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INDIA'S EQUALISATION LEVY: FROM IMPLEMENTATION TO ABOLITION AND THE QUEST FOR GLOBAL DIGITAL TAX CONSENSUS

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ABSTRACT

This paper explores India's Equalisation Levy (EL), a 2% tax on digital transactions of non-resident companies, introduced to address revenue loss due to the digital economic system and its latest abolition. While the EL aimed to create a level playing field and garner higher revenue, it faced criticism for developing additional compliance burdens, doubtlessly impacting startups, and raising concerns about double taxation. The US, representing important tech organisations suffering from the EL, strongly contested the levy, threatening a retaliatory tax on Indian entities. This highlighted the want for a global consensus on digital taxation.

The OECD spoke back with a two-pillar solution: Pillar One allocates taxing rights primarily based on value creation (e.g., user interaction), whilst Pillar Two sets an international minimum corporate tax rate. India's abolition of the EL in 2024 displays its commitment to the OECD framework.

However, demanding situations continue to be. Implementing Pillar One and making sure effective minimum tax prices require international cooperation. Clear and regular tax regulations are critical for groups to function successfully. The destiny of digital taxation hinges on balancing the revenue era, fostering innovation, and minimising compliance burdens for companies, in particular in developing economies.

The digital economy necessitates a fair and efficient worldwide digital tax system, requiring persistent dialogue, model development, and recognition of both revenue generation and fostering innovation.

KEYWORDS: Digital Tax, Equalisation Levy, OECD, Base Erosion & Profit Shifting (BEPS), Double Taxation

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INTRODUCTION

Rapid digitisation across the globe has stimulated a surge in consumption of goods and services through digital mediums, enabling businesses to operate remotely, often shifting to tax favourable locations exploiting the difference in tax rules formally called Base Erosion and Profit Shifting (BEPS),³ Garnering global governments' attention and concern over revenue losses, countries within the Organization for Economic Co-operation and Development (OECD) laid out the BEPS action plan, which specified that no unique tax rules must be devised just for the digital economy. Instead, existing rules should be adapted to handle these challenges while recognising the issue of tax avoidance. Still, countries across the world did not adhere to the same since it was a plan devised by OECD countries and was limited to be a soft law instrument aimed at uniformity with no binding effect but the expectation that other nations might adhere and translate that to their domestic laws.⁴ But with varied tax rates across Europe⁵ itself, the major bloc OECD and, also prior introduction of such imposition in India from 2016⁶, introducing the equalisation levy popularly called as the Google tax, particularly on non-resident tech companies pulling over ₹ 2 crore in revenue per year to pay 2% tax on the digital transactions interchangeably called as Digital Service Tax (DST). India also imposed 6% on online advertising services, pulling ₹ 1 Lakh crore in revenue per year, and later, about 22 countries joined this league⁷, which highly annoyed America since the most taxed were its tech giants,⁸ even resorting to threatening the nations with reciprocatory actions⁹. OECD, with a view to resolving this conflict, came up with two pillar solutions. The first threshold of a global business above €20 billion and 10% profitability would only be liable to tax and subject to at least 15% tax set as a global minimum. India joined this arrangement along with 135 other nations in 2021. Later that year, European nations embarked on a political arrangement with the US.¹⁰ The deadline to achieve this goal was kept for 31st March 2024 in India, and the US agreed to a transitory approach towards India's 2% equalisation levy and the US's response to it, further extended to

³ Allison Christians, "BEPS and the New International Tax Order", 2016 *BYU Law Digital Library* 6 (2016).

⁴ European Parliament, "Understanding BEPS: From Tax Avoidance to Digital Tax Challenges", Think Tank (October 2019).

⁵ Digital Services Taxes in Europe, 2024, Tax Foundation (2024), available at: [https://taxfoundation.org/data/all/eu/digital-tax-europe-2024/#:~:text=Implemented%20\(Effective%20from%20January%201%2C%202020.,contingent%20on%20Pillar%20One%20implementation.\(last visited Jul 27, 2024\).](https://taxfoundation.org/data/all/eu/digital-tax-europe-2024/#:~:text=Implemented%20(Effective%20from%20January%201%2C%202020.,contingent%20on%20Pillar%20One%20implementation.(last%20visited%20Jul%2027,%202024).)

