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FOREIGN COLLABORATIONS, FOREIGN DIRECT INVESTMENT AND TAXATION OF FOREIGN COMPANIES IN INDIA : SOME POLICY ISSUES

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FOREIGN COLLABORATIONS, FOREIGN DIRECT INVESTMENT AND TAXATION OF FOREIGN COMPANIES IN INDIA: SOME POLICY ISSUES.[1]

1. Introduction:

In the sphere of international economics, one of the most significant developments of this century has been the growth of the so called multinational or transnational corporations (TNCs). A TNC is usually so called because while it has production or distribution affilliates located all over the globe, management control of its operations is usually centralised. Though these TNCs existed even in the 19th century, the present century has witnessed their phenomenal growth. In a pioneering work, Barnett and Muller(1974) have attempted to document the growth of these TNCs. Though there are differences over the precise definition of these corporations, there is little doubt that today these TNCs control about 70 percent of world production and probably an even larger percentage of world trade. To a large extent, this growth has been a natural outcome of the increasing internationalisation of all economies consequent to the spread of instant global communications. What has been of particular interest to analysts has been a study of the nature of investment flows of these TNCs often referred to as foreign direct investment(FDI).

Growth of Foreign Direct Investment (FDI) in the developing countries has been most rapid in the second half of this century. The basic pattern has been a flow from the developed countries (DCs) to the less developed countries (LDCs) although there has been some reverse flow from the LDCs in recent years (see, Lall, 1986). In Table 1, we can see that while developing economies accounted for 22.4 per cent of world FDI flows in the period

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1. I am grateful to Ms. Mamta Shankar for research assistance and for painstakingly collecting the data.

1971-75, by the first half of the 'eighties this share had gone up to 24.8 per cent. A second feature of the geographical pattern of FDI flows shown in Table 1 is the concentration of FDI flows in Latin American countries and a few countries of South Asia. Thus, we see that about 10 to 12 per cent of the FDI went to the Latin American countries and 7 to 10 per cent to Asia. However, following the debt crisis of the early eighties there was a movement of FDI away from the Latin American countries. In Table 1, while the share of Latin American countries has declined from 13.5 percent to about 10.5 per cent, that of Asia has increased from 7.7 percent to 10 per cent. A consequence of the redirection of these FDI flows in the 'eighties has been the emergence of China as the largest recipient. This is seen in Table 2 where China which got negligible FDI flows in the mid-seventies was the largest recipient by 1985. From all reports, China today gets about 2 billion dollars a year in FDI flows.

Another feature of FDI flows has been the change in the sectoral composition. In the first half of this century FDI flows were concentrated in the extractive industries of LDCs particularly in Latin America. This, of course, was a continuation of the colonial pattern of trade where the LDCs supplied raw materials for use in the manufacturing sector of the DCs. However, in the 'fifties, most of the recipient countries were unwilling to allow foreign control over their natural resources of metals, oil etc. It is well known that since the fifties most TNCs have been divesting themselves of investment in extractive industries. Consequently, the 'sixties and 'seventies in particular, have seen concentration of FDI in the manufacturing sectors. In the 'eighties one sees a further change in the sectoral pattern of FDI flows. Thus, in Table 3 we note the emergence of the service sector as an important recipient of FDI flows by 1985 and a corresponding decline in the importance of the manufacturing sector. In the early 'fifties less than 20

per cent of world stock of FDI was in services. BY the late 'eighties, this share had risen to 40 per cent (UNCTC, 1988). In the case of Japan, in the period 1985-90, about 75 per cent of FDI in the developing countries has gone to the services sector (UNIDO, 1990). This development, of course, has been a natural consequence of the changing nature of the structure of the DCs where the services sector is generally the largest in relation to the agricultural and manufacturing sectors.

What have been the sources of these FDI flows? We have already noted that the main source has been the DCs, namely, USA, UK, West Germany and France. However, some significant changes have been observed in the second half of this decade. Thus, although the USA and UK were the principal sources of FDI in the 'fifties and 'sixties, a remarkable feature of the 'eighties has been the emergence of West Germany and Japan as significant foreign investors particularly from the point of view of the LDCs. Both these countries are now second only to the USA as sources of FDI. This development has been mainly a consequence of the very large balance of payments surpluses built up by these countries due to the increasing strength of their currencies in the last decade or so. This increasing pluralism of FDI flows is continuing with countries like Hong Kong and Taiwan emerging as the principal source of FDI flows to countries like China and Malaysia. From the point of view of developing countries the most disquieting feature has been that, since about 1981, the LDCs have been losing their share of FDI in favour of DCs. This has been a consequence of the large foreign debts which many LDCs have accumulated and the integration of Europe which has led to TNCs attempting to get a foot-hold in the new European market through FDI.

From the 'seventies in particular LDCs have been wooing foreign capital for a variety of reasons. On the one hand, it is clear that official Development Assistance and other forms of bilateral and multilateral aid have been drying up since the mid-'seventies. In addition, FDI has come to be viewed as the medium through which LDCs can get access to the advanced technologies of the DCs and also to their markets via the marketing networks of the Transnational Corporation (TNCs). Consequently, competition among FDI receivers is now possibly even greater than among the FDI givers. It thus becomes necessary to look at the incentives given by LDCs on a comparative basis.

In this paper we will look first at the form of foreign participation in the Indian industrial sector and see how it has changed over time. In Section 3, we see how tax policies have been instrumental in promoting or discouraging foreign investment when compared to the tax policies of some other LDCs. Finally, in Section 4, we will suggest some policy prescriptions designed to increase the flow of FDI to India.

2. The Indian Case

2.1 Definition of FDI.

At the very outset it is necessary to define the forms which foreign participation can take. TNCs can interact with host countries via FDI, portfolio investment, exports, or licensing of technology and patents (see, for a discussion, Frank, 1980). FDI has a very special meaning in that it refers to flows of equity capital into a subsidiary where the foreign investor (or TNC) has a controlling interest. Traditionally, this is defined as the TNCs share of total equity capital exceeding 10 percent to 25 per cent. However, the basic issue is to attempt to distinguish FDI flows from portfolio investment. While the former is considered

long term investment the latter is typically guided by short term considerations of speculative gains. On the other hand, a TNC exports to a host country and then switches to domestic production when entry barriers (like tariffs) make exports uncompetitive (see, Horst, 1971) or when such a move is necessary to internalise certain owner specific advantages (see, Dunning, 1972, 1979). However, it is clear that the essential criteria should be 'controlling interest' and 'long term interest'. Thus licensing or sale of a technology without any financial flows can also give the foreign investor control of the recipient firm's decision process. In this light it would seem wise to include in the concept of FDI the growth of foreign collaborations in India particularly after 1985.

