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# Challenges of levying taxes on digital services

As US announces investigation against countries, it may be more pragmatic to accept such levies and negotiate bilaterally.

Written by **Suranjali Tandon** | Updated: June 10, 2020 5:49:36 pm



We find that while India accounts for 12.5 per cent of digital buyers, only 1 per cent of global revenues from various digital platforms are earned by it.

Recently, the [United States](#) declared that its trade representative will pursue an investigation under section 301 of the Trade Act, 1974, against Austria, Brazil, the Czech Republic, the European Union, India, Indonesia, [Italy](#), [Spain](#), Turkey and the UK for implementing digital services tax. The investigations come at a time when the European Parliament announced a €750 billion fund for its recovery plan (this includes a digital services tax expected to earn €1.3 billion a year), and after India expanded the scope of the equalisation levy. This is possibly the culmination of strains observed earlier in the multilateral process.

The Base Erosion and Profit Shifting (BEPS) project was launched in 2013 at the behest of G20/OECD. The project consists of 15 action points that address different issues in international taxation. But the taxation of the digitalised economy turned out to be a relatively contentious issue. In 2015, while final reports on each of the action points were published by OECD, work on Action point 1 was far from over. The report, as is repeatedly expressed, only listed possible measures which included an equalisation levy, withholding taxes and a new nexus rule. India was the first to implement an equalisation levy on payments made for digital advertising to non-residents. The levy was introduced through the Finance Act 2016, rather than an amendment to the Income Tax Act. In doing so, the tax was not



would result in double taxation.

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In 2018, the OECD published an interim report. The report did not clearly specify a preferred measure and no consensus was imminent. In the meantime, many other countries including the EU expressed their preference for a tax applicable on the gross turnover of digital platforms. Taking cognisance of the increasing preference for such unilateral measures, the OECD responded with a significant departure from the earlier commitment. In its policy statement in 2019, it laid out the two-pillar approach to tackle tax challenges from digitalisation wherein the issue of allocation of taxing rights would be examined without prejudice. In 2019, the OECD published a series of consultation documents while continuing engagement with stakeholders to preserve the multilateral process. By the end of 2019, work on Pillar one, or as is called — unified approach — was released. The method suggested was a complex calibration of global non-routine profits, over and above the routine profit. The distribution of non-routine profits among qualifying jurisdictions is to be based on revenue thresholds. As history bears out, defining such a normal profit can be challenging. During the World Wars, an excess profits tax was introduced on the sectors that profited from the war. Excess profits were identified through a reference to normal pre-war years. Identifying such profits and administering such taxes became difficult, more so after the war ended. It is a similar puzzle that experts seek to solve.





February 2020, the US treasury secretary suggested that the Pillar 1 proposals be applied on a safe harbour basis, thus in the possibility for exclusions. The call for exclusions in multilateral dialogues can undermine confidence in the process.

In the meantime, economic activity has slumped and is at its lowest since the great depression. A fallout of this will be lower revenues even as expenditures soar. Countries will now seek ways to finance their recovery, part of which will be to defend their tax base. While the OECD still expects to achieve its target of concluding the work on the taxation of digital economy by the end of 2020, the massive fiscal strain has diverted attention to national concerns, thus encouraging the EU to consider a unilateral digital tax. Interestingly, in India, when the finance bill was presented, it contained no proposal to expand the equalisation levy. However, the Finance Act included a levy of 2 per cent on an e-commerce operator from an e-commerce supply or services made or provided or facilitated by it. The focus on taxing digital companies is particularly driven by their financial resilience during the current pandemic.

To arrest the use of digital taxes, the USTR has launched an investigation. This is not the first instance of the use of such a measure. France's announcement of digital services tax attracted a similar investigation earlier, followed by a threat to increase tariffs. The investigation seeks to find if the tax amounts to discrimination against U.S companies, retroactivity, and if it possibly reflects an unreasonable tax policy. In spite of the investigation and potential tariff measures, countries such as Spain are still considering the application of the tax. Spain is among the worst-affected of the EU members, and given the fiscal obligations, it has limited fiscal recourse. Spain's stance must also be interpreted in the context of the EU wide approach. As per the Franco-German declaration in 2018, digital services tax will enter into force on January 1, 2021, if no international solution has been agreed upon by then — thus rendering digital services tax inevitable if the multilateral process fails to deliver a consensus-based solution. One may interpret the expanded scope of India's levy and the recent announcement before the European Parliament as a desire for a simplified solution.



economy, as well as the variance in expectations from the multilateral process. We find that while India accounts for 12.5 per cent of digital buyers, only 1 per cent of global revenues from various digital platforms are earned by it. The US, however, reports a third of the global revenues for the same share in digital buyers. Thus, a redistribution of taxing rights can have significant revenue implications for countries like India and the US, making a consensus-based solution harder to achieve. A uniform solution can undeniably mitigate complications of varied approaches. It may be more pragmatic to accept such levies and negotiate bilaterally for its conversion to withholding tax.

*The writer is assistant professor, NIPFP*



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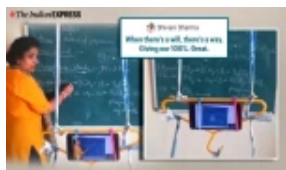

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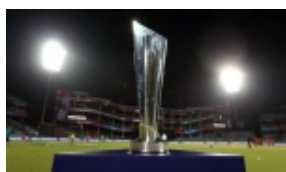
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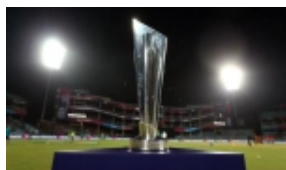
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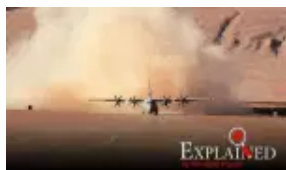

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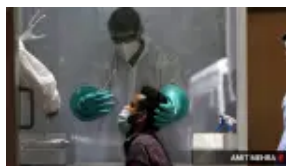

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