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United States' 301 findings on India's Equalisation Levy – What next!

Mukesh Butani, Tarun Jain (BMR Legal) · Wednesday, January 20th, 2021

Introduction

One of the key reasons highlighted by OECD imploring the urgent need for consensus on digital tax under its Inclusive Framework were the repercussions arising on account of unilateral digital taxes. Recent reports released by the United States Trade Representative ('*USTR*') reveal that such concerns are real and carry ominous ramifications. A case in point is the finding of USTR that India's Equalisation Levy, particularly concluding that its expansive scope (legislated in Finance Act 2020) is discriminatory and 'actionable'. This article highlights the run up to these developments and what's next in store.

Revisiting the journey of India's Digital Services Taxes

India was amongst the first proponents of a Digital Services Tax ('*DST*'). Propelled by the OECD/G-20 2015 BEPS Report on Action 1, an expert Committee constituted by the Government of India recommended enactment of an Indian DST. The Committee highlighted the "asymmetry in tax burden between Indian and multi-national enterprises [which] is likely to have a distortionary impact on the market competition and can adversely affect the development of Indian digital enterprise industry, apart from creating strong incentives for Indian enterprises to either locate themselves outside India or sell their businesses to foreign enterprises."^[1]

The Committee realised that "[i]n view of the differences between the preferences of different countries, it may take a long time for the international community to arrive at a recommendation that is likely to be adopted uniformly by all countries in a way that will completely harmonize international taxation on digital economy" whereas, it stressed, it was imperative for India to take urgent action to address inequities and limitations in the existing regulations in taking the digital economy. The Committee recommended^[2] enactment of Equalisation Levy ('*EQL*') "on payments made for digital services to foreign beneficial owner, who enjoy an unfair advantage over their Indian competitors providing similar services by digital or more traditional means, with the objective for equalizing their tax burden with other businesses that are subjected to income-tax in India, without disturbing the existing tax treaties."^[3]

Virtually all recommendations of the Committee were accepted by the Government of India, excepting restricting the scope to digital advertising which quickly engrafted into a standalone law. Chapter VIII of the Finance Act, 2016^[4] enacted the levy of 2016 *EQL* as a new tax, on payments

made to Non-Residents Digital Service Providers ('NRDSP') for rendering specified services, distinct from the traditional tax on income, outside the scope of Indian double tax treaties and levied on gross amount paid for digital transactions. The liability to discharge the EQL and undertake compliances, however, was on the Indian Residents making the payment to such NRDSP. "Thus, the NRDSP were largely unaffected as, effectively, the cost of the 2016 levy and the compliance burden was upon the Indian Service Receivers. Furthermore, the 2016 levy was restricted only to digital advertisements, which did not affect most NRDSPs." [5]

Given delays in achieving global consensus and, perhaps, low revenue collections from the narrow base of 2016 EQL and the need for mobilising tax revenues at a moment when the economy was slipping away in Covid-19 shutdown, the scope of EQL was substantially expanded by the Finance Act, 2020. [6] This expanded levy, let us call it *2020 EQL*, which formed the subject-matter of 301 inquiry, is effectively a substantive tax in itself and distinct from the 2016 EQL. The salient features of the 2020 EQL are:

- The charge is on an 'e-commerce operator', [7] which "means a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both" [8]. In other words, the NRDSP is covered within the scope of 2020 EQL only if it is an e-commerce operator, which covers not just owners of digital platforms but even those who operate or manage them.
- The 2016 EQL is at two percent on the consideration received by the covered e-commerce operator.
- While the charge is on e-commerce operators, the charge is not limited just to operations as an e-commerce operator. [9] Instead, the 2020 EQL covers any consideration received by covered e-commerce operator even "from e-commerce supply or services made or provided or facilitated by it". The law specifically defines the expression 'e-commerce supply or services' [10] to cover "(i) online sale of goods owned by the e-commerce operator, (ii) online provision of services provided by the e-commerce operator, (iii) online sale of goods or provision of services or both, facilitated by the e-commerce operator; or (iv) any combination of activities listed in clause (i), (ii) or clause (iii)."
- The 2020 EQL is wide in its scope and beyond the contours of similar DST levies by other jurisdictions. It covers "all supplies by e-commerce operator not just to a person resident in India" and extends to (a) "all supplies to a person buying goods or services using Indian IP address", (b) "sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement through internet protocol address located in India"; and (c) "sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India". [11] Thus, the 2020 EQL does not just cover transactions between Non-Residents and Indian Residents but also covers in certain cases transactions between Non-Residents as well.
- The 2020 EQL excludes the following; (i) where the e-commerce operator has an Indian Permanent Establishment and the supplies are connected to such PE, (ii) the service is covered within the scope of 2016 EQL, or (iii) the *de-minimus* threshold of INR 20mn. [12]
- The 2020 EQL is effective from April 1, 2020 and tax is payable on quarterly basis by the covered NRDSP. [13]