⁶ India announces its first-ever digital tax, Digital Watch Observatory (2016), available at: <https://dig.watch/updates/india-announces-its-first-ever-digital-tax> (last visited Jul 27, 2024).

⁷ Taxation of the Digitalized Economy, KPMG (2021), available at: <https://kpmg.com/xx/en/home/insights/2019/06/tnf-digital-economy0.html> (last visited Jul 30, 2024).

⁸ BBC News, Technology giants face European "digital tax" blow, Bbc.com (2018), available at: <https://www.bbc.com/news/business-43486403> (last visited Jul 27, 2024).

⁹ David Lawder & Leigh Thomas, U.S. drops tariff threat in digital tax transition deal with European countries, Reuters (2021), available at: <https://www.reuters.com/world/europe/european-countries-reach-digital-services-tax-deal-with-us-2021-10-21/> (last visited Jul 27, 2024).

¹⁰ Joint Statement from the United States, Austria, France, Italy, Spain, and the United Kingdom, Regarding a Compromise on a Transitional Approach to Existing Unilateral Measures During the Interim Period Before Pillar 1 is in Effect, U.S. Department of the Treasury (2021), available at: <https://home.treasury.gov/news/press-releases/jy0419> (last visited Jul 27, 2024).

June 30th, 2024¹¹. And finally, India announced that it would abolish the 2% equalisation levy on August 1, 2024¹². The memorandum attached to the financial bill explained that this step was taken in line with the suggestions from stakeholders regarding the ambiguous nature of tax and increased compliance for foreign companies¹³, while the abolition seems to be motivated to follow international obligations and avoid US retaliatory tax on Indian companies. The significance goes much beyond; the article aims to explore the same.

BACKGROUND AND RATIONALE

In the contemporary world, businesses can flourish even remotely due to the digital age; therefore, the traditional tax practices implementing the tax in the physical presence of a business entity emerge as redundant, with companies opting to close their books in low-tax jurisdictions.¹⁴ The data shows that by May 2020, there had been a spike in e-commerce transactions and reached up to \$82.5, a whopping 77% increase from 2019¹⁵. The fact requires foreign digital companies to pay taxes to make a level playing field for domestic countries and, therefore, the term 'Equalization'. Further, to protect domestic companies against the monopoly of multinational companies, it became necessary to introduce such a law.

Further, unlike traditional businesses, digital businesses create value and subsequent profits through customer engagement and facilitating interactions.¹⁶ For example, carpooling apps facilitate the communication between drivers and passengers. Therefore, the traditional taxation mechanism was not sufficient.

The equalisation levy was also in line with the recommendation of the Organization for Economic and Cooperation Development (OECD) regarding defeating the Base erosion and profit sharing (BEPS) project so that multinational companies could not avoid paying the tax.

The equalisation levy was also important for increasing the domestic revenue. The data indicates that in the year 2019-20, the Indian government collected ₹1,136 crores in digital tax, and in the next annual year, it collected ₹2,057, further in the year 2022-2023; it collected ₹4,000 crores, a whopping 100% increase from the previous year.¹⁷ This increased revenue was helpful in realising various developmental projects, including

¹¹ Shishir Sinha, India, US extend the transitional approach on equalisation levy on e-comm supplies until June 30, *BusinessLine* (2024), available at: <https://www.thehindubusinessline.com/economy/india-us-extend-the-transitional-approach-on-equalisation-levy-on-e-comm-supplies-until-june-30/article68345335.ece> (last visited Jul 27, 2024).

¹² Amiti Sen, India to withdraw 2% equalisation levy affecting non-resident digital companies, *BusinessLine* (2024), available at: <https://www.thehindubusinessline.com/economy/india-to-withdraw-2-equalisation-levy-affecting-non-resident-digital-companies/article68437536.ece> (last visited Jul 27, 2024).

