RESPONSE FROM THE GOVERNMENT OF INDIA TO THE REQUEST FOR PUBLIC COMMENTS FROM THE USTR IN THE MATTER OF INITIATION OF INVESTIGATION OF DIGITAL SERVICES TAXES UNDER SECTION 301 OF THE U.S. TRADE ACT

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I INTRODUCTION

1. The Government of India (**GOI**) notes with regret the "Initiation of Section 301 Investigations of Digital Services Taxes" initiated by the USTR ("**S.301 DST Initiation**") with respect to India's Equalisation Levy of 2% imposed on "e-commerce supply or services" through India's Finance Act, 2020.

2. Apart from noting the facts relating to the 2% Equalisation Levy, S.301 DST Initiation does not provide any reasons as regards the underlying sweeping apprehensions of the United States, that have been listed in part III of the S.301 Initiation titled "*Request for Public Comments*".

3. India further notes with concern the S.301 Initiation "*invites comments with respect to*", *inter alia*, "*the determination required under section 304 of the Trade Act, including what action, if any, should be taken*". In this regard, the GOI takes note of the finding of a WTO panel in the dispute *United States- Sections 301-310 of the Trade Act of 1974*,[1] that the statutory language of Section 304 of the Trade Act of 1974, reserves to the USTR the right to make a unilateral determination of inconsistency even prior to exhaustion of proceedings under the WTO's Dispute Settlement Understanding (**DSU**). The panel in that dispute noted that "*the statutory language of Section 304 constitutes a serious threat that determinations contrary to Article 23.2(a) may be taken and, in the circumstances of this case, is prima facie inconsistent with Article 23.2(a) read in the light of Article 23.1*." However, based on the statement made by the United States before the panel to the effect that it would render determinations under Section 304 only in conformity with its WTO obligations, the panel ruled that the section was not inconsistent with Article 23.2(a) of the WTO's DSU, provided that this condition represented by the United States is complied with, and should the same be repudiated or in any other way removed by the U.S. Administration or another branch of the U.S. Government, the findings of such conformity would no longer be warranted.[2]

4. At the outset, India reassures the United States that the Equalisation Levy is entirely consistent with India's commitments under the WTO and international taxation agreements. The GOI further understands that should the United States have any specific concerns or clarifications, the United States would raise these issues at the appropriate forum, in accordance with the provisions for dispute settlement as agreed under the specific international agreements.

[1] WT/DS152/R (adopted 27 January, 2000).
[2] Ibid, para 7.131 read with para 8.1.

5. The GOI is participating in these proceedings in complete good faith and transparency, with a view to explain and clarify the underlying policy rationale and implementation of the Equalisation Levy. The GOI has also acceded to the request from the USTR to engage in bilateral discussions under Section 303(a) of the United States Trade Act of 1974, which it hopes will enable the two countries to arrive at a shared understanding and mutual appreciation of each other's taxation regimes.

6. The GOI is willing to engage in further discussions to clarify any questions or concerns that the Government of the United States may have.

II GOI'S RESPONSE TO THE SECTION 301 INITIATION

The Equalisation Levy is a Non-discriminatory Levy

7. India's Equalisation Levy does not discriminate against non-resident e-commerce operators. The underlying policy objective and application of India's Equalisation Levy, is to ensure that neutral and equitable taxation is applicable to e-commerce operators that are resident in India or have a physical presence in India and those that are not resident in India. The purpose is to ensure a level-playing field with regard to e-commerce activities undertaken in India. This, in fact, is the very antithesis of the underlying apprehensions listed out in the USTR's S.301 DST Initiation.

8. India's Equalisation Levy at 2% is applicable on non-resident e-commerce operators that do not have a permanent establishment in India. The threshold application for the levy for companies with annual revenues in excess of Rs. 20 million (which the USTR has noted to be approximately US$ $267,000), is a low threshold aimed at exempting very small e-commerce operators globally. It does not discriminate against companies based in the United States as it applies equally to all non-resident e-commerce operators not having permanent establishment in India, irrespective of the origin of such companies.

9. The concept of Equalisation Levy in India emerged as a result of the deliberations of the OECD *Base Erosion & Profit Shifting (BEPS) Project*, which crystallized in the *Report on Action 1 of BEPS Project*.[3] The BEPS Report on Action 1 was accepted by India and other members of the OECD, thereby representing a broad consensus view on the issues discussed in the report. This report formed the basis of detailed consultations by a *Committee on Taxation of E-Commerce* constituted by the GOI ("**India Committee**"), which had submitted its Report in February 2016.[4] The India Committee Report analyzed

[3] OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris ("**BEPS Report on Action 1")**.
[4] Report of the Committee on Taxation of E-Commerce (February, 2016), "Proposal for Equalisation Levy on Specified Transactions" (**"India Committee Report"**).