There are perhaps two nuances where the 2020 EQL differs from the 2016 EQL which has led the 2020 EQL to be dubbed controversial and invited scrutiny of the USTR. First, the scope of 2020 EQL is not subject-specific and extends to all classes of supplies, unlike the 2016 EQL which applies only to digital advertisements. Second, the 2020 EQL is a direct liability on the NRDSP,

which must itself discharge it and undertake compliance, unlike the 2016 EQL for which compliance is the responsibility of the Indian resident service receiver.

Run-up to the 301 proceedings, findings, and current status

One needs to go back in time and appreciate the prevailing scenario when the 2020 EQL came to be introduced. At a time, *inter alia* (a) the discussions on the OECD’s Inclusive Framework and, specifically, Pillar One were at its peak, though without an imminent solution in sight, (b) the United States had recently withdrawn from these discussions, (c) the failure of the consensus amongst the members of the European Union was evident and unilateral tax measures by some EU Member States were being announced, (d) the United States had initiated actions against the French DST and threatened retaliatory measures, and (e) the strain in trade ties between the United States and China were manifest with its accompanying ramifications. Thus, an environment prevailed where unilateral tax and trade measures were already on the horizon and being extensively debated with regard to their rationale, equity, fairness, etc. To add to these dimensions, by March 2020, when the 2020 EQL was announced, an overwhelming influence of Covid-19 was already felt in India and in view of the nation-wide lock-down, it was evident that the digital services would perhaps serve as a silver-lining in the gloomy economic outlook. Therefore, there were mixed views on the appropriateness and timing of the 2020 EQL.

Given its preoccupation with the French DST, it was unsurprising that the USTR took cognizance of the 2020 EQL, besides other unilateral DSTs. Within a few months of 2020 EQL’s enforcement, the USTR initiated investigations under Section 301 of the US Trade Act of 1974 “with respect to DSTs adopted or under consideration by Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, Italy, Spain, Turkey, and the United Kingdom” purportedly based upon “evidence [that] suggests the DSTs are expected to target large, U.S.-based tech companies.”[14] India officially participated in these investigations and defended the 2020 EQL, highlighting that it was not discriminatory or targeting the US’ entities and applied across-the-board to all NRDRPs.

On January 6, 2021, the USTR released its findings distinctively against the DSTs of India, Italy and Turkey. The common refrain of these findings is that the levies of each of these three jurisdictions are discriminatory, unreasonable and restricting US commerce.[15] Specially in the context of 2020 EQL, a detailed report of USTR disapproves it.[16] The USTR has highlighted 2020 EQL as having the largest scope in comparison with other DST:[17]

	India	Turkey	France	Italy	Spain	U.K.	Austria
Advertising	?	?	?	?	?	?	?
Platform services	?	?	?	?	?	?	
Data-related services	?	?	?	?	?	?	
Content provision	?	?					
Sale of own goods	?						
Education services	?						
Software-as-a-service	?						
Cloud services	?						
Financial services	?						

On the merits, the USTR has concluded that the 2020 EQL:

- Is discriminatory against US companies, because (a) it applies only to NRDSP, and (b) it targets only digital services and not similar services provided non-digitally.
- Contravenes prevailing international tax principles, and is therefore unreasonable, because (a) it failed to provide tax certainty to stakeholders, (b) has extraterritorial reach contravening international tax principles, and (c) applies to ‘revenue’ instead of international principle which applies the ‘income’ standard.
- Burdens or restricts US commerce, because US companies face (a) additional tax burden, (b) taxation for a broad range of digital services, (c) considerable compliance costs, and (d) double taxation.

