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Research

Tax, Trade and Investments

An Indian Policy Perspective

September 2021

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About NALSAR

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Contents

Executive summary

International taxation, trade and investment are inextricably linked. Tax is one of the key determinants influencing foreign investment and trade.

As per statistics published by the World Bank, international trade contributes 36.47% of India's GDP. The US is one of the top 10 trading partners of India. As the Indian economy recovers from the aftermath of COVID-19, it is essential that India has a coherent tax, investment and trade policy. The issue of taxation of digital economy has garnered interest of the international tax and political community. Pursuant to a half decade long struggle India along with 133 other countries, has agreed to the OECD/G20 Inclusive Framework Agreement comprising of a two-pillar solution. While countries have reached to a broad agreement, the key details are being negotiated currently and are due to be finalised in October 2021. With the embargo on the trade deal between India and US, India's stance on the tax deal will be one of the factors which will shape future India-US relations. Further, Indian Government aims to double trade with all key trading partners including the USA in this financial year. There has been a great emphasis on improving exports, removing trade barriers and stimulating the economy.

On the foreign investment side, basis provisional estimates FDI inflows in the year 2020-21 are estimated to be USD 52 billion as against USD 42 billion in 2019-20 depicting an increase of 24%. Even in the post COVID era, foreign investment could prove to be the key driver of economic recovery, especially for developing countries. This has been recently reaffirmed by the Government that **"The country today stands at a juncture where quick recovery of the economy after Covid-19 pandemic is the need of the hour and foreign investment has an important role to play in promoting faster economic growth and employment".** Tax certainty as a tax policy goal and as a factor that provides further assurance to foreign investors is an important factor as reiterated by the Government.

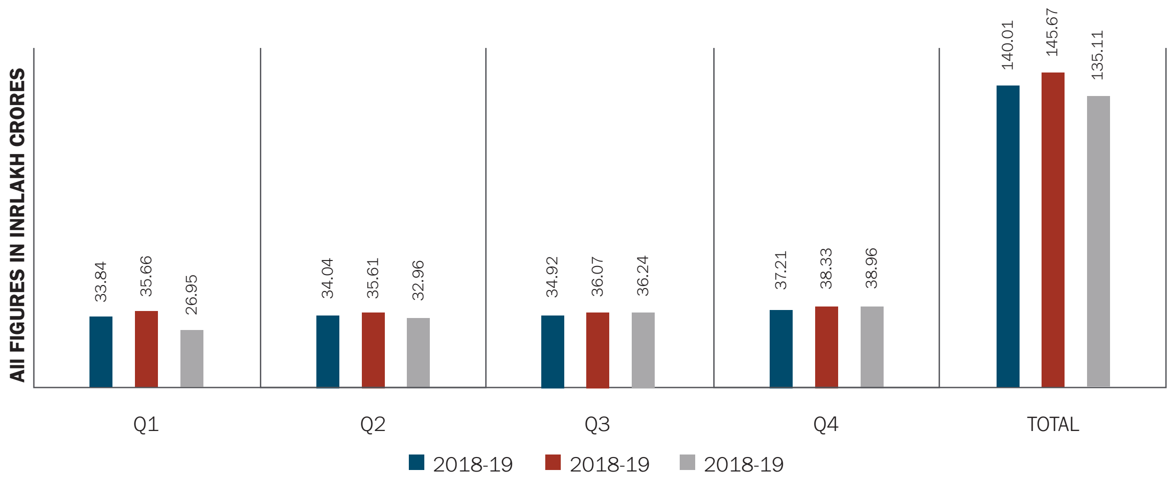
Against this background, the Indian government broadly has two options, either to sign OECD deal basis the negotiations at the global level or continue with current unilateral tax regime. Unilateralism in tax policy may not only harm Indian technology companies going global but also invite unilateralism in the form of retaliatory trade tariffs. Multilateralism, despite its imperfections, is a better approach both in trade and tax policy matters, which in turn provides a stable framework for foreign investments.

This paper sets out different considerations for a cohesive tax, trade and investment policy from an Indian perspective. We discuss India's international trade relationship with major economies around the world, India's trade plans amidst COVID-19 while considering the government's tax policy objectives and foreign investment goals.

1. Indian economy and COVID-19

The COVID-19 pandemic has drastically affected the global gross domestic product (**"GDP"**) significantly contracting global trade. According to latest national income estimates released by the Ministry of Statistics and Programme Implementation, India's GDP contracted further by 7.4% in the second quarter of 2020-21. The third and fourth quarters of 2020-21 saw a weak recovery with GDP rising by just 0.5% and 1.6%, respectively.[1]

GDP AT CONSTANT (2011-12) PRICES

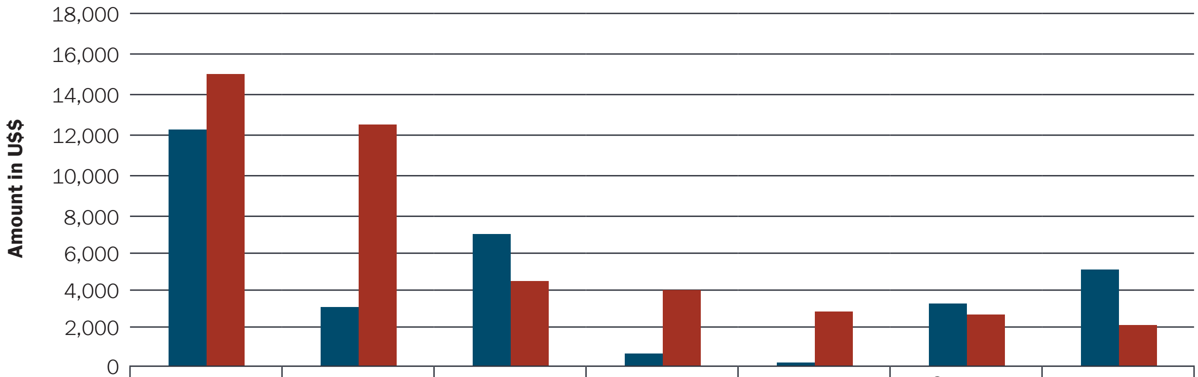


Source: Statement 6, Press Note on Provisional Estimates of Annual National Income 2020-21 and quarttery estimates of Gross Domestic Product for the Fourth Quarter of 2020-21. National Statical Office. Ministry of Statics and Programme Implementation. Government of India https://static.pib.gov.in/WriteReadData/specificodes/documents/2021/may/doc202153111.pdf

Basis provisional estimates FDI inflows in the year 2020-21 are estimated to be USD 52 billion as against USD 42 billion in 2019-20 depicting an increase of 24%.[2] Even in the post COVID era, foreign investment could prove to be the key driver of economic recovery, especially for developing countries.[3] This has been recently reaffirmed by the Government that **"The country today stands at a juncture where quick recovery of the economy after Covid-19 pandemic is the need of the hour and foreign investment has an important role to play in promoting faster economic growth and employment".**[4] Noting that domestic investment has flagged and that it has not kept pace with expectations, a cut in direct taxes, a predictable tax regime, import duty relief and production linked incentives were cited as measures from the Government that should get the private sector wanting to invest.[5] The chart below depicts the largest sources of foreign investors into India.

