiary in a globally recognized financial hub.

Global Norm - This is a standard practice followed by multinational corporations worldwide to optimize their global tax and operational strategies.

Implications of this Trend

Positive Implications

Facilitates Global Expansion - Routing investments through hubs like Singapore allows Indian companies to set up SPVs for managing regional operations.

Example - Infosys and Bharti Airtel use their Singapore-based subsidiaries to manage their extensive Asia-Pacific operations.

Attracts Foreign Capital - The stable legal frameworks and bilateral investment treaties in these jurisdictions make it easier to form joint ventures and attract foreign capital.

Example - Many Indo-European joint ventures are structured through Singapore to leverage its smooth and predictable legal processes.

Provides Competitive Parity - It allows Indian firms to compete on a level playing field, as their global counterparts (like Google and Apple using Ireland and the Netherlands) employ similar strategies.

Concerns

Profit Shifting and Tax Base Erosion - Companies may book profits in their low-tax subsidiaries, thereby minimizing their tax liability in India. This erodes India's corporate tax revenue base.

Example - The past misuse of the India-Mauritius Double Taxation Avoidance Agreement (DTAA) for "round-tripping" investments back into India to evade taxes.

Regulatory Arbitrage and Weak Oversight - Firms can exploit the gaps between Indian regulations and the laws in foreign jurisdictions, making it difficult for Indian agencies like the RBI, SEBI, and the Enforcement Directorate (ED) to monitor financial flows effectively.

Impact on Domestic Value Addition - In response to high tariffs on Indian exports (e.g., from the U.S.), companies might shift manufacturing or processing operations to their overseas SPVs to bypass these tariffs, leading to a loss of jobs and value addition in India.

The Policy Dilemma - The government faces a challenge in balancing two competing needs - avoiding over-regulation that could harm the global competitiveness of Indian firms, and preventing under-regulation that could lead to tax revenue loss and illicit financial flows.

India's Steps to Address the Challenges

India has implemented several measures to counter the misuse of low-tax jurisdictions -

Renegotiation of Tax Treaties - The Double Taxation Avoidance Agreements (DTAAs) with countries like Mauritius (2016) and Singapore (2017) were renegotiated to plug loopholes related to capital gains exemptions.

General Anti-Avoidance Rule (GAAR) - 2017 - This rule was introduced to empower tax authorities to scrutinize and disallow arrangements that are deemed to have been made expressly to avoid taxes.

Transparency Mechanisms - India has adopted the OECD's Common Reporting Standard (CRS) for the automatic exchange of financial account information between countries.

Profit Shifting Controls - The government has implemented the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan to prevent companies from artificially shifting profits to low-tax locations.

Global Minimum Tax - India is part of the OECD's Pillar 2 initiative, which aims to ensure that multinational enterprises pay a minimum effective tax rate on their profits, regardless of where they are headquartered.

SEBI Regulations - The Securities and Exchange Board of India (SEBI) has tightened norms for Foreign Portfolio Investors (FPIs), especially those from Mauritius, to ensure greater transparency in beneficial ownership.

Black Money Act, 2015 - This act provides for strict penalties and prosecution for holding undisclosed foreign income and assets.

Source - [https - //www.thehindu.com/business/nearly-60-of-indias-outward-fdi-goes-to-tax-havens-reflecting-strategic-potential-of-these-countries/article70040924.ece](https://www.thehindu.com/business/nearly-60-of-indias-outward-fdi-goes-to-tax-havens-reflecting-strategic-potential-of-these-countries/article70040924.ece)