¹³ Ministry of Finance, "Memorandum Explaining the Provisions in The Finance Bill, 2024", Government of India, <https://www.indiabudget.gov.in/doc/memo.pdf> (July, 2024).

¹⁴ R Sarvamangala, & Farzana A, "A Comprehensive Analysis of Digital Taxation in India".11 *SJCC Management Research Review* 1, 137–151 (2022).

¹⁵ Team Tax Research Department, "Taxation on E-Commerce" 135 *Tax Bulletin*, The Institute of Cost Accountants of India (2023).

¹⁶ Traditional vs. Platform-Based Business Models: 4 Key Differences, *Business Insights Blog* (2024), available at: <https://online.hbs.edu/blog/post/platform-based-business-models> (last visited Jul 30, 2024).

¹⁷ An explainer on India's digital tax revenues, *Finshots* (2022), available at: <https://finshots.in/archive/indias-digital-tax/> (last visited Jul 29, 2024).

public services and infrastructure. While the EL generated significant revenue, its abolition may lead to short-term losses. However, potential gains from increased foreign investment¹⁸ can help recover it overtime.

Finance Act 2016 introduced a new chapter, titled Equalization Levy applying only to B2B Transactions w.e.f 1st June 2016, defined as a ‘Tax’ on considerations entitled in the hands of non-residents for specified services that include online advertising, space for advertising or any such service with a rate specified at 6% and which continues to exist but the scope was further expanded in 2020 to cover commerce supplies taxable at a rate of 2% including both Goods and Services for total receipts worth at least ₹ 2 crores both B2B and B2C transactions, provided they do not have a permanent establishment in India this levy has been announced to be withdrawn it was subject to exemption under Income Tax Act under Section 10(50), due by 7th of next month when each quarter ends by ascribed with penalties to ensure timely payment with 1% interest rate charged on every month of delay, failure to deduct such amount will make the non-resident company subject to penalty equivalent to the amount required to be deducted and if deducted but not paid to the government a penalty of ₹1000 per day upto levy amount, even imprisonment is prescribed if any false statement is filed in such regard.

Before concerns could be raised about double taxation, the government devised it as a levy on the transaction and not consumption, creating it as a separate class from existing tax rules. Suppose A US-based e-commerce giant sells digital e-books to Indian customers. The total value of these sales in a financial year is INR 2 crore. The levy is calculated as 2% of INR 2 crore, amounting to INR 4 lakh. This is a tax on the transaction itself, irrespective of where the profits are ultimately taxed as income (direct tax) and product GST (indirect tax). Thus, the ambiguity persists as to the nature of the tax, whether it is a direct tax or an indirect tax.¹⁹ The burden of the levy on clients and sellers needs to be studied, as it could be passed immediately to Indian corporations and may translate into increased prices.

IMPACT ON DIGITAL COMPANIES

In an investigation by the executive office of the president, it has been revealed that DST has burdened US companies with an excess of US\$30 million per year compared to prior tax burdens.²⁰ US has claimed that DST discriminates against U.S. firms because they are the leaders in the digital services market. It also highlighted that in the DST, the Indian government was taxing revenue rather than profit. It has put a strain on companies that generate low revenue.

Further, the low revenue threshold of companies was another problem because small or medium-sized companies were also not getting exemptions. If the company’s revenue is around the threshold of ₹2 crores,

¹⁸ W. Steven Clark, Tax Policy for Investment, 5 *eJournal of Tax Research*. (2007)

¹⁹ Ashok Lahiri, Gautam Ray & D Sengupta, “Equalisation Levy”, 1 *Working Paper*, Brooking India (2017).

²⁰ Office of the United States Trade Representative, “Section 301 Investigation Report on India’s Digital Services Tax” (January 2021).

then they have to pay tax under DST. This has resulted in most companies falling under its jurisdiction. As a result, startups would be exposed to such liability, and this would disincentivise them and further deteriorate if they have not achieved break-even yet. Further, if an established company is a low-profit company with high-cost transactions, it is left with nothing to grow on.