1. Swati Dhingra & Maitreesh Ghatak, The pandemic in data: How Covid-19 has devastated India's economy, The Scroll June 2021 https://scroll.in/article/999275/the-pandemic-in-data-how-covid-19-has-devasted-indias-economy
2. RBI Annual Report, Appendix Table 9: FDI Flows to India: Country wise and industry wise https://m.rbi.org.in/Scripts/AnnualReportPublications.aspx?Id=1336
3. Foreign direct investment flows in the time of COVID-19, OECD Policy Responses to Coronavirus (COVID-19), May 2020.
4. Statement of objects and reasons , The Taxation Laws (Amendment) Bill, 2021.
5. Punj, Shwweta. 2021, August 16. Why domestic investment remains slumped even though FDI is at a record high. India Today. Available at: https://www.indiatoday.in/india-today-insight/story/why-domestic-investment-remains-slumped-even-though-fdi-is-at-a-record-high-1841182-2021-08-16

FDI Inflows in India



	Singapore	US	Mauritius	UAE	Saudi Arabia	Cayman Islands	Netherlands
2019-20	12,612	3,401	7,498	343	89	3,496	5,295
2020-21	15,908	13,204	4,491	4,071	2,815	2,558	2,138

Source: RBI Annual Report. Appendix Table 9: FDI Flows to India: Country wise and Industry wise
https://m.rbi.org.in/Scripts/AnnualReportPulications.aspx?Id=1336
*Amounts for 2020-21 are indicated on a provisional basis

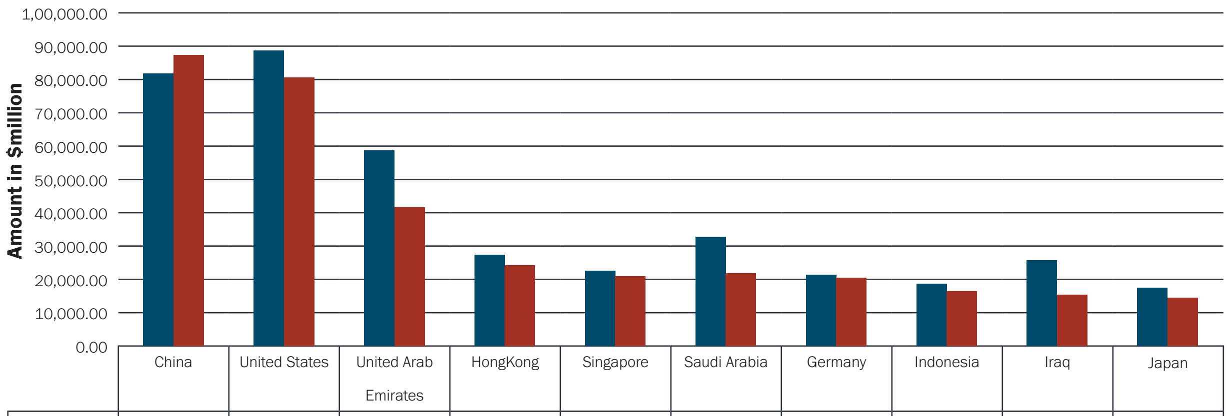
It is no surprise that the tax regime of a country is one of the key factors that has an impact on foreign investment into a country.[6]

6. Tax Effects on Foreign Direct Investment, OECD Policy Brief February 2008.

2. International trade in India

As per statistics published by the World Bank, international trade contributes 36.47% of India's GDP.[7] Globally, there has been a shift from trade in goods to trade in services with 70% of trade among developed countries is in the services sector.[8] As per Department of Commerce, India's trade surplus from services has been consistently growing since 2019 with the trade surplus being USD 7.44 billion as of August 2021 against USD 6.88 billion in August 2020.[9]

India's Top Trading Partners



	China	United States	United Arab Emirates	HongKong	Singapore	Saudi Arabia	Germany	Indonesia	Iraq	Japan
2019-20	81,873.50	88,908.64	59,110.24	27,902.44	23,669.44	33,094.23	21,982.01	19,191.20	25,618.35	16,954.92
2020-21	86,399.40	80,498.56	43,318.41	25,335.21	21,980.40	22,043.37	21,189.34	17,496.38	15,786	15,359.21

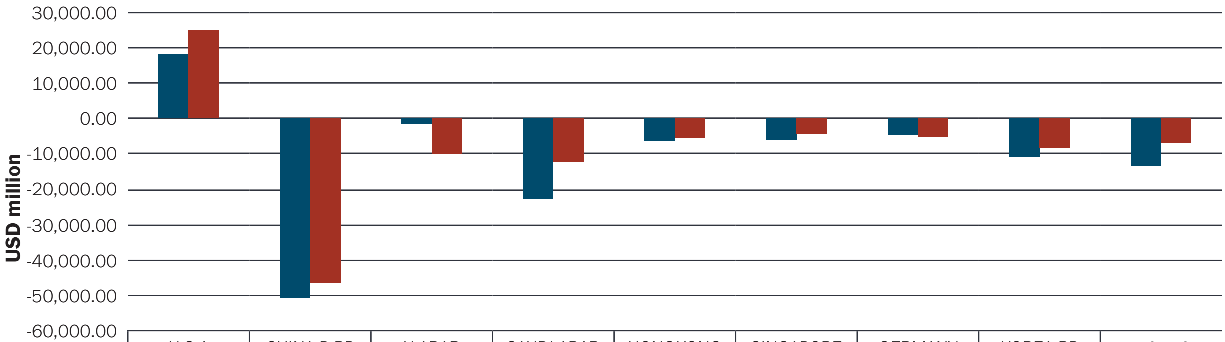
Source: Banerji, Sumant. June 29, 2021. 'Boyott China' flops: Maninland China overtakes US to become India's largest trade partner in FY21. Business Standard. Last accessed on Sepember 6, 2021. at https://www.businesstoday.in/latest/economy-politics/story/boycott-china-flops-mainland-china-ovrtakes-us-to-become-indias-largest-trade-partner-in-fy21-300020-2021-06-29

The United States (**"US"**) is amongst the top 10 trading partners of India taking into account merchandise and services trade. As indicated above, in fiscal year 2021, Indo-US bilateral trade contracted by 9.5 per cent to $80.5 billion. The US is India's largest export market and the only country in the top 10 trading partners with which India has a trade surplus. India's trade surplus with the US was at $23 billion in 2020-21, as against $17 billion in the previous two years. Reports suggest that in the current fiscal, India's trade surplus with US is around $5 billion so far.[10]

7. The World Bank Data, Trade (% of GDP) – India https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?locations=IN
8. Jeffrey Owens and James X. Zhan. Trade, investment and taxation: policy linkages.
9. India's Foreign Trade: Latest Figures, Ministry of Commerce and Industry, Department of Commerce. Available at: https://commerce.gov.in/trade-statistics/latest-trade-figures/
10. Nair, Remya & Basu Nayanima. 2021, August 23. India's trade deal with the US remains a non-starter for now. Here's why. The Print. Available at: https://theprint.in/economy/indias-trade-deal-with-the-us-remains-a-non-starter-for-now-heres-why/720392/

2. International trade in India

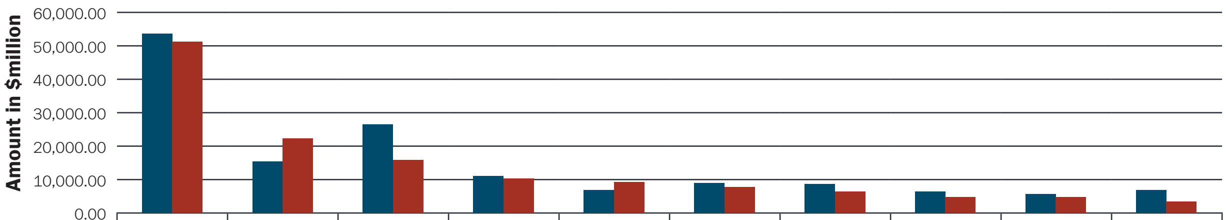
India's Top Trading Balances



	U.S.A	CHINA P RP	U ARAB EMTS	SAUDI ARAB	HONGKONG	SINGAPORE	GERMANY	KOREA RP	INDONESIA
2019-20	17,268.90	-48,647.99	-1,403.06	-20,620.51	-5,968.20	-5,824.11	-5,400.21	-10,814.55	-10,932.55
2020-21	22,735.05	-44,025.10	-9,943.45	-10,330.15	-5,010.42	-4,629.42	-5,518.09	-8,088.35	-7,443.95