2.2 Foreign Collaborations and FDI.

At the outset we would like to note that for this section we have relied entirely on information regarding approvals given to foreign collaborations as listed by the Department of Science and Technology. In the absence of any official monitoring agency we have no way of finding out how many of these collaborations were implemented and in what form.

In India, a collaboration was expected mainly to serve the function of bringing in foreign technology not available domestically. This was outlined in the Technology Policy statement of 1983. Essentially a collaboration can take the form of either a financial collaboration, a technical collaboration or both. A financial collaboration can take the form of equity inflows or loans. Finally, a technical collaboration is one where the foreign collaborator undertakes to sell technical designs and drawings on the basis of a lump sum fee (or royalty) which is specified in the agreement. In actual practice collaborations tend to have elements of both financial and technical agreements.

The collaboration agreements are also subject to some restrictions. First, after 1968, the limit of the collaborations agreement is 5 years, as opposed to 10 years earlier, and extensions are rarely given. Second, fresh agreements with the same foreign partner are frowned upon. Third, the foreign partner is not allowed to place any export restrictions on the domestic partner (except to a country where the foreign collaborator already has an affiliate) or tie the agreement to purchase of inputs from a pre-specified source. Fourth, in continuation of the general policy on patents the domestic collaborator cannot be constrained in passing on the technology to other domestic producers. Finally, while royalty payments are restricted to 5 per cent of the value cf production, royalties and lump sum payments must together not exceed 8 per cent of the value.

Table 4 shows the jump in the number of collaborations particularly after 1985. Tables 5 and 6 indicate the sectoral and geographical composition of collaborations. Inspection of Table 6 reveals that the USA, Federal Republic of Germany and the United Kingdom account for the largest number of collaborations. However, the share of UK has been declining while France, Italy and Japan have been emerging as important partners. Second, the sectoral distribution of collaborations (Table 5) shows the concentration of collaborations in three sectors, that is, Electricals and Electronics (24.8%), Industrial Machinery (18.7%) and Chemicals and Mechanical Engineering (24%) over the period 1981-88.

A look at the Equity component of the collaborations (Tables 7 and 8) and the lump sum payments (Tables 9 and 10) yields some interesting facts. While the geographical distribution shows the same picture as in the case of the total number of collaborations the sectoral distribution reveals that the largest equity is in

the chemicals sector. Further, the chemicals sector is also the one where the contracted lump sum payments are the highest. Another interesting point is revealed by comparing the total flows of lump sum fees and FDI. It is clear that the contracted outflows in the form of lump sum payments are more than twice the inflows in the form of FDI. Unfortunately, no information was available on the loan component of the agreements. However, a look at the aggregate actual outflows over the 'eighties (Table 11) clearly indicates the changing nature of foreign investment in India. Inspection of Table 11 shows that while remittances of profits and dividends accounted for about 70 per cent of total outflows in the early 'seventies, the figure was down to about 11 per cent by 1986/87. By 1986/87 payments for technical know how (lump sum payments) and royalties accounted for over 50 per cent of total remittances. Further, at the same time the second largest outflow was interest payments by the private sector accounting for 39 per cent of total outflows.

Looking at the pattern of foreign collaborations and payments over time, some broad conclusions can be drawn. For one, foreign partners have been opting for short term rather than long term commitments. This is reflected in the increasing importance of foreign collaborations and the greater emphasis on lump sum payments in the agreements. While FDI via equity flows implies a long term investment (since returns to the foreign investor from remitted profits and dividends will only accrue after a time) lump sum payments constitute a short term, assured and risk free return to technology transfers. This attitude on the part of the foreign partner is largely a consequence of government policy. As we noted earlier, a collaboration agreement is limited to 5 years (as against 10 years in the 'sixties) with no extensions given. Consequently, both the Indian collaborator and the foreign partner are expected to complete the process of technology

transfer and adaptation in 5 years. Some tentative surveys (see, Ashok Desai, 1988) indicate that in fact the technology transferred has been rather outdated.

Another disturbing feature of the pattern of outflows is the importance of interest payments on foreign loans taken by the private sector. This is probably explained by the fact that, like lump sum payments, interest payments also constitute a fairly quick and riskless return on invested money.

We therefore conclude that quick, short term gains have been the guiding motive behind foreign investment and have been helped to a large extent by the emphasis laid by the government on foreign collaborations as the mechanism for technology transfer. We will return to this issue a little later in the discussion on taxation.

3. Taxation

Taxation of income of foreign companies is complicated because of the problem of determining whether the home of the parent company or the country where the subsidiary is located has the final right of taxation. Since no country would be willing to give up its right to tax any entity located within its boundaries, it is an accepted convention that the country of residence of the company levies its own taxes at source. However, to alleviate the burden of double taxation of foreign source income in the home country of the parent company, the home country usually gives a credit for foreign taxes paid with the credit limited to the lower of the two taxes paid. It has been shown that the method of double tax relief can have important consequences for FDI (see, for example, Horst, 1977; Pant 1989) However, it is not our intention here to go into the theoretical issues of international taxation. Further, the problems of double

taxation of international mobile capital is to some extent reduced by signing of a tax treaty between home and host countries. Most developing countries have signed tax treaties with the major investor countries on a bilateral basis.

We have seen in Table 2 that the FDI flows in Asia have been going mainly to countries like Thailand, Malaysia and China. India in particular has been receiving less than 200 million dollars annually in the form of long term equity flows. While one of the reasons for this has been discussed in the earlier section another important influence on the flows of FDI can be a country's tax policy.

