How important is tax competition to India?

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India can be resilient against the competitive tax policies of neighbouring countries and the US, but tax experts at International Tax Review's India Tax Forum want the country to amend corporate tax rates and expand the base to maintain this.

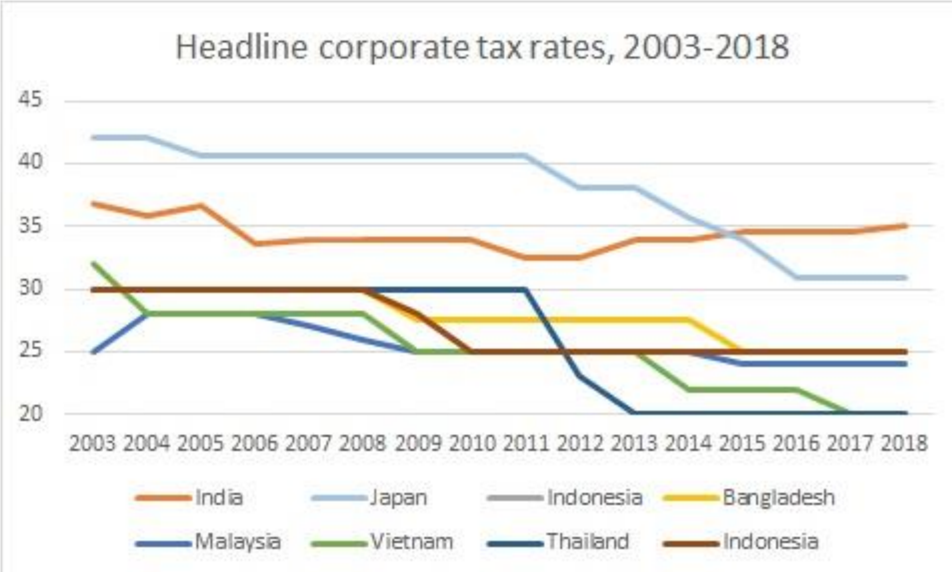
A key area of debate at *ITR's* event was the US Tax Cuts and Jobs Act, which cut the US's headline corporate tax rate from 35% to 21%, and whether it necessitates a change in policy for India.

In the race to the bottom of corporate tax rates, India is something of an outlier. Its headline corporate tax rate has in fact risen from an all-time low of 32.44% in 2011 to 35% today, while worldwide rates on average have been falling. The country effective rate, as high as 48.3%, is the highest in the world.

"As a result of the US tax reform, there has been some amount of concern in terms of tax competition which will take place because of them bringing down the rate to 21%. They have become, now, extremely competitive," one CFO said, describing US tax reform as a "huge development" for the global economy. "Even the average OECD rate is 24%. The rest of the world, including India, will have to take cognizance of this in trying to structure their tax rates."

There are two main areas of tax competition for India to consider: Local competition from fellow Asia-Pacific (ASPAC) jurisdictions for investment, and the US Tax Cuts and Jobs Act.

Across the ASPAC region, tax rates are falling. Bangladesh, Indonesia, Malaysia, Sri Lanka, Taiwan, Thailand and Vietnam all have rates under 30%, while smaller jurisdictions including Brunei, Hong Kong, Mauritius and Singapore's rates are below 20%.



"Malaysia [and] Vietnam are examples of where we saw rates being reduced from late 30s, early 40s to somewhere around the mid-20s now," said one tax advisor. "So it does put India in a slightly less competitive position, [especially when] you start adding up the dividend distribution tax, which most other countries regard as a cost."

Although India has been cutting its corporate tax rate for the 99% of companies with revenues up to INR 2.5 billion ($35 million) that are subject to a lower 25% rate, the promises to extend this to all companies has not been fulfilled by government.

When adding in other taxes including the dividend distribution tax (DDT) and the minimum alternative tax (MAT), the effective rate can reach an eye-watering 48.3% – the highest in the world.

Many advisers and businesses feel that this rate ultimately lowers the level of inbound investment into India, and that it should be cut.

"I think that India will have to work a lot as far as tax rate reduction is concerned, because the competition is intensifying across the globe, not only in the ASPAC region," said a partner at an advisory firm. "As far as corporate income tax level in India is concerned it is already at a very high rate. The second thing is about the DDT. It makes things very difficult for India."

Mitigating factors

However, it's not all bad news for Indian tax rates and how they compare to other countries. For example, while the US's headline rate is 21%, the effective rate is far higher, which puts India on a more equal footing.

"When you say 'high rate of corporate tax', you need to look at the effective rate of tax," said one delegate. "For instance in the US, you have taxation at federal, state and even city level. So if you look at the tax overall, it's not going to be the headline rate of 21%, it's going to be a lot higher."

Additionally, India's economy is simply not as susceptible to tax competition as many others.

"I wouldn't say India needs to worry, because it is more jurisdictions that were getting disproportionate shares [of tax income due to comparatively low tax rates] compared to the market that need to be concerned," said one panellist.

Digital respite?

With such a large population, measures to tax the digital economy – which are likely to be levied according to the numbers of users of digital services – could prove lucrative for India.

"If we look at the tax-to-GDP ratio of India, in comparison to the global ratio, it is much lower," said a government source. "As of today, I think India needs to expand the tax base to generate more revenues."

The government has shown that it is firmly behind such efforts, and moved quickly to introduce the equalisation levy and the concept of a significant economic presence, though these measures have not proved to be effective revenue raisers.

Ultimately, though, cutting corporate tax will be a political decision. Even if taxing the digital economy provides India with much-needed revenue, giving it the flexibility to reduce corporate tax rates for large multinationals – it may instead choose to spend this revenue on development or reduce borrowing.

No matter what the corporate tax rate, companies will always choose to be present in India.

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