Source: Department of Commerce Export Import Data Bank, accessible at https://tradestat.commerce.gov.in/eidb/Default.asp

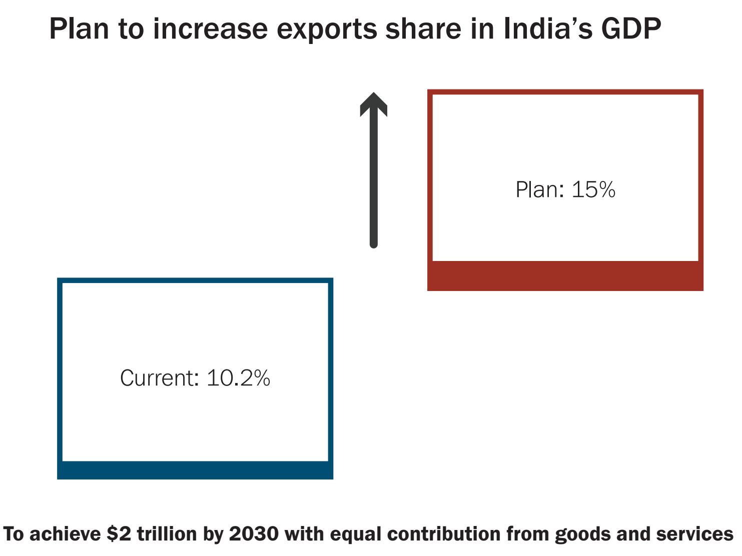
India's Export Revene



	United States	China	United Arab Emirates	HongKong	Bangladesh	Singapore	United Kingdom	Germany	Nepal	Netherland
2019-20	53,088.77	16,612.75	28,853.59	10,967.12	8,200.75	8,922.66	8,737.85	8,290.90	7,160.35	8,366.11
2020-21	51,621.77	21,187.15	16,695.42	10,162.39	9,102.58	8,675.47	8,158.52	8,124.82	6,765.93	6,472.80

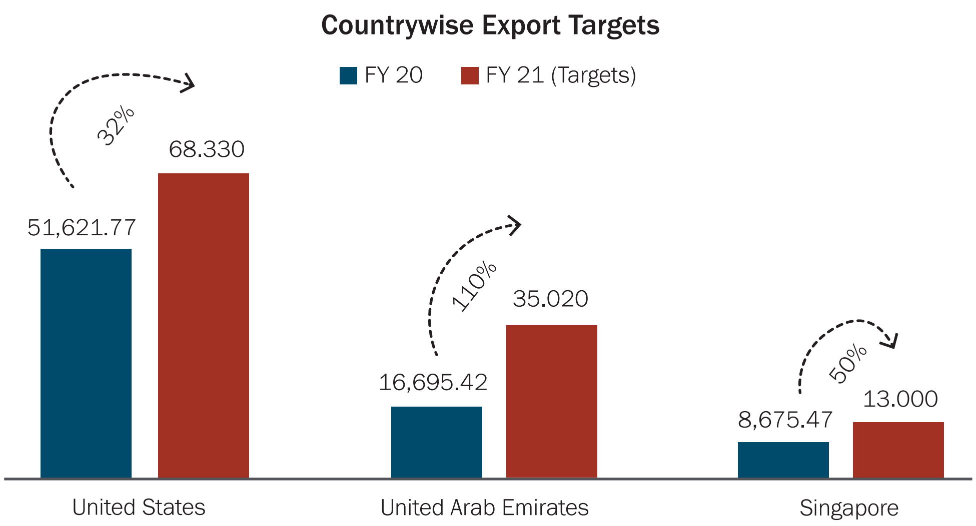
Source: Banerji, Sumant. June 29, 2021. 'Boyott China' flops: Maninland China overtakes US to become India's largest trade partner in FY21. Business Standard. Last accessed on Sepember 6, 2021. at https://www.businesstoday.in/latest/economy-politics/story/boycott-china-flops-mainland-china-ovrtakes-us-to-become-indias-largest-trade-partner-in-fy21-300020-2021-06-29

As indicated below, the Ministry of Commerce has indicated that the government is seeking to enhance share of exports in India's GDP.



Source: Suneja, Kritika, Aug 30, 2021. $400 billion target: India seeks to double UAE exports, raise bar for US and UK. The Economic Times, last accessed on September 08, 2021 at https://economictimes.indiatimes.com/news/economy/foreign-trade/400b-target-india-seeks-to-double-uae-exports-raise-bar-for-us-uk/articleshow/85747602.cms

The Ministry of Commerce and Industry has also set country-wise goals targeting significant increase in exports to US, UAE and Singapore for the current financial year.[11]



Source: Suneja, Kritika, Aug 30, 2021. $400 billion target: India seeks to double UAE exports, raise bar for US and UK. The Economic Times, last accessed on September 08,2021 at https://economictimes.indiatimes.com/news/economy/foreign-trade/400b-target-india-seeks-to-double-uae-exports-raise-bar-for-us-uk/articleshow/85747602.cms

Given that the trade-deal between India and US is off the table and the Indian government now seeks to work on other issues like market access, lowering of non-tariff barriers, mutual recognition pacts etc.,[12] India's stance on the tax deal will be one of the factors which will shape future not only India-US relations but also India's relation with other trading partners like UK, EU, Australia and Canada. It has been noted that the digital tax imposed

11. Suneja, Kritika. 2021, August 30. $400 billion target: India seeks to double UAE exports, raise bar for US and UK. The Economic Times. Available at: https://economictimes.indiatimes.com/news/economy/foreign-trade/400b-target-india-seeks-to-double-uae-exports-raise-bar-for-us-uk/articleshow/85747602.cms

12. 2021, August 21. Reboot to reset: On India-U.S. trade ties. The Hindu. Available at: https://www.thehindu.com/opinion/editorial/reboot-to-reset-the-hindu-editorial-on-india-us-trade-ties/article36024463.ece

on large US multinationals was one of the stumbling blocks during the trade negotiations between the two countries and that a successful global multilateral solution would pave way for fresh negotiation.[13] Therefore, neutralization of tax advantages in various jurisdictions may have an impact on the trade negotiations.

13. Shukla, Anuradha. 2021, July 4. Agreement on global digital tax likely to boost India-US trade negotiations. The New Indian Express. Available at: https://www.newindianexpress.com/business/2021/jul/04/agreement-on-global-digital-tax-likely-to-boost-india-us-trade-negotiations-2325120.html

3. Digital Taxation

The issue of taxation of digital economy has garnered interest of the international tax and political community. As policymakers continue to find a consensus-based solution, political expediency has resulted in countries taking varied approached towards taxing digital economy. The chart below indicates the various measures taken by countries to tax the digital economy.