To look at the relative taxation of foreign companies in India, we have tried to compare the tax policy with that of other major recipients of FDI among the LDCs, namely, China, Malaysia, Thailand and Brazil. We have looked at the policies towards foreign investment of these countries in a format which makes comparability with India easier. We have looked at the tax rates as laid out in the Direct Tax treaties of these countries with the major sources of FDI, namely, USA, Canada, France, Sweden, Italy, United Kingdom and Japan. The withholding tax rates on dividends, interest, technical fees and royalties for these four countries and India are given in Appendix A.

A perusal of Appendix A indicates that there are no major differences in the nominal rates of withholding tax applied in the five countries. Some differences however do exist. Thus, Malaysia does not have a separate withholding rate on dividends which are taxed at the 35 per cent rate applied to profit income. However, the tax paid is allowed as a credit against income and profits tax to prevent double taxation. Second, China applies a

relatively low 7 per cent withholding tax rate on patent royalty payments to West Germany, Italy, UK and USA and a 6 per cent rate in the case of France.

However, exemptions, local laws etc. are in force in each country so that the effective tax rate may have little or no relation to the nominal tax rates. What we have tried to do in this section is to look at the basis on which each country tries to encourage FDI through a number of tax and regulatory concessions.

The most striking difference in the tax treatment between India and the other countries is that all the four countries insist on a certain minimum level of FDI. Thus Thailand does not permit FDI below 5 million baht and has no ceiling on foreign ownership of equity. Similarly, China by and large encourages foreign investment only in equity joint ventures but insists that the foreign participant holds at least 25 per cent of the equity capital. China also imposes a ceiling of 70 per cent on the ratio of registered capital to the total amount of investment but relaxes this to 33 per cent, if foreign equity exceeds 30 million dollars. Indian policy on the other hand tries to limit the quantum of foreign equity and, as argued earlier, may in fact seek to discourage it all together.

A second common thread in the policies of these countries is to give tax concessions linked to the time period of foreign investment. Again, China insists that new joint ventures be for a period of at least 10 years with no income tax in the first two profit making years and a 50 per cent reduction in income tax in the next three years. We have already argued how the Indian policy militates against long term investment by promoting short term foreign collaborations rather than FDI.

A third concession given in most of the other countries is in the context of local content, in particular, employment. Thailand generally insists on majority Thai ownership of companies but is willing to relax this if the foreign company is creating local employment or locating in a backward area or providing some social and economic benefits. Malaysia allows 100 per cent foreign ownership if the company exports more than 80 per cent of its production but this export obligation can be reduced if the foreign company gives employment to at least 350 Malaysians and its product does not compete with any local product. In fact, in Malaysia a foreign owned company can get upto 100 per cent of its capital expenditure as an investment allowance, if in addition to exporting 50 per cent of its production it satisfies certain other conditions relating to value added, local employment and location. Similarly, China also provides concessions for foreign companies located in notified areas.

A careful perusal of the Indian policy shows that the only factor on the basis of which foreign companies get concessions is export obligations. Thus, for example, the 40 per cent limit on equity for non-FERA companies can be relaxed up to 100 per cent if the company undertakes to export 100 per cent of its production. In general, the Indian policy on FDI discourages long term investment unless a very large export commitment exists. While other countries also impose restrictions on foreign ownership the relaxation or tax concessions are not linked only to export performance but also to important domestic policy issues like employment, local content and location.

Conclusion

Our main objective in this paper has been to look at the changes in the form of foreign participation in India. We find that there has been a shift from long term FDI in the form of foreign equity to short term involvement via collaborations which ensure quick and riskless returns in the form of lump sum payments, royalties and interest. Our objection to this is two fold. First, the foreign collaborator has no long term interest since he has no sunk costs in the form of a share of capital etc. Second, the foreign investor is assured of a return irrespective of the long term viability of the imported technology.

We also looked at the tax treatment of foreign investment in India and compared it to the tax treatment in China, Malaysia, Thailand and Brazil. The most remarkable finding is that all these countries place a lower limit on the amount of foreign equity. Further, tax concessions are based on either the duration of the foreign investment or the size of equity participation.

Finally, it is rather illuminating that while Indian concessions to foreign investment (for example in percentage of foreign equity allowed) are based only on export performance, other countries have also linked concessions to important domestic policy objectives like local employment, location and other social objectives. That employment oriented concessions in particular are nowhere to be found in the Indian tax and non-tax policies towards foreign investment, must remain the greatest lacunae in Indian policy planning.

To summarise, the policy towards foreign investment must attempt to encourage long term investment in the form of FDI via equity investment by the foreign partner. Tax policy needs to be re-oriented in this light. Some specific changes can be made. For

one, any tax concession must be linked to the period for which foreign equity is committed, that is, the longer the period the greater the tax concessions. Second, the tax concessions can be graded with larger concessions, the greater the equity committed by the foreign investor. Third, it is necessary to impose some ceiling on the foreign debt to equity ratio to prevent the country getting into debt traps.

In concluding, we may note that it is not our contention that tax factors or policy towards FDI by themselves attract FDI. It is likely that the general environment (Labour Laws, Attitudes of bureaucracy to foreign investment etc.) is the more important influence on the inflow of FDI, however what we have tried to argue is that even in a positive environment the nature of Foreign collaboration in India and the inadequate tax laws are sufficient to scare away FDI.

A N N E X T U R E S   A.1 - 5

WITHHOLDING RATES UNDER THE DOUBLE TAX TREATIES IN BRAZIL, CHINA, INDIA, MALAYSIA, THAILAND.

BRAZIL

Withholding tax Rates (in %) on Brazilian Source Dividends, Interest, Royalties paid to non-residents under Double Tax Treaties.

Country	Date of Treaty	1 Dividends	2 Interest	3 Royalties	4 Technical Fees
France	1.1.73	15	15	10,15 or 25	-
Federal Republic of Germany	1.1.76	15	10 or 15	25 or 15	-
Italy	1.1.82	15	15	25 or 15	-
Japan	1.1.68	12.5	12.5	15 or 12.5	-
Sweden	11.1.76	25 or 15	25 or 15	25 or 15	-
U.K.	-	-	-	-	-
U.S.A.	-	-	-	-	-
National Laws of Brazil		25,15,8 12,10	25	25	-

Notes:1. In case of dividends, the rate is 15% generally, but in some cases it is 25%. In Japan's case the rate is lesser (12.5%). Under the National Laws of Brazil, dividends paid to individuals and to legal entities domiciled or resident outside Brazil are normally subject to a 25% withholding tax. If the dividend had already been subject to withholding tax at a lower rate, only the difference is due. The 8% 'withholding tax' is specifically creditable against the liability of the non-resident (this is additional to the corporate income tax).