in detail the BEPS Report on Action 1, which had highlighted the need for modifying existing international taxation rules, and laid out three options for the consideration of countries, i.e., (a) a new nexus based on significant economic presence, (b) a withholding tax on digital transactions, and (c) Equalisation Levy. The BEPS Report on Action 1 did not recommend any specific option, recognizing that more work may be required in the area of attribution of profits. It however noted that: *"Countries could, however, introduce any of these three options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties."*[5]

10. The India Committee accordingly analyzed in depth each of the three options presented by the BEPS Report on Action 1 in view of the challenges emerging in the digital economy and the resulting asymmetry in tax burden faced by purely domestic enterprises on the one hand, and multi-national enterprises on the other, and the resulting distortionary impact on the market competition which can adversely affect the development of purely domestic enterprises,[6] and recommended the application of the Equalisation Levy on specified digital services.

11. The GOI notes that the BEPS Report on Action 1 provides an internationally accepted recognition of the broader tax challenges arising from digital enterprises, their unprecedented business models including multi-dimensional businesses, mobility of these enterprises, their ability to relatively easily avoid taxes in jurisdictions that significantly contribute to their profitability, and the challenges and difficulties that arise in the application of currently practiced international taxation rules in their case.[7]

12. An equally important objective of the Equalisation Levy is to provide greater clarity, certainty and predictability in respect of characterization of payments for digital services and consequent tax liabilities to all stakeholders, so as to minimize costs of compliance and administration and also minimize tax disputes in these matters. [8]

13. The ongoing multilateral consultations under the aegis of the G-20-OECD due in this regard, to which India has been one of the key members, have not arrived at any consensus even after many years of discussion. Further, as discussed above, the Equalisation Levy is seen as an additional safeguard against BEPS and loss of revenue in India due to activities of the e-commerce operators operating in India. This has necessitated introduction of 2% Equalisation Levy on e-commerce supply or services. This levy is non-discriminatory as it has uniform applicability.

[5] BEPS Action 1 Report, p.13.
[6] India Committee Report, para 169.
[7] India Committee Report, para 32.
[8] India Committee Report, para 125.

The Equalisation Levy only has prospective application

14. There is no retroactive element in the Equalisation Levy. The levy was enacted before 1 April, 2020 which is the date when it was made effective.

The Equalisation Levy cannot be said to have "extra-territorial" application

15. The OECD's BEPS Report on Action 1,[9] has clearly brought out tax challenges arising from the digitalization of the economy, and that the physical presence nexus in existing international taxation rules, which were developed in the last century keeping in view the business models of that time, is no longer the only justifiable indication of nexus. It also noted that the dynamic evolution of taxable nexus with business models, justifies its further evolution to the needs of new business models of digital economy, and recommended the equalisation levy as one of the options that countries could consider. India's Equalisation Levy is a consequence of that understanding.

16. India further notes that the Supreme Court of the United States in a recent ruling in a case relating to taxation,[10] has held that physical presence is **not** required for the levy of sales tax by a state where the online seller has no physical presence but makes online sales to buyers of the state. The principle under the United States' legal framework is clearly along the same lines as that of India, which is that, in a digitalized world, a seller can engage in busines transactions without any physical presence.

17. The India Committee has also noted the growing recognition by courts in India that the digital enterprises undertake business in ways that were not conceived when the existing laws were made, and applying those laws to these new realities of digital world necessitates an interpretation that is consistent with the digitalized reality. It noted the observations of the Delhi High Court in non-tax disputes, wherein it has been held that the availability of transactions through the website at a particular place is virtually the same thing as a seller having shops in that place in the physical world.[11] This clearly resonates with the U.S. Supreme Court's ruling in *South Dakota vs Way fair Inc.*

[9] OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

[10] *South Dakota vs Way fair Inc*, 585 U.S. _(2018).

[11] *World Wrestling Entertainment, Inc v. Reshma Collection & Ors*., 2014 SCC OnLine Del 2031 ("**WWE case**"); which has been relied on in a subsequent decision in *Lotus Green LLP v. Renowned Buildtech Private Limited*, 246 (2018) DLT 263. The Delhi High Court in the WWE case relied on the principles laid down by the Supreme Court of India in *Dhodha House v. S. K. Maingi* 2006 (9) SCC 41, and observed that the terms "*carries on business in Delhi*" were satisfied when the appellant's customers were located in Delhi, accessed the website in Delhi, communicated their acceptance to the offer of merchandise advertised on the website, at Delhi, and received the merchandise in Delhi, even though the server for the appellant's website was not located in Delhi.

III CONCLUDING REMARKS

18. Far from targeting any U.S. company or companies, the purpose of the Equalisation Levy is to ensure greater competitiveness, fairness, reasonableness and exercise the ability of governments to tax businesses that have a close nexus with the Indian market through their digital operations.

19. The GOI would be happy to provide any clarifications as may be required by the USTR in these proceedings or in bilateral discussions under Section 303(a) of the United States Trade Act, 1974.