Other countries were charging DST. Still, the major concern of the US was India because apart from the taxes being charged by another country, India was charging tax in further categories as well, which included educational services, financial services, and software.

The companies were also facing cost compliance as they were required to check whether they came under the DST, the tax planning, accounting for their burden, and measures to remit the tax.

The levy includes all sectors and is wide enough to turn out to be arbitrary as digital transactions such as reserving a hotel, etc, which are not finalised and still taxable.²¹

Further, since the companies cannot avail themselves of input tax credits, They have turned to redraft contracts to transfer the compliance burden to Indian Companies.²²

Out of all sectors, education was one of the sensitive sectors, and here, the DST was being applied to online education as well. Online education is considered to be less expensive. Still, by putting the tax on it, the whole purpose became futile, and ultimately, it was the student who became the scapegoat in this process.²³

The process of equalisation levy payment involves prior deduction (withholding by an Indian payer from a non-resident) of levy charges on transactions exceeding the ₹1 lakh threshold, inviting cash flow management, which will now be resolved. The primary impact of this process is an additional compliance burden. Additional accounting and compliance costs, such as the appointment of a local tax manager and embassy-monitored PAN application verification, which is a time-consuming process²⁴, are no longer a requirement. Low-revenue startups would be exempt from taxes, allowing for easier growth on corporate confidence lines; it introduces clarity on taxability, which was lacking and further removed the sense of discrimination.

²¹ Mattias Cruz Cano, "MNEs say India's equalisation levy continues to cause uncertainty", *International Tax Review* (2020), available at: <https://www.internationaltaxreview.com/article/2a6a737ngqhzagxi2qwao/mnes-say-indias-equalisation-levy-continues-to-cause-uncertainty#:~:text=However%2C%20the%20levy%20has%20been,not%20been%20corrected%20until%20now>. (last visited Aug 1, 2024).

²² Mbhele, S.N., "An international comparison of digital service tax", Doctoral dissertation, University of Johannesburg (2022.), available at: https://ujcontent.uj.ac.za/view/pdfCoverPage?instCode=27UOJ_INST&filePid=138697240007691&download=true, (last visited Aug 1, 2024).

²³ "India Equalization Levy" *International Trade Administration / Trade.gov*, 2020 available at: <https://www.trade.gov/market-intelligence/india-equalization-levy> (last visited August 5, 2024).

²⁴ Arvind Singal & Nitin Kapoor, "Equalisation levy: The challenges ahead for India's DST", *International Tax Review* (2020), , available at: <https://www.internationaltaxreview.com/article/2a6a66eh04saxacspperk/equalisation-levy-the-challenges-ahead-for-indias-dst> (last visited Aug 1, 2024).

US PRESSURE AND INTERNATIONAL CONTEXT

The US, under Section 301, had probed India's 2% DST for non-resident companies. Under Section 301 US (Relief from Unfair Trade Practice), a probe into matters that are discriminatory and unfair can be initiated.²⁵ The US has questioned the ethics of India and has claimed that the equalisation levy is targeting 119 companies, out of which 86 are of the US, and is hampering US commerce and contravening the principles of international taxation. The US also raised the point where it claimed that its law exempts Indian companies while taxing, and if, in return, India taxes their companies, then it becomes discriminatory. In its report, one more problem that arose was that the DST was only imposing the tax on digital services, whereas if the same service is being given in non-digital mode, then no levy will be imposed on it. This has created a loophole as the same services are being taxed differently by changing the mode, ultimately discriminating the services. Certain international tax principles need to be followed. The US has claimed that the equalisation levy contradicts it, as the legislation regarding levy is unclear and ambiguous, leading the companies to be confused as to whether their services come under levy or not. Secondly, the argument that those countries that do not have permanent establishments would be taxed contradicts international taxation principles. Further, the principle that the tax shall be imposed on income and not the revenue has also contravened the international tax rules.