Further, by way of a public notice, it is informed that the USTR shall now “determine what action, if any, to take under Section 301(b)” which “will be addressed in subsequent proceedings under Section 301”.[18] As the experience of 301 investigations against French DST reveal,[19] the USTR may consider imposing retaliatory tariffs to counter impact arising on US’ business interests.

India has been quick to issue an official retort to the USTR findings[20] and defended the 2020 EQL as being enacted “to ensure fair competition, reasonableness and exercise the ability of governments to tax businesses that have a close nexus with the Indian market through their digital operations”. In particular, on the necessity for DSTs, it has been stated that the 2020 EQL “is a recognition of the principle that in a digital world, a seller can engage in business transactions without any physical presence, and governments have a legitimate right to tax such transactions” and that the 2020 EQL is not outside the international tax framework, being “one of the methods suggested by 2015 OECD/G20 Report on Action 1 of BEPS Project which was aimed at tackling the taxation challenges arising out of digitization of the economy”. It is noteworthy that India has reserved its right to “take appropriate action keeping in view the overall interest of the nation”.

Way forward

Currently the USTR has refrained from announcing measures against the 2020 EQL. Perhaps the deferment is to await the policy of the new administration to be sworn in shortly. Views are already being expressed that the 301 finding has the potential to ignite trade wars considering that “it is unlikely that India will budge on its stand” and “some hard negotiations” are round the corner, the solace being that “India will not be alone in this war”.[21] The apprehension of the trade-wars are not without basis, given the recent precedent of India retaliating to US’ tariff measures.[22] Conversely, a hope exists that the new administration would revisit the earlier policy and not like to commence the US-India relationship with such transactional approach, particularly when it is recently reported that the two countries are ‘negotiating on wide range of trade concerns’.[23] Moreover, there are larger issues at play between US and India with regard to an impending Free Trade Agreement and strategic partnership with regard to defence and security, a direction for which could emerge in the months following the new administration taking charge.

In our view, however, the 2020 EQL and the 301 findings cannot be viewed divorced from the larger context of the stalemate on Pillar One consensus. The fact that the 301 proceedings were against ten countries reveal that the pressure to tax revenues accruing of NRDSPs is real and equally concerning both developing and developed countries. Unilateral DSTs, thus, appear to be a domestically available credible choice to address the economic downslides owing to the health crisis. In the specific context of 301 proceedings, a vivid possibility exists for bilateral solutions on DST,[24] either on the lines of the UN proposal leading to tax treaty changes or otherwise, wherein

the competing national interests, peculiarities and accentuating national priorities push the countries to choose bilaterally negotiated solutions refraining the application of unilateral DSTs such as the 2020 EQL.

In the specific context of 2020 EQL, we had on an earlier occasion highlighted that the law suffers from vagueness and there is lack of clarity in respect of various aspects which can create issues in implementation and likely lead to litigation.[25] This is besides the fact that the 2020 EQL overlaps in certain ways with the tax in India under the GST laws which similarly oblige the NRDSP to take discharge tax after taking registration and undertaking compliances. So far India has refrained from clarifying any aspect, possibly in view of the pending USTR inquiry and given that certain aspects would require a legislative intervention. Given, with the annual Indian Budget due on February 1, 2021, it is likely that certain immediate changes may be announced on the scope and contours of the 2020 EQL. The larger context and fate of 2020 EQL and other DSTs, however, hinges upon the ability of the global community, either at the forum of OECD or otherwise, to agree to a solution on the broad principles for taxing the digital economy. Until such time, given the pressing economic commitments of the Governments across the world and the leverage available from the unilateral DSTs, it is unlikely that a lasting solution would appear and taxes such as 2020 EQL would continue to be in vogue with or without the 301 like retaliations.

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Partners, BMR Legal. Views are personal.

[1] Report of the Committee on Taxation of E-Commerce, *Proposal for Equalisation Levy on Specified Transactions* (February 2016), available at <https://incometaxindia.gov.in/News/Report-of-Committee-on-Taxation-of-e-Commerce-Feb-2016.pdf>, paragraph 169.

[2] *Ibid*, paragraphs 190-201.

[3] *Ibid*, paragraph 125.