In certain cases this withholding tax is paid at a 15% rate, namely:

(i) dividends and other similar profits distributed in cash and paid by an exempted investment company;

(ii) gains realized from the sale of shares issued by investment companies, as calculated in the original foreign currency;

In cases (i) & (ii) the benefits are paid on investments that entered into Brazil prior to 29.12.1982 and if maintained in Brazil for more than 6 years, the withholding tax is levied at the rates given below:

Investment maintained in Brazil for periods	Rate of withholding tax
6 to 7 years	12%
7 to 8 years	10%
over 8 years	8%

2. In the case of interest, the tax rate is 15% in French and Italian treaties with Brazil, for Japan it is lesser i.e. 12.5%. In the case of Germany, taxation in the source country is limited to 10% for interest paid to a bank under certain conditions and to 15% in other cases. In Sweden's case interest income is taxable in both

states but the taxation in the source country is limited to 25% for interest paid to individuals or partnerships and to 15% for other cases. Under the National Laws, the rate prescribed is 25%.

3. The tax rates for Royalties is 25% for trade marks (applicable to all the treaties considered here) and 15% in other cases (under the Japanese treaty it is 12.5%). The tax rate is 10% for copyrights, films and tapes under the Brazil-France treaty provisions.

4. Provisions for Technical fee taxation are not made under the treaty arrangements.

PEOPLE'S REPUBLIC OF CHINA

Withholding Tax Rates (in %) on Chinese Source Dividends, Interest, Royalties and Technical Fees paid to Non-Residents (Including Non-Residents of Tax Treaty Countries) Where the Income is not Connected with a Permanent Establishment in China.**

Country	Date of treaty	Dividends	Interest	Royalties (use of equipment)	Royalties General
		1	2	3	4
France	01.0.86	10	0 or 10	10	10
F.R.G	11.07.85	10	0 or 10	10	7
Japan	01.01.85	10	0 or 10	10	10
Italy	14.11.89	10	0 or 10	10	7
Sweden	01.01.87	10	0 or 10	10	7
U.K.	23.12.84	10	0 or 10	10	7
U.S.A.	21.11.86	10	0 or 10	10	7
National Laws of China		10[a] 20[b]	20[b]	20[b]	20[b]

Notes:

1. Dividends: Under treaty arrangements with all the countries considered here, the rate of taxation on dividends from Chinese source is 10 percent applicable on Foreign enterprise-other than those which provide advance technology and equity joint venture.

2. Interests: Under all the treaties considered here public bodies are exempted from tax on interest from Chinese source, otherwise the rate is 10%.

3. Royalties (General): The tax is 10% in the case of Japan and France but the royalties paid for the use of or the right to use industrial, commercial or scientific equipment are subject to tax on 70% of 10% of the gross amount of such royalties in the case of U.S., U.K. and F.R.G.

   For copyright, television royalties the rate of taxation for the countries under consideration is 10%.

4. Royalities (use of equipment): Under all the treaties mentioned here the rate of taxation is 10%.

5. National Laws of China:

   (a) The joint venture income tax applies only to one type of business operation: the equity joint venture between foreign and Chinese partners, where a foreign participant in an Equity joint venture remits abroad part of the share of the profits, the joint venture income tax is withheld at the rate of 10 per cent.

(b) The foreign enterprise income tax applies to business operations other than equity joint venture between foreign and Chinese partners. The foreign enterprises income tax is withheld at the rate of 20% from gross amount paid to a foreign enterprise or 10% on advanced technology after approval by the tax authority.

INDIA

Withholding tax rates (in percent) on Indian-source dividends, interest, royalties and technical services fees paid to NRI generally and under tax treaties where the income is not connected with a permanent establishment in India.**

Country	Date of treaties	Dividends (1)	Interest payments (2)	Royalties (3)	Technical Service Fees (4)
France	26.03.69	-	-	-	-
F R G	18.03.59	15	0,10 or 15	-	20
Italy	12.01.81	-	0, or 15	-	-
Japan	05.01.90	-	-	-	-
Sweden	30.07.58	15 or 25	0,10,or 15	20	20
U.K.	16.04.81	15	0,10,or 15	30	30
U.S.A*	12.09.69	15 or 25	0,10,or 15	10,15,or 20	10,15,20
National Laws of India regarding tax rates		25 or 30	15,25,30 44 or 65	30,50,or 65	30,50,65

Notes: * Not yet in force. (However, recently it was concluded that Indo-US convention on the avoidance of double taxation and the prevention of fiscal evasion with regard to taxes on incomes will come into effect in India on April 1, 1991, in respect of income arising in any previous year).

1. <u>Dividends</u> - In the case of Japan, Italy and France national laws apply (i.e.25%). For the rest of the countries the double tax convention specifies 15% of the gross amount of the dividends, if the beneficial owner is a company which owns at least 10% of the voting stock of the company paying the dividends and 25% of the gross amount of the dividend in all other cases.

2. <u>Interest</u> - In the case of Japan and France national laws apply. For rest of the cases the taxes charged shall not exceed.

(a) 10% of the gross amount of the interest, if such interest is paid on a loan granted by a bank carrying on a bonafide banking business or by a similar financial institution (including an insurance company) and

(b) 15% of the gross amount of the interest in all other cases.

Exemptions are provided in the case of interest beneficially owned by the government, a political subdivision or local authority or the Central Bank as the case may be.

3. <u>Royalties</u> - In most of the cases i.e. (F.R.G., Japan Italy, France) national laws apply. In case of the U.S. withholding rates will vary between 10-20 per cent (according to the new convention).Lastly under the treaty arrangements with Sweden and U.K. it is 20 and 30 percent respectively.

4. <u>Technical services Fees</u> - Same provisions as in the case of Royalties apply. Only exception is FRG, here the tax rate for technical services must not exceed 20%.