	What dose it mean	Illustrative list of countries adopting such approch
Consumption Taxes	Consumption Taxes are Value-added Taxes (VAT) and other taxes on the sale of final goods or services	Countries like Austraila, Japan, Mexico, New Zealand, US have introduced consumption based taxes
Digital Services Taxes	DST are gross revenue taxes with a tax base that includes revenues derived from a specific set of digital goods or services or based on the numbeber of digital users within a country	Countries like France, Italy, India, Spain, UK, Austria have introduced DSTs
Tax preferences for digital businesses	Tax preferences are policies such as research and development (R&D) credits and patent boxes that reduce the tax buden on digital businesses	Countries like Germany, Belgum, France and the UK have introduced R&D tax incentives; Countries like China, India, Israel, Korea, Spain, Ireland, Italy have introduced patent box regime
Digital Permanent Establishment (PE) Rules	These policies include redefining what constitutes a PE to include digital companies that have no physical presence within a jurisdiction	Countries like India, Indonesia, Israel, Kenya, Nigeria, Saudi Arabia and Slovakia have introduced digital PE rules
Gross based witholding taxes on digital services	Gross-based withholding taxes are used by some countries instead of corporate taxes or consumption taxes to tax revenue of digital films in connection to transctions within a jurisdiction	Countries like Pakistan, Peru, Thailand, Turkey and Uruguay have introduced gross bassed withholding taxes; The withholding tax rates range from 5% in Pakistan and Thailand to 30% in Peru

Recently, pursuant to a half decade long struggle India along with 133 other countries, agreed to the Organization for Economic Co-operation and Development (**"OECD"**)/G20 Inclusive Framework Agreement (**"IF Agreement"**) comprising of a two-pillar solution.[14] The chart below provides a high level summary of the IF Agreement.

Pillar One	Pillar Two
▪ Revamp tax allocation rules so that a specified portion of the residual profits of an MNE would be taxed in the market jurisdiction from where such MNE derived its revenues ▪ In-scope MNEs: MNEs with global revenue > 20 billion euros and profitability rate > 10% • Only Extractives and Regulated Financial Services are carved out. ▪ New nexus rule will permit Amount A allocation to a jurisdiction on basis of revenue derived by an MNE from such jurisdiction. Current threshold is 1 million euros and revenue sourcing rules are yet to be finalized ▪ Unilateral Measures - Digital Services Taxes and other relevant similar measures to be rolled back ▪ Implementation - A multilateral instrument will be developed and opened for signature in 2022 with Amount A coming into effect in 2023	▪ Proposes to a global minimum tax of at least 15% in home countries of MNEs so as to disincentivize profit shifting to low-tax jurisdiction ▪ In-scope MNEs: MNEs with revenue > 750 million: However, a jurisdiction in which an MNE is headquartered may apply the IIR even if revenue threshold is not met ▪ GloBE rules comprise of two domestic interlocking rule being IIR and UTPR • IIR - top up tax on a parent entity in respect of low taxed income of a constituent entity • UTPR - denial of deductions or an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR ▪ STTR - a treaty based rule to allow source jurisdictions to impose tax on certain related party payments subject to tax below a minimum rate.

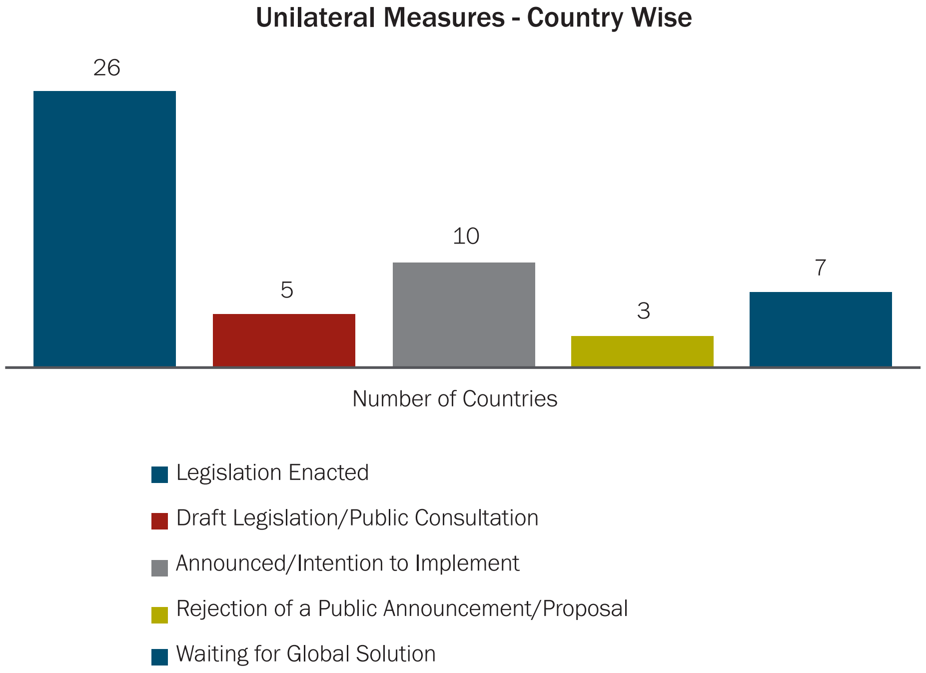
14. **Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy,** Members of the OECD/G20 Inclusive Framework on BEPS, July 5, 2021.

While these are certainly positive developments indicative of the commitment towards finding solutions, the devil lies in the details. The real challenge comprises in arriving at a political consensus and resolving the outstanding technical and policy-based issues with respect to agreement on the quantum of allocable profit for Amount A of Pillar One, fixation of the 'minimum' in the global minimum tax, implications of the same on the overall tax sovereignty of jurisdictions to impose unilateral measures.

It needs to be acknowledged that any global tax deal will be forged in the backdrop of the COVID-19 pandemic that has drastically affected the economies around the world. Revenue concerns that were even otherwise prominent for public financing of nation state are even more crucial now to support the frail health system, social and economic infrastructure especially in case of developing countries. Any global tax deal therefore must be entered into in recognition of the economic and political realities of the post COVID-19 world order.

Advent of DSTs

The OECD identified a number of tax issues arising from digitalization of economy in its 2015 Action Plan 1 Report.[15] As indicated above, several countries have adopted unilateral measures to monetize from digital transactions. The chart below shows the status of legislations proposed by various countries in this regard.



Source : KPMG. "Taxation of the digitized economy: Developements Summary. Updated: Aug 25, 2021".2021. https://tax.kpmg.us/content/dam/tax/en/pdfs/2021/digitalized-economy-taxation-developements-summary.pdf . last accessed on 08 Sept. 2021. p. 5

Countries such as Austria, France, India, Italy, UK etc. have already introduced the unilateral measures as DSTs. The scope, applicability, character and nature of these DSTs differ significantly. While some forms of DST are akin to income taxes, others veer closer to consumption taxes and some DSTs are neither a tax on income nor a tax on consumption.[16] The table below depicts the variance in rate, scope and thresholds of few DSTs implemented around the world:[17]

15. 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, https://doi.org/10.1787/9789264241046-en.

