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INDIA-USA TO ADOPT A TRANSITIONAL APPROACH ON EQUALISATION LEVY

9 December 2021

Marking a significant step in international tax negotiations, India has issued a press release on 24 November 2021 (Press Release) confirming that India and USA have agreed on a transitional approach on India's 2% equalization levy on e-commerce supply or services and USA's trade action against India as a consequence of the said levy.

Background

India's equalisation levy

In 2020, as part of the measures to address the tax challenges posed by the increased digitalization of the economy, India had introduced 'equalization levy' of 2% on certain e-commerce transactions carried out by non-residents (EL).

USA's trade action

On 6 January 2021, the Office of the US Trade Representative (USTR) had issued reports and findings from the Section 301 of the Trade Act, 1974¹ investigations of the levy adopted by India. According to the USTR release, the levy on e-commerce transactions introduced by India was said to discriminate against US digital companies (Apple, Amazon, Google, Facebook etc), was inconsistent with prevailing principles of international taxation, and was expected to burden / restrict US commerce and trade practices. On this basis, India's EL was considered actionable under Section 301.

OECD's two-pillar solution

In October 2021, a global consensus was reached amongst more than 130 countries (including India and USA) for a two-pillar solution to address the tax challenges arising from the digitalization of the economy. In this regard, a statement was released by the OECD (Statement) - please see our [Ergo](#) analysing the Statement. As part of the Statement, it has been agreed that countries will be required to withdraw all digital services taxes and other similar unilateral measures, and to commit not to introduce such measures in the future.

Until the finalization and implementation of the agreed global framework, as broadly envisaged in the Statement, to address the tax challenges of the digital economy USA has for the interim period reached an agreement with certain countries (Austria, France,

¹ Section 301 of the Trade Act, 1974 grants the Office of the USTR a range of responsibilities and authorities to investigate and take action to enforce U.S. rights under trade agreements and respond to certain foreign trade practices

Italy, Spain, United Kingdom) on a transitional approach to existing unilateral measures. In this regard, on 21 October 2021, a joint statement was issued by US and these other countries.

Transitional approach agreed between India and USA

Now, India has issued the Press Release confirming that India and USA have agreed that the same terms that apply under the aforesaid joint statement will apply between India and USA with respect to EL and USA will terminate the trade tariff actions it had announced in response to the EL and will not take any further actions. The Press Release also states that the final terms of this important agreement between India and USA will be finalized by 1 February 2022. Broadly, this understanding would pave way for the following measures:

- The EL will continue to apply to US companies until a global agreement on taxation of multinational enterprises comes into effect or 31 March 2024, whichever is earlier.
- The EL levied during the interim period, as specified, will be available as credit against future corporate income-tax liability accrued under Pillar 1 of the Statement, in the specified manner. The period during which the credit accrues will commence from 1 April 2022 until either the implementation of Pillar 1 or 31 March 2024, whichever is earlier.

Comments

This is an important development for US businesses having India as one of the key markets and underscores the negotiatory manner in which cross-border taxation is being developed. This shall help put to rest the trade impediments between India and USA because of taxes on digital businesses and should facilitate ongoing trade negotiations. One will need to evaluate and assess the fine print of the final agreement in furtherance of the understanding between India and USA. Given that significant developments have taken place in the international tax framework in the past few months, any amendments in the related domestic tax law framework as part of the upcoming Union Budget exercise in February 2022 is something to watch out for.

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