Under the national laws - If no rate is given and the treaty does not specify any limitation, the national rates apply. As regards technical service fees, in the absence of any specific provision in the treaty the provisions relating to business profits will generally apply.

Some of the treaty withholding rates apply only to payments in respect of obligations created after the enforcement of the treaty.

If two treaty withholding rates are given for dividends, the lower rate generally applies to dividends paid to corporate shareholder which have at least a specified percentage shareholding in the paying company.

Certain exemptions from withholding tax for interest generally apply If, there are two treaty rates of withholding, the lower rate generally applies to interest paid to a bank or financial institution.

The rate of income tax applicable to foreign companies on assessment for the year 1988/89 is generally 65%. A lower rate of 50% applies to royalties and technical service fees received from the government of India for agreements made between 30.3.61 - 1.4.76 for royalties and agreements made between 29.2.64 - 1.4.76 for technical services fees.

Dividends: 25% withholding rate on income by way of dividends.

Interest Income: Interest payable on money borrowed or debt incurred in foreign currency is 25%;and 44% on interest payable on a tax free security. 15% interest is payable on a tax free security by non-resident individual.

Royalties: 30% on income by way of royalties payable by the government or an Indian concern in pursuance of an agreement made with the government or the Indian concern after 31.3. 1976, where such royalty is in consideration for transfer of all or any rights in any book, on a subject which may be imported under an open general licence according to the import trade control policy for the period 1.4.77 - 31.3.78.

For agreements between 31.3.61 - 1.4.76 - 50% (including the granting of a licence) in respect of a copyright.

Malaysia Withholding Tax Rates (in %) on Malaysian Source Dividends, Interest, Royalties and Technical Fees Paid to Non-residents (including Non-Residents of Tax Treaty Countries) where the Income is not Connected with a Permanent Establishment in Malaysia.**

Income Items Countries	Date of treaty	Dividends (1)	Loan Interest (2)	Patent Royalties (3)	Technical Fees (4)
France	24.04.75	Nil	0 or 15	0 or 10	15
FRG	08.04.77	Nil	0 or 15	0, 10 or 15	0
Italy	28.01.84	Nil	0 or 15	0 or 15	15
Japan	30.01.70	Nil	0,10,15	10 or 15	15
Sweden	21.11.70	Nil	0 or 15	0 or 15	15
U.K.	30.03.73	Nil	0 or 15	0 or 15	15
U.S.A.	-	-	-	-	-
National Laws		Nil	0 or 20	0 or 15	15

Notes:

1. <u>Dividends:</u> Malaysia does not at present levy a separate withholding tax on dividends in addition to the tax levied at a rate of 35% on profits on income of a company. Upon paying a dividend a company resident in Malaysia is required to deduct tax at the company rate of 35 per cent, where no deduction of tax is made the tax is deemed to be withheld on the distributed dividend as an advance tax by the distribution company. The tax so deducted or deemed to be deducted is creditable against the company income tax due by the paying company on the profits or income.

   At the end of each assessment year two total amounts must be determined for each resident company in Malaysia, one total represents the tax paid or payable by the company on its profits or income and the other represents the tax deducted or deemed to be deducted from dividends paid to its shareholders. Where the former total exceeds the latter, the difference is carried forward for franking future dividends, where the latter exceeds the former the excess becomes debt due to the treasury. The deduction of tax on dividends paid during the assessment year is an underlying tax of the company resident in Malaysia levied on the profits or income out of which the dividends are paid and not a separate tax on dividends. In addition, companies resident in Malaysia pay a development tax on development source income.

2. <u>Loan Interest</u>: The tax rate under the treaties is generally 15%. Under the national laws the withholding tax on loan interest from Malaysia paid to non-residents is levied at the rate of 20% of the gross amount. Interest arising from an approved loan for financing development projects or for the purchase of capital equipment for development projects and loans from a non-resident bank to a bank in Malaysia and interest paid by banks licensed under the Banking Act 1973 are exempt from Malaysian withholding tax.

   Certain other exemptions are also provided in the case of specific treaties. They are as follows:

(a) In the case of France and F.R.G., interest from an approved loan for financing development projects or for the purchase of capital equipment for development projects in Malaysia is exempt from tax in Malaysia.

(b) In the case of Italy, Interest from an approved loan or long term loan shall be exempt from tax in Malaysia.

(c) In the case of Sweden & U.K., if the loan or indebtness has been approved by the government of Malaysia, such interest shall be exempt from tax in Malaysia.

(d) In the case of Japan, interest arising from the Malaysian government, its local authorities and financial institutions' derived by the government of the other contracting State, (including its subsdivisions and financial institutions) is exempt from tax in Malaysia.

(e) In the case of Japan, if the loan or indebtness in respect of which the interest is paid is made to or incurred by an enterprise engaged in an industrial undertaking the rate is maximum 10%.

(3) Royalties: When the payer in Malaysia is liable to pay royalties derived from Malaysia to any other person including a company not known to him to be resident or to have a place of business in Malaysia at the time of payment, he shall upon paying or crediting the royalty, deduct therefrom income tax at the rate of 15%.

The following exemptions are given in the case of France, FRG and Sweden:

If the agreement under which such royalties are payable has been approved by the government of Malaysia they shall be exempt from tax in Malaysia, In the case of U.K. the beneficial owner is exempt from tax on "approved industrial royalties" engaged in one of the following activities:-

(i) Manufacturing, assembling or processing
(ii) construction, civil engineering or ship building
(iii) electricity, hydraulic power, gas or water supply.

In some cases (France, FRG and Japan) the treaty rate is 10%, if not exempted.

4. Technical Fees:- Tax is withheld at 15% for all countries except FRG, where specific treaty provision grants relief from tax with respect to special classes of income.

* In the updated version (supplement 80) w.e.f. April 1991, the rates pertaining to France for Royalties are 0, 10, 15.