16. James J. Nedumpara, Skirmishes over Digital Service Taxes: The Perils and Systemic Costs of Section 301 Actions, Trade, Law and Development, Summer, 2021 Vol. XIII, No. 1

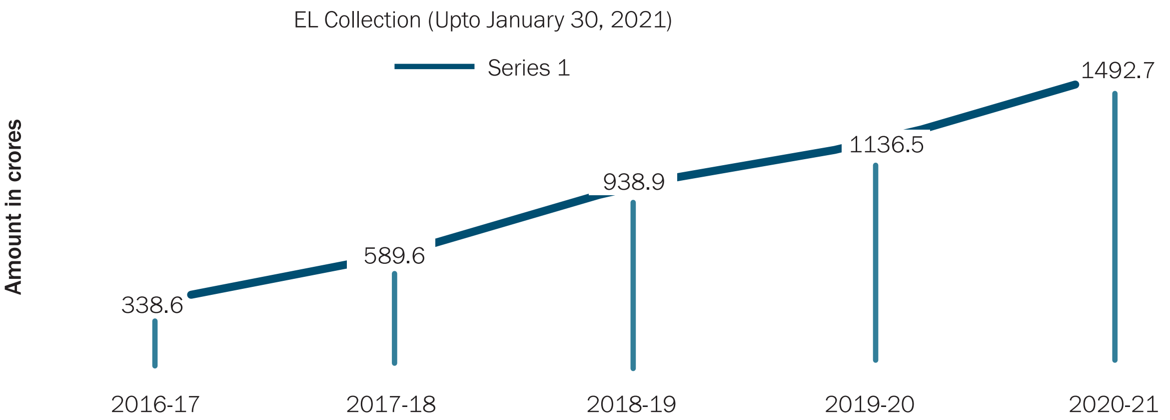
17. KPMG. 2021, July 22. Taxation of the digitized economy: Developments Summary., Available at https://tax.kpmg.us/content/dam/tax/en/pdfs/2021/digitalized-economy-taxation-developments-summary.pdf

3.Digital Taxation

S. No.	Country	Rate	Scope of DST	Thresholds
1.	Austria	5%	• Revenues from advertising services on digital interfaces or any type of software or websites rendered in Austria	• Global turnover: EUR 750 million • Domestic turnover: EUR 25 million
2.	France	3%	Revenues from • Digital intermediary services and • Targeted online advertising services	• Global turnover: EUR 750 million • Domestic turnover: EUR 25 million
3.	Italy	3%	Revenue from • Advertising on a digital interface; • Multilateral user interface platforms (social media); • Transmission of digital interface's user data	• Global turnover: EUR 750 million • Domestic turnover: EUR 5.5 million
4.	Spain	3%	Revenue from: • Digital advertising services; • Digital intermediation services; • Data transmission services	• Global turnover: EUR 750 million • Domestic turnover: EUR 3 million
5.	United Kingdom	2%	Revenue from: • Internet search engines; • Social media services; • Online marketplaces.	• Global turnover: 500 million pounds • Domestic turnover: 25 million pounds

While it is clear that countries want to monetize revenue from digital transactions through levy of DSTs, it will be important to deliberate on who will bear the costs of these DSTs. Some digital platforms, including Apple,[18] Google,[19] and Amazon,[20] have said that they will pass costs on to app developers, advertisers and third-party sellers on their platforms respectively. Others, like eBay,[21] have said they will absorb the costs.

India was also the first country to introduce an equalization levy (**"EL"**) in 2016 which was initially applicable on online advertising services and is now expanded to apply on online sale of goods or online provision of services by e-commerce operators. The collection by Indian government under EL (alongwith the expanded 2% equalization levy) has steadily increased over the past few years as is evident from the chart below.

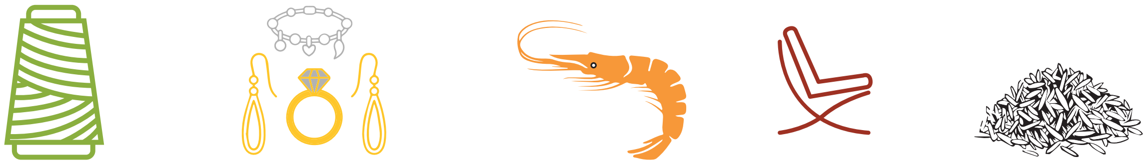


Source Suneja Kritika Feb 12, 2021 Rs 1.492 cr worth equalisation levy collected in last 10 months Govt to Parliament. The Economic Times Last accessed on September 07, 2021 at https://economictimes indiatimes.com/news/economy/finance/govt-collects-rs-1492-crore-equalisation-levy-between-apr-2020-jan-2021/articleshow/80879675.cms?utm_source-contentofinterest&utm_medium=text&utm_campaign=cppst

18. Apple, "Upcoming tax and price changes for apps and in-app purchases", 1 September 2020, https://developer.apple.com/news/?id=oyy56t2r
19. https://support.google.com/google-ads/answer/9750227?hl=en
20. Amazon Services, "Upcoming fee changes in the UK following introduction of Digital Services Tax", 4 August 2020, https://sellercentral-europe.amazon.com/forums/t/upcoming-fee-changes-in-the-uk-following-introduction-of-digital-services-tax/322163
21. eBay, "Protecting your business from Digital Services Tax costs", 10 August 2020, https://community.ebay.co.uk/t5/Announcements/Protecting-your-business-from-Digital-Services-Tax-costs/ba-p/6701162

The Office of the United States Trade Representative (**"USTR"**) initiated investigations under Section 301[22] of the Trade Act of 1974 (**"Section 301 Investigation"**) against 11 DSTs including India's EL. The Section 301 Investigation involved determination of whether the act, policy, or practice i.e., India's EL – is actionable under Section 301 of the Trade Act of 1974 (**"Trade Act"**), and if so, what action, if any, to take under Section 301. The USTR concluded that the EL is 'actionable' under the Trade Act and proposed to impose retaliatory additional tariffs of up to 25% ad valorem on an aggregate level of trade for certain goods.[23] The aim of such retaliatory tariff was to neutralize the impact which India's EL is expected to have on U.S. companies. While the USA has suspended the retaliatory tariffs for 180 days to provide additional time to complete the ongoing multilateral negotiations, a failure to fructify the agreement or withdrawal from the global deal is likely to result in implementation of the retaliatory tariffs which may impact the industries specified below:

USTR LEVY ON INDIAN GOODS



The IF Agreement states that the "package will provide for appropriate coordination between the application of the new international tax rules and the removal of all DSTs and other relevant similar measures on all companies". Recently, the G24 in its comments submitted to the OECD Secretariat, indicated that if the developing countries are expected to withdraw unilateral measures due to agreement on Pillars One and Two, then there should be sufficient revenue under Pillar One and a broader STTR. The G 24 was suggested that removal of unilateral measures should be gradual and progressively alongside the implementation of Amount A. Australia, Chile and Germany have withdrawn public announcements or proposals,[24] but it remains to be seen when and to what extent DSTs will be completely removed.

22. Section 301 of the Trade Act sets out three types of acts, policies, or practices of a foreign country that are actionable: (i) trade agreement violations; (ii) acts, policies or practices that are unjustifiable (defined as those that are inconsistent with U.S. international legal rights) and burden or restrict U.S. Commerce; and **(iii) acts, policies or practices that are unreasonable or discriminatory and burden or restrict U.S. Commerce.**

23. Proposed Action in Section 301 Investigation of India's Digital Services Tax, March 31, 2021 https://ustr.gov/sites/default/files/enforcement/301Investigations/Proposted_Action_India_FRN_March.pdf

24. KPMG. 2021, July 22. Taxation of the digitized economy: Developments Summary., Available at: https://tax.kpmg.us/content/dam/tax/en/pdfs/2021/digitalized-economy-taxation-developments-summary.pdf,

4. IF Agreement and the path ahead

India has been at the forefront of the global negotiations at the IF, emerging as a key voice advocating market and source-based taxation rights. India has consistently demanded a higher percentage of the revenue to be shared with the market jurisdictions. India has also expressed its concerns regarding the bifurcation of profits into routine and residual, arguing that market jurisdictions should be allocated a share in the routine profits as well.[25]

