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TAX FLASH NEWS

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India and US agree on a transitional approach on Equalisation Levy 2020

Background

To address the tax challenges posed by the increased digitalisation of the economy, an Equalisation Levy (EL) was introduced in India by the Finance Act, 2016 on online advertisement and digital advertising provided by non-residents. The Finance Act, 2020 expanded the scope of the EL to include consideration received by e-commerce operators from e-commerce supply or services, taxable at a rate of 2 per cent. Various other countries had also introduced Digital Services Taxes (DSTs) to tackle the challenges of the digitised economy.

Introduction of these unilateral measures impacted the multi-national US technology companies. The USA found such unilateral measures unreasonable or discriminatory which burdens or restricts their commerce. The USA was planning to introduce various trade actions under Section 301 of the Trade Act, 1974 against the countries which have introduced such unilateral measures.

On 8 October 2021, 136 out of the 140 member countries of the OECD/G20 Inclusive Framework approved a statement finalising a framework for a major international tax reform. The reform focuses on prevention of tax avoidance by Multinational Enterprises (MNEs), through a two-pillar approach, by addressing the gap in the existing tax rules. Pillar One provides for a new nexus rule to align the evolving digital economy and Pillar Two ensures that MNEs will pay a minimum tax in the each of the jurisdictions that they operate. Pillar One demands removal and standstill of DST and other relevant similar measures.

In line with this statement, on 21 October 2021, the USA, Austria, France, Italy, Spain, and the UK reached an agreement on a transitional approach to existing unilateral measures while implementing Pillar one. The agreement is reflected in the joint statement that was issued by those six countries. The joint statement describes a compromise reached by the countries on a transitional approach to the treatment of existing DSTs and other relevant similar measures during the interim period before new Pillar One rules come into effect.

Joint statement from the USA, Austria, France, Italy, Spain, and the UK

The Joint statement dated 21 October 2021 provides the following key points:

- Key impetus of the OECD/G20 Inclusive Framework's negotiations was to stop the proliferation of DST and other relevant similar measures' by replacing them with a consensus-based reallocation of taxing rights among Inclusive Framework members.

- In line with this objective, Austria, France, Italy, Spain and the UK have agreed that as part of Pillar one, they will withdraw all unilateral measures on all companies and refrain from imposing new unilateral measures.

- In general, such countries had preferred for withdrawal of unilateral measures to be contingent on implementation of Pillar one, while the US had preferred withdrawal of such measures immediately as of 8 October 2021, the date political agreement with respect to Pillar one was reached.

- This joint statement describes a political compromise on a transitional approach to existing unilateral measures while implementing Pillar one.

- Under the **'Unilateral Measures Compromise'** (UMC), Austria, France, Italy, Spain, and the UK, which have all enacted unilateral measures before 8 October 2021, are not required to withdraw such measures until Pillar one takes effect.

- However, to the extent that taxes that accrue to Austria, France, Italy, Spain, and the UK with respect to existing unilateral measures during the interim period after political agreement is reached, and before Pillar one takes effect, exceed an amount equivalent to the tax due under Pillar one in the first full year of Pillar one implementation (prorated to achieve proportionality with the length of the interim period), such excess will be creditable against the portion of the corporate income tax liability associated with Amount A as computed under Pillar one in these countries, respectively.

- The 'Interim Period' for UMC is the period beginning on 1 January 2022 and ending on the earlier of the date the Pillar 1 multilateral convention comes into force or 31 December 2023.

- As a part of the UMC, the USA agrees to terminate proposed trade actions and commit not to impose further trade actions against Austria, France, Italy, Spain and the UK with respect to their existing DST until the end of the interim period.

Press release issued by the Ministry of Finance

- On 24 November 2021, the Ministry of Finance of India has issued a press release[1] stating that India and USA have agreed that terms of Joint Statement issued on 21 October 2021 shall apply between the USA and India with respect to India's charge of 2 per cent EL on e-commerce supply of services and the USA's trade action regarding the said EL.

- The interim period in case of India will be from 1 April 2022 till implementation of Pillar one or 31 March 2024, whichever is earlier.

- Further India and USA will remain in close contact to ensure that there is a common understanding of the respective commitments and endeavour to resolve any further differences of views on this matter through constructive dialogue. The final terms of the agreement shall be finalised by 1 February 2022.

Our comments

India and the USA have agreed on a transitional approach on 2 per cent EL levied by the Finance Act 2020. However, 6 per cent EL introduced by the Finance Act, 2016 does not form part of this compromise. This agreement would benefit MNE groups covered under Pillar 1 as they would have a right to get credit of excess taxes collected via EL during the interim period over the Pillar 1 prorated liability.

This compromise indicates a possibility that EL may continue to be in force in India till Pillar 1 is implemented. An early withdrawal in the upcoming Union Budget 2022 could have helped avoid prolonged litigation on several open issues in the EL provisions and boost investor sentiment.

[1] Press release issued by the Ministry of Finance of India, dated 24 November 2021

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