*** For UK the rate is 10% w.e.f. April 1991.

Thailand

Withholding tax rates (in percentages) on Thai-source Dividends, Interest, Royalties and Technical Fees paid to non-resident (including non-residents of tax treaty countries) where the income is not connected with a permanent establishment in Thailand.**

Country	Date of treaty	Dividends[1]	Interest[2]	Patent Royalties[3]	Technical[4***]
France	27.12.74	15 or 20[a]	0,3 or 10[a]	10 or 15[a]	10 or 15[a]
FRG	10.07.67	15 or 20[a]	0,10,25[b]	15	15
Italy	22.12.77	15 or 20[b]	0,10,25[b]	15	15
Japan	01.03.63	15,20,25[c]	0 or10[c]	15	15
Sweden	20.10.81	20[d]	0,10,25	15	15
U.K.	18.02.81	15 or 20[d]	0,10,25[b]	15	15
U.S.A.	-	-	-	-	-
National Law in Thailand		20 7-55*	0,10,25 7-55*	25 7-55*	25 7-55*

Notes:* Individual income tax rates, levied progressively from 7 to 55% will be withheld from payments in respect of these items if paid to non-resident individuals of Thailand. In the updated version as of April 1991 (supplement 80), these provisions no longer apply.

1. Dividends: (a) In the case of France and F.R.G., if the beneficiary of the dividends is a company (partnership excluded) owning at least 25% of the capital of the Thai company paying the dividends and is engaged in an industrial undertaking the tax shall not exceed 15% of the gross amount of the dividends, in all other cases the rate is 20%.

(b) The Thai tax shall not exceed 20% of the gross amount of the dividends if the company paying the dividends is engaged in an industrial undertaking or if the recipient of the dividends is a company resident in Italy owning at least 25% of the voting shares of the Thai company or 15%, if both conditions are fulfilled.

(c) The tax shall not exceed 25% on dividends paid by a corporation of Thailand to its parent corporation (which owns 25% of the shares with voting powers) in Japan.

(d) The Thai tax on dividends shall not exceed 20% of the gross amount of the dividends if the Thai company is engaged in an industrial undertaking or if the U.K. company receiving the dividends controls atleast 25% of the voting power of the Thai company, or 15% of the gross amount of the dividends if both conditions mentioned above are fulfilled, provided the dividend received is subject to tax in the U.K.

The national law stipulates 20% tax rates.

2. Interest (a) In the case of France, in addition to the taxation of interest according to the laws of Thailand, the convention provides that the tax shall not exceed 3% of the amount of the interest paid on loans or credits which are granted for a period of 4 years or more with the participation of a Public Finance organization to a public utility authority or to an enterprise in

France and which are big to the sale of plant and machinery or studies relating to the equipping of, or the supply of industrial commercial or scientific installations as well as public works and 10% when the interest is paid to any financial establishment in France.

(b) Interest arising in Thailand and received by the government of the other contracting state (including local tax in Thailand, Interest paid to financial institutions or insurances companies, is subject to a rate not exceeding 10% or 25% of the gross amount of all other interest arising in Thailand (applicable to F.R.G., Italy, U.K.).

(c) In the case of Japan interest received by the government of Japan including a local authority of a Financial Institution fully owned by the government of one of the contracting states shall be exempt from tax in Thailand. Interest received by a resident of Japan on bonds issued by the government of Thailand including a local government shall be exempt from tax in Thailand. The rate of tax is 10% on interest received by any Financial institution including an insurance company resident in Japan on debentures issued by or on loans made to an enterprise of Thailand engaged in an industrial undertaking. Under the national laws for interest payments, interest paid to foreign banks or insurance companies is subject to a rate of 10%. In all other cases the rate is 25%.

Interest paid by the Thai government or by a financial institution organized to promote agriculture commerce or industry is exempt from tax. Exemption applies also when interest is paid to the national government or a local government of the other state or in some cases to its Central Bank or certain public institutions.

3. <u>Patent Royalties:</u> (a) In the case of France, generally 10% rate is applicable when the tax levied is on royalties arising in Thailand relating to experience acquired in the industrial field and for all other cases it is 15%.
For other countries under consideration the 15% rate is applicable. Under the national laws 25% rate is applicable.

4.*** <u>Technical Fees:</u> Same provisions apply as in case of Royalties. These provisions no longer apply w.e.f. April 1991.

** For the purposes of double tax treaty conventions, the term 'Permanant Establishment' wherever used means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Table 1: Distribution of FDI Inflows by Major Regions,
Annual Averages in Selected Periods

(Amount in billion US dollars, and Relative Share in Percentage)

	1971-75 Amount	Share	1975-80 Amount	Share	1981-85 Amount	Share
World	15.60	100.00	32.10	100.00	48.70	100.00
Developed Market Economies	12.10	77.60	24.60	76.60	36.60	75.20
Developing Economies	3.50	22.40	7.50	23.40	12.10	24.80
-Latin America[a]	2.10	13.50	4.00	12.50	5.10	10.50
-Asia[b]	1.20	7.70	2.00	6.20	4.80	9.90
-Others	0.20	1.20	1.50	4.70	2.20	5.40

Sources: United Nations,"Transnational Corporations in World Development--
Third Survey", op. cit.,p. 286,and "Transnational Corporations in world
Development-- Trends and Prospects", op. cit., p.76

Notes: a) Including the Caribbean.
b) Including Island Developing Countries in the Pacific

Table2:Selected Developing Economies In The ESCAP Region. FDI Inflows, Various years and Periods

Million US $

	1975	1980	1981	1982	1983	1984	1985	Annual 1975-80	Average 1981-85
Total	1647.30	3197.10	5267.80	4827.50	4720.00	4773.30	4494.00	2007.20	4816.70
BRUNEI	0.90	-19.60		6.20	3.60	0.80	0.80	-0.00	2.30
CHINA		57.00	265.00	429.50	636.10	1257.70	1659.10		796.50
FIJI	14.10	36.40	36.20	36.80	32.10	23.40	33.80	10.10	32.40
HONG KONG	199.20	273.90	1087.90	651.80	603.00	681.70	-216.00	241.10	561.70
INDIA	85.10	79.20	91.90	72.10	5.60	-36.90	70.00	41.00	40.50
INDONESIA	475.90	179.60	133.20	226.30	288.60	226.50	272.10	289.90	229.40
MALASIA	350.90	934.50	1265.20	1397.70	1260.40	797.50	694.50	524.30	1083.00
PAKISTAN	25.50	58.60	107.30	65.10	31.00	55.40	134.00	32.80	78.60
PAPUA NEW GUINEA		75.60	86.30	86.10	139.40	115.90			
PHILIPPINES	98.30	-106.70	172.20	15.50	104.80	9.20	-11.20	73.60	58.10
REPUBLIC OF KOREA	57.10	7.80	101.40	68.40	69.50	111.70	230.50	60.70	116.30
SINGAPORE	286.50	1119.30	1409.10	1391.10	995.20	883.60	973.70	502.00	1130.50
SOLOMON ISLAND	7.90	2.50	0.20	1.00	0.30	1.80	0.90	4.60	0.90
SRI LANKA	0.10	43.00	49.30	63.60	37.70	32.60	30.90	15.00	42.80
TIAWAN(CHINA)	19.80	166.00	151.00	104.00	149.00	201.00	340.00	91.30	189.00
THAILAND	21.90	190.00	293.60	193.20	349.60	403.90	161.40	85.20	280.30
VANUATU				7.00	5.90	7.60	4.60		
VIETNAM	4.10		17.90	11.90			-0.10		