I. Revenue collection

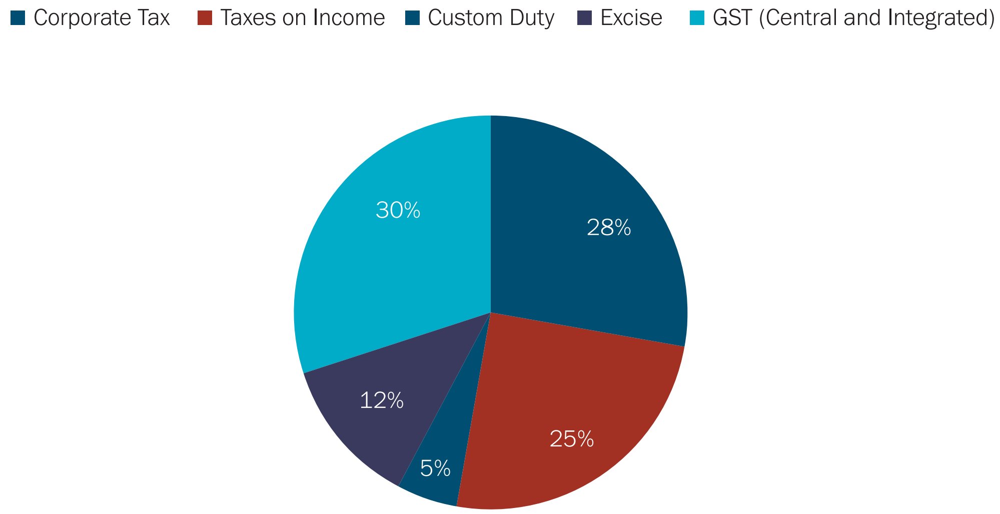
As per a report published in the European Network of Economic and Fiscal Policy Research policy brief only 78 companies in the world would be subject to the Pillar One allocation.[26] Given the collection under EL, concerns have been raised regarding the revenue that Pillar One would bring to India. As per media reports, the EL itself has generated more revenue for India in the last year[27] (USD 124 million in FY 2018-19) than what is presumed to come to India through Pillar One at this stage.[28] Having said this, an important point to be considered is that a higher threshold for Pillar One would mean that lesser Indian companies are covered under scope of Pillar One, thereby having a lesser impact on Indian tax collections. Currently, basis our research (**see Annexure I for details**) on publicly available information, only 7 Indian companies may satisfy the revenue threshold of Euro 20 billion under Pillar One. Of these 7 companies, 5 companies may fall under the extractive or financial service industry and hence be out of scope of Pillar One. Further, the remaining two companies may not satisfy the profitability thresholds. Hence, as per current financial data on public domain, none of the Indian companies may be within scope of Pillar One if the threshold for applicability of Pillar One is Euro 20 billion.[29] As a consequence, revenue forgone by India due to Indian companies being covered under Pillar One may be minimal.

In this context, it is also important to note the mix of sources from where India collects revenue to understand better the significance of revenue gained or lost under Pillar I. Corporate income tax comes second after indirect taxes.

25. EY India, **Rasmi Ranjan Das, Joint Secretary, Foreign Tax & Tax Research and Competent Authority for India talks about Pillar One and Pillar Two frameworks and developments made by the OECD,** May 2021.
26. Michael Devereux and Martin Simmler, Who Will Pay Amount A?, EconPol Policy Brief 36, July 2021.
27. https://www.businesstoday.in/latest/economy-politics/story/tax-on-online-ads-on-google-facebook-makes-govt-richer-by-rs-939-crore-225948-2019-09-09
28. Vibhore Batwara, Arikit Ghosh, Ipsita Agarwalla, and Meyyappan Nagappan, **Inclusive Framework Reach an Agreement on Digital Taxation - How We Got Here and the Road Ahead,** The National Law Review July 2021.
29. The above analysis has been made basis two data sets: (i) Business Standard March 2021 report available on https://bsmedia.business-standard.com/_media/bs/data/general-file-upload/2021-03/unlisted%20companies.pdf (covers data of the Indian unlisted (public and private) companies for the year ending March 2019 and March 2020) and (ii) Fortune India 500 list available on https://www.fortuneindia.com/fortune-500?year=2020 (covers data of the Indian listed companies for the year ending March 2020)

4.IF Agreement and the path ahead

Tax Revenue Collection by Union Government (2019-20)



Source: Receipt Budget, 2021-22

Further, Indian headquartered MNCs often set up offshore structures using the Overseas Direct Investment route and make global investments through jurisdictions considered as tax havens. Without a controlled foreign corporation law, Tax Justice reports have estimated that India loses over USD 10 Billion in tax amount due to use of offshore structures and tax havens.[30] The IF Agreement encapsulates a two-pillar solution wherein India is likely to gain the ability to mop up taxes under Pillar Two as well.

II. Stable international tax policy

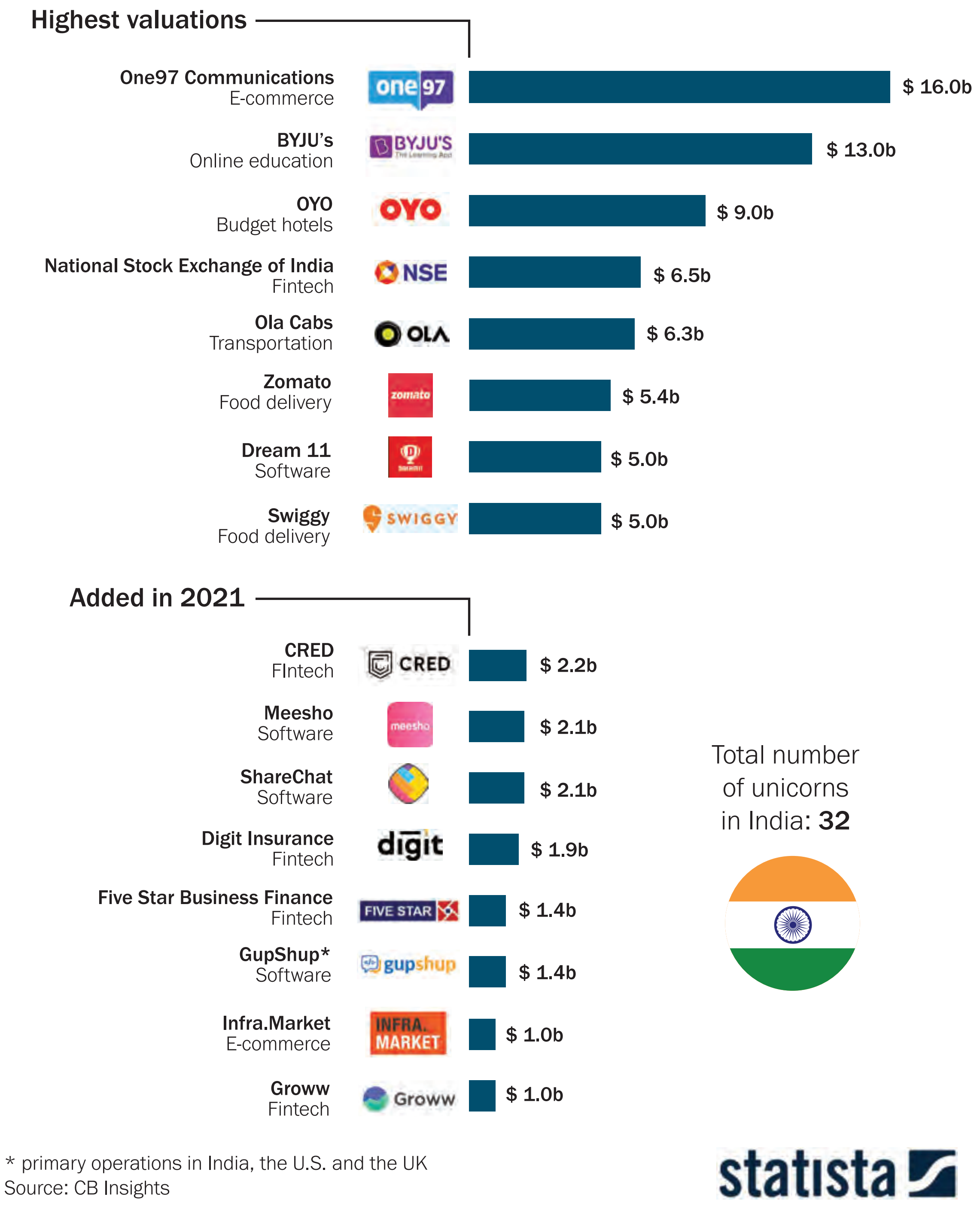
The IF Agreement is in accordance with India's policy objectives of having practical international tax rules that recognise the demand of market jurisdiction for a share in profits of MNEs.[31] India has, for long, demanded the modernising of the international tax system, with allocation of profits to market jurisdictions based on demand side factors, the IF Agreement represents the acceptance of India's position at the global level. Indian Government has also noted that the modernising of the international tax rules is an important consideration to be kept in mind while undertaking the negotiations.[32]