The above problem led the company to be taxed twice. After all this, the US took fierce steps and proposed retaliatory tariffs on India and imposed 25% on certain products to compensate \$55 million in taxes.²⁶ However, the OECD took the step of settling the dispute amicably and proposed a model for taxing digital services globally. Where it set up two pillar models, and 134 countries complied with it. But before the implementation of Pillar 1, The Ministry of Finance of the Government of India and the Department of Treasury of the United States reached an amicable settlement wherein it was mentioned that during the interim period for two financial years 2022 – 2024, the accrued should be creditable for future taxes under Pillar 1 arrangement—preventing double taxation for companies that have already paid the DST. Resembling the arrangement made among the US and five other European Nations²⁷.

OECD's efforts began with the 20th Century Model Tax Convention, which has been subjected to multiple revisions in recent years. The basic objective of the OECD is the fair distribution of taxing rights and the determination of how Multinationals will allocate their profits across different jurisdictions.

²⁵ Kashish Parpiani, "Understanding America's response to India's equalisation levy", *orfonline.org* (2023), available at: <https://www.orfonline.org/expert-speak/understanding-america-response-india-equalisation-levy> (last visited Aug 3, 2024).

²⁶ Amiti Sen, "India to withdraw 2% equalisation levy affecting non-resident digital companies", *BusinessLine* (2024), <https://www.thehindubusinessline.com/economy/india-to-withdraw-2-equalisation-levy-affecting-non-resident-digital-companies/article68437536.ece> (last visited Aug 3, 2024).

²⁷ "India and USA agree on a transitional approach on Equalisation Levy", *Pib.gov.in* (2020), available at: <https://pib.gov.in/PressReleasePage.aspx?PRID=1774692> (last visited Aug 3, 2024).

Current tax systems often rely on the residence principle, taxing MNEs at their place of residence, wherein residents are taxed on their global income and non-residents are taxed on their domestically sourced income. However, value creation occurs differently in the digital economy (intangibles, data-driven activities). Physical presence thresholds may not align with the reduced need for physical presence in modern businesses.

Digitalisation posed novel issues, which led to the OECD BEPS Action Plan. Action 1 report lays out two concerns: business without physical presence and difficulty in attributing any profits on data being an intangible value driver.²⁸ The urgency arose due to profits shifting using transfer pricing (shifting profits by setting prices for transactions between their subsidiaries in different countries) and BEPS structures. The European Parliament's report on tax challenges in the digital economy highlights several key issues. These include the difficulty in defining tax jurisdiction, attributing value to user-generated data, and classifying e-commerce transactions.²⁹ The European Commission notes that digital businesses often pay lower effective tax rates than traditional ones, prompting calls for reform.³⁰ The report also discusses the demanding situations posed by new commercial enterprises and the dematerialisation of transactions, emphasising the need for updated tax guidelines to cope with these complexities.

To address these issues, the OECD developed the BEPS Action Plan, which led to the introduction of two pillars. The first Pillar directed the company to distribute profits around the globe better based on where the value is consumed, and at the same time, the Second obliged national governments to adopt a common approach aimed at the global minimum corporate tax of 15%, with about 136 countries as signatories to the same. If implemented successfully, it will significantly reduce the tax havens.³¹ The decision of the central government to abolish the 2% equalisation levy came in line with their commitment to OECD Pillar 2 being one of the signatories and with respect to the efforts of OECD as a whole. However, the implementation of Pillar 2 may face great challenges, not from India but from countries that have been leveraging this low tax rate to attract businesses.

²⁸ Ashleigh Forman, "Equalising taxing rights in the digitalised economy: an analysis of diverse tax practices implemented globally", *Wits.ac.za* (2019), available at: <https://wiredspace.wits.ac.za/items/c29710a1-87aa-418e-a3f8-e4a779521c43> (last visited Aug 2, 2024).

²⁹ Hadzhieva E "Tax Challenges in the Digital Economy", *European Parliament 2016 rep*, available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2016/579002/IPOL_STU%282016%29579002_EN.pdf (accessed 2 August 2024).