Source:United Nations " Transnational Corporation In World Development"-Trends and Prospects,op. cit., Annex Table A.1, pp. 506-507.

Table 3: Selected Developed Market Economies; Sectoral Distribution of Outward Stock of FDI, 1975 and 1985 (in percentage)

COUNTRY	Extractive		Manufacturing		Services		Others	
	1975	1985	1975	1985	1975	1985	1975	1985
Canada	21.1	22.90	50.50	46.20	28.40	30.90	NA	NA
FRG	4.10	3.80	48.30	43.00	41.90	48.30	5.70	4.90
Japan	28.10	15.50	32.30	29.20	36.20	51.80	3.40	3.50
UK	11.10	33.30	59.50	31.80	29.40	34.80	NA	NA
USA	26.40	23.10	45.00	37.90	24.30	33.70	4.30	5.20
Netherlands	46.50	55.40	38.60	22.20	14.70	22.10	0.30	0.30

Source: United Nations Survey of Transnational Corporations TNC's in World Development: Trends and Prospects (N.Y, 1988), Table V.4, page 86.

Table 4: Foreign Collaboration Approvals: 1965-88

Year	Total No. of Collaborations	Cases involving FDI	Percentage Cases with FDI
1965	241	71	29.5
1966	202	49	24.3
1967	182	62	34.1
1968	131	30	22.9
1969	134	29	21.6
1970	183	32	17.5
1971	245	46	
1972	257	36	14.0
1973	265	34	12.5
1974	359	55	
1976	277	39	14.1
1977	267	27	
1978	307	44	
1979	267	32	12.0
1980	526	65	12.4
1981	389	56	14.4
1982	588	113	19.2
1983	673	129	19.2
1984	740	148	20.0
1985	1041	256	24.6
1986	960	256	26.7
1987	903	259	28.7
1988	957	289	30.2
Total	12847	2724	

Source: National Register of Foreign Collaboration:1988
Department of Scientific & Industrial Research
Ministry of Science & Technology, New Delhi

Table 5:
Foreign Collaborations: Sectorwise Distribution 1981 -88

Sector	Nos.	%
Alternate/Renewable Energy	38	0.60
Chemicals	720	11.70
Electrical & Electronics	1531	24.80
Industrial Machinery	1156	18.70
Mechanical Engineering	751	12.20
Machine Tools	176	2.80
Metallurgy	314	5.10
Textiles	87	1.40
Transport	287	4.70
R & D/Consultancy	75	1.20
Misc.	1034	16.80
Total	6169	100.00

Source : Same as Table 4

Table 6: Foreign Collaboration Approvals: 1978-89

Countries	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	% Of Total (in 1989)
USA	59	40	125	85	100	135	146	197	189	196	191	127	21.0
FRG	58	55	100	74	110	129	135	180	183	149	178	112	18.5
UK	61	63	110	79	106	119	127	147	130	122	134	66	15.7
JAPAN	28	12	34	27	51	56	78	108	111	71	96	62	9.9
ITALY	13	16	25	18	37	30	37	56	58	50	53	37	5.6
FRANCE	21	17	24	23	28	40	38	61	39	214	42	23	5.1
SWITZERLAND	18	14	38	26	41	47	30	42	32	31	41	22	4.8
NETHERLANDS	10	6	8	9	14	13	14	16	26	23	15	12	2.1
SWEDEN	8	5	10	11	15	15	14	29	29	19	11	17	2.4
CANADA	3	2		2	1	6	8	15	15	9	10	6	
FINLAND	1	3	5	2	4	1	2	4	5	2	10	5	
USSR	2	2	6	2	2	4	1	4	5	6	7	9	
TOTAL	307	267	526	389	590	673	752	1024	957	853	926	605	

Source: "CMIE Economic Outlook" 18 September 1990 and "The National Register of Foreign Collaboration(1988)"

Table 7
Sectorwise Distribution of Payments Approved 1981-88

Rs. in Million

Sector	1981	1982	1983	1984	1985	1986	1987	1988	Total	%
Alternate/Renewable Energy Sources	NA	0.70	0.60	6.10	31.00	6.70	1.60	10.50	57.20	0.20
Chemicals	107.60	240.70	498.40	1340.30	936.50	3029.90	1834.80	2137.30	10125.50	37.50
Electrical & Electronics	72.50	456.50	262.00	322.60	1061.10	1302.60	682.40	826.70	4986.40	18.50
Industrial Machinery	98.30	211.00	257.50	325.00	826.90	127.10	350.30	1160.00	3356.10	12.40
Mechanical Engineering	47.10	192.10	108.50	172.30	162.40	319.50	239.50	239.00	1480.40	5.50
Machine Tools	10.40	3.30	24.20	82.70	47.80	39.00	68.10	79.40	354.90	1.30
Metallurgy	31.40	123.70	34.80	92.00	363.00	428.60	514.00	432.30	2019.80	7.50
Textiles	116.70	22.30	19.90	86.20	317.30	24.70	12.40	84.20	683.70	2.50
Transport	35.10	89.40	131.20	72.00	144.80	131.00	106.80	116.50	826.80	3.10
R & D/Consultancy	NA	16.10	23.00	4.30	56.20	NA	33.90	76.00	209.50	0.80
Misc.	46.00	85.60	191.00	499.80	558.30	473.20	338.80	676.80	2869.50	10.70
Total	565.10	1441.40	1551.10	3003.30	4505.30	5882.30	4182.60	5838.70	26969.80	100.00