A stable international tax policy is likely to go a long way in supporting the Indian tech and start-up companies. Recently, the Chief Executive Officer of NITI Aayog, noted that 14 Indian start-ups have become unicorns in the first half of 2021.[33] Furthermore, it was reported that MX TakaTak became the most downloaded app in Asia ahead of the social media giants and it was among the top 10 most downloaded apps on Google Play and Apple store.[34]

30. https://taxjustice.net/wp-content/uploads/2020/11/The_State_of_Tax_Justice_2020_ENGLISH.pdf
31. Press Release dated: 2 July 2021 of the Ministry of Finance, India available at https://www.pib.gov.in/PressReleseDetail.aspx?PRID=1732150
32. EY India, **Rasmi Ranjan Das, Joint Secretary, Foreign Tax & Tax Research and Competent Authority for India talks about Pillar One and Pillar Two frameworks and developments made by the OECD,** May 2021.
33. https://www.thehindubusinessline.com/info-tech/indian-tech-ecosystem-has-come-a-long-way-amitabh-kant/article35504939.ece
34. https://economictimes.indiatimes.com/tech/technology/mx-takatak-beats-facebook-instagram-in-asia-downloads/articleshow/83585996.cms?from=mdr

India's Unicorns

Startups with a valuations of $ 1 billion or more in India (as of April 2021)



* primary operations in India, the U.S. and the UK
Source: CB Insights

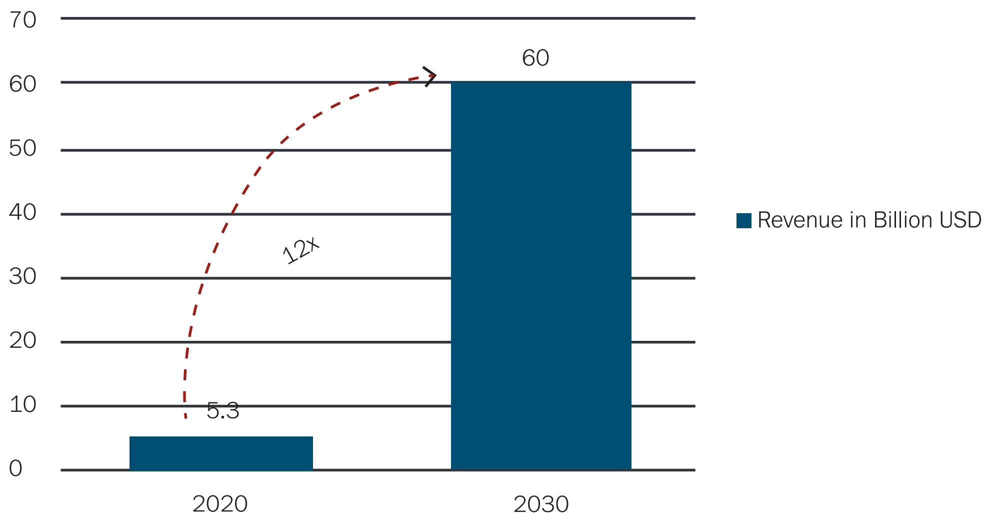
As mentioned above, if the IF Agreement fails to materialise due to a lack of consensus, global proliferation of unilateral levies (similar to India's Equalisation Levy) would, severely affecting ease of doing business and disproportionately enhancing the tax costs for Indian unicorns with global user bases. This may impact Ed-Tech companies based out of India which are increasingly deriving revenues from users in rest of the world.[35] Byjus,

35. Bhargava, Anjuli. 2021, September 2. India's edtech firms aim global as a massive consolidation plays out. The Business Standard. Available at: https://www.business-standard.com/article/companies/india-s-edtech-firms-aim-global-as-a-massive-consolidation-plays-out-121090101614_1.html

Simplilearn and Eruditus have a majority of their learners in rest of the world and almost all these companies are location agnostic when it comes to the learner profiles. Simplilearn for instance has 40% of its revenues from learners in the US. On the back of such revenues, Indian Ed-Tech firms have also received tremendous interest and investments from foreign investors. Estimates suggest that Indian Edtech companies have raked in USD 2.2 Billion, up from USD 553 Million in 2019.[36]

Similarly, imposition of unilateral levies can severely impact the Indian Software as a Service (**"SAAS"**) companies aiming to go global. The Indian SAAS companies, which includes 10 unicorns, are expected to generate USD 18-20 billion revenues by 2022.[37] The Indian SAAS industry has the potential to reach a valuation of over USD 1 trillion by 2030 on basis of the expected revenue growth of the Indian SAAS companies.[38]

Indian SaaS Companies expected Revenue



Source: "Indian SaaS - The Next Big Thing" report by Nasscom and "Shaping India's SaaS Landscape" report by SaaSBOOMi and Mckinsey (July 2021)

36. https://www.business-standard.com/article/companies/india-s-edtech-firms-aim-global-as-a-massive-consolidation-plays-out-121090101614_1.html

37. https://economictimes.indiatimes.com/tech/technology/indian-saas-firms-set-to-rake-in-18-20-billion-revenues-by-2022-report/articleshow/79498924.cms

38. ET Bureau. 2021, July 7. India's SaaS space can create $1 trillion in value by 2030. Available at: https://economictimes.indiatimes.com/tech/information-tech/indias-saas-space-can-create-1-trillion-in-value-by-2030/articleshow/84206394.cms

5. Impact on trade

As mentioned above, as of August 25, 2021, 26 countries, including India, have imposed legislations targeting digital transactions. Many other countries have expressed an intention to bring unilateral measures if a global agreement is not reached.[39]

In the past, the US has aggressively used unilateral actions under Section 301 (which is the embodiment of unilateralism) to force countries to eliminate trade barriers.[40] Pursuant to the Section 301 investigation conducted by USTR, approximately 40 tariff lines were identified for imposition of retaliatory tariffs on India.[41] These tariff lines appear to have been carefully selected to include goods that are of strategic interest to India. For instance, the USTR has identified precious metal and stone as one of the categories of products on which retaliation is expected which was the largest category of exports to the US from India in 2019 with an estimated worth of 11 billion dollars.[42] Similarly, textiles have been identified as a strategic sector for retaliation. In terms of quantum of impact, a 25 per cent ad valorem hike on the aggregate level of trade has been proposed, which is approximately $55 million.[43] While the present proposed action is in the form of tariffs on goods, the USTR under Section 301 (c) of the Trade Act of 1974 permits imposing duties, fees, or other import restrictions on both goods and services of the country in question. Hence, although goods trade constitutes a much more significant aspect of India's trade with the USA, the prospect of retaliatory measures on the services sector, cannot be ruled out. Further given that the moratorium on customs duties on electronic transmissions is still in place, retaliation on e-commerce service providers itself is unlikely, with other sectors and modes of service supply that may instead face retaliation. This may include for example, issuance of visas for supplying services under Mode 4, i.e. physical presence of the service provider in the territory of another World Trade Organisation (**"WTO"**) Member.