³⁰ Press corner, European Commission "Digital Taxation: Commission proposes new measures to ensure that all companies pay fair tax in the EU" *European Commission* (2024), available at: https://ec.europa.eu/commission/presscorner/detail/en/IP_18_2041 (last visited Aug 3, 2024).

³¹ Richard Partington, "OECD deal imposes global minimum corporate tax of 15%", *The Guardian* (2021), available at: <https://www.theguardian.com/business/2021/oct/08/oecd-deal-imposes-global-minimum-corporate-tax-of-15> (last visited Aug 2, 2024).

GILTI tax (Global Intangible Low-Taxed Income) is a domestic mechanism of taxation used by US government focused on US-based companies to prevent base erosion and profit shifting, targeting income from foreign sources its integration or alignment with the Global Minimum Tax Framework is crucial to ensure successful implementation³², since the US exerts great influence on other nations. And its significant position in the world will help establish a precedent. The successful implementation of the global minimal tax would show the effectiveness of worldwide cooperation in addressing complex tax challenges.

The abrupt repeal of the Equalization Levy on August 1, 2024, without a clear roadmap for the implementation of OECD Pillar One, has created a complex situation for taxpayers. There is no official announcement concerning whether India will incorporate OECD Pillar One into its domestic law. While there are speculations about a potential implementation in FY26, this is not yet confirmed. The Equalization Levy was abolished on August 1, 2024, but the closing date for tax payment became August 7, 2024. This creates a gap where it is uncertain whether taxpayers are liable for the Equalization Levy for this financial year or not.

CONCLUSION

The brisk growth of the digital financial system has basically challenged the manner in which governments tax companies. Traditional tax frameworks, constructed on physical presence, struggle to capture the price created via businesses working remotely. This has led to worries about lost revenue, unfair competition for home companies, and the erosion of tax bases.

India's reveal in the Equalisation Levy exemplifies those challenges and the continuing search for solutions. The Equalisation Levy aimed to generate tax revenue by way of non-resident digital businesses working in India. While it demonstrably expanded government revenue, it additionally attracted grievances for creating compliance burdens, probably impacting startups and elevating concerns about double taxation.

The US, representing among the massive tech companies tormented by the Equalisation Levy, strongly contested the levy. This culminated in probable reciprocatory taxation retaliation and highlighted the need for an international consensus on digital taxation.

The OECD, spotting the need for a coordinated method, proposed a two-pillar solution. Pillar One focuses on allocating taxing rights based on where the value is created (e.g., user consumption), even as Pillar Two sets an international minimum corporate tax rate.

India's choice to abolish the EL displays its dedication to the OECD framework. However, demanding

³² Global Minimum Tax: An easy fix?, *KPMG (2021)*, available at: <https://kpmg.com/xx/en/home/insights/2021/05/global-minimum-tax-an-easy-fix.html> (last visited Aug 5, 2024).

situations stay. The hit implementation of Pillar One, with its attention on complex profit allocation, is unsure. The international minimal tax price of 15% would possibly face resistance from nations to the usage of low tax prices to draw companies. –

Looking ahead, numerous key issues need attention. Businesses require clear and regular tax regulations to function correctly. The evolving nature of the OECD framework and its ability to delay implementation creates uncertainty; Taxation has to now not stifle the growth of new agencies, particularly in developing economies. Ensuring a stage gambling subject, even as fostering innovation, is important. Tax regimes should be efficient and minimise compliance expenses for corporations, mainly small and medium corporations. The advantages of digital taxation ought to translate into investments in bridging the digital divide and making sure there is equitable access to the Internet economy.

The Digital economic system has undeniably revolutionised the way we live and do commercial enterprise. Establishing an honest and efficient mechanism of Digital taxation requires global cooperation—a commitment to fostering a thriving digital environment that advantages all stakeholders.

In conclusion, while India's abolition of the EL signifies a flow in the direction of a worldwide solution, the adventure is a long way from over. Continuous talk, model, and a focus on each revenue generation and fostering innovation are critical for navigating the evolving landscape of Digital taxation.