Source: Same as table 4

Table 8:Foreign Investment(Including NRI)
Sector wise

in Rs. Million

Sector	1981	1982	1983	1984	1985	1986	1987	1988
CHEMICALS	10.9	795.95	7.576	709.43	88.23	300.08	na	679.1
ELECTRICALS	8.6	44.814	78.358	56.67	301.11	301.17	na	372.6
INDUSTRIAL MACHINARY	23.48	47.501	20.695	52.84	33.37	10.48	na	49.6
MECHANICAL ENGINEERING	10.42	166.2	23.395	45.6	83.66	80.057	na	141.5
METULLARGY	1.11	6.044	5.16	24.63	147.79	137.84	na	147.5
MISCELLANEOUS	10.61	153.108	276.554	232.1	473.42	251.12	na	1123.7
TOTAL(INCLUDING OTHERS)	108.7	1508.0	618.7	1127.6	1420.74	1258.4	169.87	2709.1

Source:National Register of Foreign Collaborations, various issues.

Table 9:Lumpsum Payments (Countrywise).
in Rs. Million

Country	1981	1982*	1983	1984	1985	1986	1987	1988
USA	240.63	605.46	397.95	289.487	1145.207	2121.0	na	1099.5
FRG	131.14	235.8	226.55	362.12	165.09	1364.1	na	1074.9
UK	59.819	152.855	157.87	377.443	536.43	619.3	na	1242.8
JAPAN	30.78	192.87	117.6	237.42	262.53	494.4	na	795.4
S. KOREA		0.45	29.01	2.811	15.26	na	na	15.0
ITALY	31.5	46.24	22.058	183.97	215.03	235.1	na	144.2
FRANCE	38.98	268.00	70.79	159.13	150.865	87.0	na	494.7
SWITZERLAND	24.82	96.43	58.14	10.29	85.48	221.2	na	495.0
SWEDEN	10.75	31.81	18.99	7.14	43.49		na	30.6
CANADA	0.12	0.26	10.975	11.05	77.35		na	13.6
TOTAL(INCLUDING OTHERS)	565.1	1441.4	1551.1	3003.3	4505.3	5882.3	4182.6	5838.7

Source:Same as Table 7.

* Unexplained discrepancy in the total of 1982

Table 10
Foreign Investment 1981-88
Rs in Million

Country	1981	1982	1983	1984	1985	1986	1987	1988	Total	%
USA	22.5	73.6	138.9	132.0	589.8	390.9	454.9	983.1	2785.7	26.7
FRG	54.2	35.3	48.4	46.6	139.3	228.8	165.9	378.4	1096.9	10.5
UK	7.1	25.1	98.0	42.1	40.9	81.4	503.0	111.1	908.7	8.7
JAPAN	6.5	1011.1	160.8	72.7	171.0	56.2	77.1	243.8	1799.2	17.3
ITALY	0.5	59.9	11.5	8.0	86.7	29.6	81.0	347.6	624.7	6.0
FRANCE	0.8	25.8	8.0	16.6	59.8	19.0	53.6	181.6	365.2	3.5
SWITZERLAND	6.5	112.7	11.3	2.4	11.3	34.5	89.6	108.5	376.8	3.6
SWEDEN	NA	15.3	8.0	15.8	18.7	47.5	22.4	4.4	132.1	1.3
NETHERLANDS	0.8	NA	26.9	NA	7.0	70.8	10.4	13.6	129.5	1.2
OTHERS	9.9	149.2	106.9	791.4	278.2	299.7	240.8	334.0	2210.1	21.2
Total	108.7	1508.0	618.7	1127.6	1402.7	1258.4	1698.7	2706.1	10428.9	100.0

Source:Same as Table 4

Table 11:Remittance of Profits,Dividends etc. from India To Other Countries: 1964-65 to 1986-87

	Profits	Dividends	Royalties	Technical Fees	Interest payment by Pvt.Sector	Total
1964-65	15.60	22.00	4.40	3.60	6.20	51.80
	(30.1)	(42.5)	(8.5)	(6.9)	(12.0)	
1965-66	13.50	19.40	2.95	6.98		42.83
1966-67	14.47	28.77	5.13	10.43		58.80
1967-68	15.95	32.70	4.32	14.68		67.65
1968-69	12.96	30.25	4.78	17.97	12.73	78.65
1969-70	12.72	31.41	5.80	13.05	9.28	72.26
	(17.6)	(43.4)	(8.0)	(18.0)	(12.9)	
1970-71	13.12	43.48	5.23	20.63	12.80	95.26
1971-72	9.94	38.87	5.86	13.90	12.13	80.70
1972-73	15.54	39.00	7.33	11.33	15.60	88.80
1973-74	21.91	37.51	6.21	14.08	16.27	95.98
1974-75	7.19	18.46	8.46	12.56	36.70	83.37
1975-76	20.36	24.84	10.49	25.66	24.65	106.00
	(19.2)	(23.4)	(9.9)	(24.2)	(23.2)	
1976-77	19.39	48.47	15.88	37.80	25.11	146.65
1977-78	10.13	68.01	19.50	28.14	22.70	148.48
1978-79	10.24	45.35	12.65	55.52	31.44	164.20
1979-80	14.37	50.92	9.53	43.97	25.22	144.01
1980-81	21.10	55.92	8.88	104.93	22.32	204.15
1981-82	12.16	58.92	15.99	270.70	41.08	398.85
1982-83	19.12	70.31	39.72	258.58	80.23	467.96
1983-84	20.00	62.11	27.60	314.89	81.51	506.11
1984-85	16.68	74.58	28.49	300.60	123.91	544.26
1985-86	11.80	75.20	23.50	367.90	218.70	697.10
1986-87	11.60	85.50	40.10	358.40	318.90	813.50
	(1.3)	(10.5)	(4.9)	(44.0)	(39.2)	

Source: CMIE, Economic Outlook ,September 1990
Note:Figures in the Parenthesis are Percentage of Total.

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