[4] Available at <https://taxguru.in/wp-content/uploads/2016/05/Finance-Act-2016.pdf>

[5] **Mukesh Butani & Tarun Jain**, *USTR 301 investigations: Bad news, but India may have wiggle room*, Financial Express, June 6, 2020, available at <https://www.financialexpress.com/opinion/digital-services-taxes-bad-news-but-india-may-have-wiggle-room/1982932/>

[6] Chapter VI, Finance Act, 2020, available at <http://egazette.nic.in/WriteReadData/2020/218938.pdf>

[7] Section 165A(1), Finance Act, 2016 (as amended by Finance Act, 2020). Available at <https://incometaxindia.gov.in/pages/acts/equalisation-levy.aspx>

[8] Section 164(ca), *ibid*.

[9] Section 165A(1), *ibid*.

[10] Section 164(cb), *ibid*.

[11] Section 165(A)(2),(3), *ibid.*

[12] Section 165A(2), *ibid.*

[13] Section 166A, *ibid.*

[14] Vide Federal Register (Docket No. USTR–2020–0022), available at https://ustr.gov/sites/default/files/enforcement/301Investigations/DST_Initiation_Notice_June_2020.pdf

[15] The USTR Reports are available at <https://ustr.gov/issue-areas/enforcement/section-301-investigations/section-301-digital-services-taxes>.

[16] USTR, *Section 301 Investigations: Report on India's Digital Services Tax*, available at <https://ustr.gov/sites/default/files/enforcement/301Investigations/Report%20on%20India%E2%80%99s%20Digital%20Services%20Tax.pdf>

[17] USTR, *Section 301 Investigations: Report on India's Digital Services Tax*, available at <https://ustr.gov/sites/default/files/enforcement/301Investigations/Report%20on%20India%E2%80%99s%20Digital%20Services%20Tax.pdf>, pg. 24.

[18] USTR, *Notice of Determination Pursuant to Section 301: India's Digital Services Tax*, available at <https://ustr.gov/sites/default/files/files/Press/Releases/IndiaDSTFRNJLB.pdf>

[19] For details, see https://ustr.gov/sites/default/files/enforcement/301Investigations/France_Digital_Services_Tax_Notice_July_2020.pdf

[20] Press Information Bureau, *India's response to S 301 Report of U.S. on Equalisation Levy* (January 7, 2021), available at <https://pib.gov.in/Pressreleaseshare.aspx?PRID=1686865>

[21] For illustration, see Lubna Kably, *India's Equalisation Levy: Will it ignite a new trade war?* (January 8, 2021), available at <https://timesofindia.indiatimes.com/business/india-business/indias-equalisation-levy-will-it-ignite-a-new-trade-war/articleshow/80164190.cms>

[22] Press Information Bureau, *Customs Duty on US Products*, (July 3, 2019), available at <https://pib.gov.in/newsite/PrintRelease.aspx?relid=191175>

[23] See, Economic Times, *India, US negotiating on wide range of trade concerns: Congressional Report* (January 11, 2021), available at <https://economictimes.indiatimes.com/news/economy/foreign-trade/india-us-negotiating-on-wide-range-of-trade-concerns-congressional-report/articleshow/80210876.cms?from=mdr>

[24] See generally, Mukesh Butani & Tarun Jain, *Digital Taxes: If multilateral fails, look for bilateral solutions*, Financial Express, October 21, 2020, available at <https://www.financialexpress.com/opinion/digital-taxes-if-multilateral-fails-look-for-bilateral-solutions/2110316/>

[25] ASSOCHAM & BMR Legal, *Equalisation Levy 2.0: India's Digital Service Tax in the*

Making, (July 4, 2020), available at <https://www.linkedin.com/feed/update/urn:li:activity:6686370831171403776/>, pp. 21-28.

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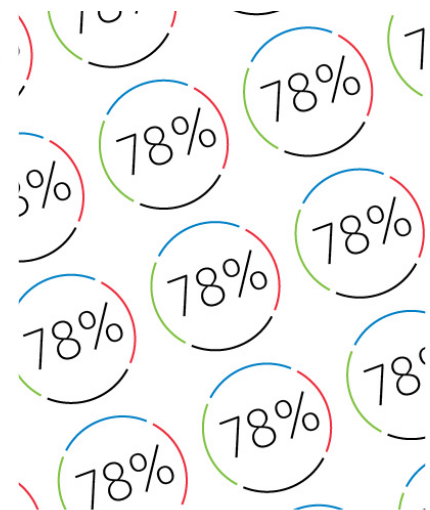
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