The US retaliatory tariffs, if implemented, have the potential to initiate a trade war between various countries, if a global agreement to tax the digital economy is not reached. Going by some past instances of retaliatory tariff (i.e. the 25% tariffs imposed by the US on steel imports and 10% tariffs on aluminium imports) the adverse impact on trade was evident from the reduction of export of steel and aluminium to US after imposition of these tariffs by the Trump administration.[44] The imposition of these tariffs by the Trump administration resulted in the Indian government imposing retaliatory tariffs worth US$ 1,395 million on imports from the US.[45] In context of the ongoing debate on the IF Agreement, the OECD has warned that a trade war caused by unilateral DSTs could in the worst-case scenario reduce global GDP by more than 1% annually.[46] Reports also suggest that exporting nations are generally more susceptible to the tariff war than their larger counterparts, presumably because contractual obligations between importing and exporting firms are much weaker.[47]

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39. KPMG. 2021, July 22. Taxation of the digitized economy: Developments Summary, Available at https://tax.kpmg.us/content/dam/tax/en/pdfs/2021/digitalized-economy-taxation-developments-summary.pdf
40. James J. Nedumpara, Skirmishes over Digital Service Taxes: The Perils and Systemic Costs of Section 301 Actions, Trade, Law and Development, Summer, 2021 Vol. XIII, No. 1
41. https://ustr.gov/sites/default/files/enforcement/301Investigations/Proposted_Action_India_FRN_March.pdf
42. https://ustr.gov/countries-regions/south-central-asia/india
43. https://www.business-standard.com/article/economy-policy/us-readies-tariffs-on-select-indian-goods-over-equalisation-levy-121032700907_1.html
44. Prema-chandra Athukorala. Trump's Trade War: An Indian Perspective (2020) by the Asian Economic Panel and the Massachusetts Institute of Technology
45. **ibid**
46. Statement of the OECD on 12 October 2020. It can be accessed at: https://www.oecd.org/tax/international-community-renews-commitment-to-address-tax-challenges-from-digitalisation-of-the-economy.htm
47. Prema-chandra Athukorala. Trump's Trade War: An Indian Perspective (2020) by the Asian Economic Panel and the Massachusetts Institute of Technology

5.Impact on trade

Further, as has been seen in the case of the Steel and Aluminium tariffs imposed by the US, such unilateral action also runs the risk of challenges at the WTO's dispute settlement body. Unilateral retaliatory action is not permitted under the WTO rules and has in the past been considered a violation of Article 23 of the WTO Dispute Settlement Understanding.[48] This is because the WTO rules vest the WTO dispute settlement system with the sole authority to determine the existence of violations of WTO rules and to authorize appropriate levels of retaliation in return. Such unilateral action may also independently violate other WTO obligations of the United States. In the present scenario as well, there is a possibility that countries affected by the retaliatory tariffs may challenge these at the WTO, thereby leading to an escalation of the conflict and further souring of bilateral relations. In the context of India as well, India has in the past raised WTO disputes against inconsistent action by the United States and given the significant monetary impact of such potential retaliatory tariffs on India, it may not shy away from action at the WTO.

As such the authors of this paper are of the view that unilateral actions, either on the tax or trade side are not the ideal approach in any given situation. Such measures undermine multilateral institutions and approaches, create more uncertainty and volatility which will in turn decrease overall investment, trade and economic activity or at the very least increase costs of doing business, all of which ultimately result in reduced consumer welfare.

Thus, resolving this thorny tax issue is key for resumption of trade talks with the USA and preventing a potential trade war or escalation. Given the ambitious target to increase the share of exports in India's GDP, a cohesive approach towards tax and trade policy may be considered. Therefore, a holistic view considering the tradeoffs between different trade and tax policy aspirations of the Government may result in a better overall position.

48. WTO, WT/DS152/R 'United States – Section 301-310 of the Trade Act of 1974 – Report of the Panel', 22 December 1999, para 7.126. Summary provided in https://www.wto.org/english/tratop_e/dispu_e/cases_e/1pagesum_e/ds152sum_e.pdf.

6. Tax Certainty and Attracting Foreign Investments

Coming to investments, a stable tax system and tax certainty are a key factor for attracting foreign direct investment.[49] Past surveys have indicated that tax certainty in corporate tax and VAT are important factors for taking investment decisions. Unclear taxes, conflicting approaches or lack of effective dispute resolution mechanisms were considered as increasing tax uncertainty.[50] The recent 2020 taxpayers charter seeks to build trust between the tax payer and tax authorities as an aspect of increasing investor certainty.[51] With a view to reduce tax disputes and increase tax certainty the Government has in recent years stepped up efforts on multiple fronts. Introduction of dispute settlement schemes such as Vivaad se Vishwas, to making amendments to settle the indirect transfer controversy or improving the efficiency of the Mutual Agreement Procedure process with more disposals in lesser time, efforts have been made to improve tax certainty.

However, the lack of clarity in the scope and implementation of many DSTs, as well as the inconsistent practice across jurisdictions is likely to increase tax certainty based on those standards.

Unilateral amendments or approaches have seen setback in recent times with the roll back of retrospective application of indirect transfer taxes. In the aftermath of unfavourable rulings in Cairn and Vodafone arbitration cases, there has been an attempt to restore investors' confidence in India's commitment to ease of doing business recognising the importance of foreign direct investment in the recovery of India's economy.[52] It has been noted that INR 5,000-10,000 crores in revenue is not that important for India when it has a budget of INR 30 lakh crores, as opposed to complying with international commitments and shoring up investor confidence.[53] Signing up to the global tax deal would certainly increase tax certainty through the removal of unilateral levies, their inconsistent application and by bringing in an effective dispute resolution mechanism as set out in Pillar One.

49. IMF and OECD, **2019 Progress Report on Tax Certainty: IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors,** June 2019, https://www.imf.org/external/np/fad/pct/pdf/Progress%20Report%20G20%20Tax%20Certainty%202019.pdf

50. IMF and OECD, **Update on Tax Certainty: IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors,** July 2018, https://www.oecd.org/tax/tax-certainty-update-oecd-imf-report-g20-finance-ministers-july-2018.pdf, p. 5

51. https://www.businesstoday.in/opinion/columns/story/india-withdraws-retro-tax-what-next-305830-2021-09-03?utm_source=btweb_story_share

52. https://www.moneycontrol.com/news/business/explained-why-did-government-take-a-u-turn-on-retrospective-tax-law-what-does-this-mean-for-the-vodafone-cairn-arbitration-cases-7283721.html

53. https://economictimes.indiatimes.com/news/economy/policy/retro-tax-amendments-will-end-legacy-cases-bring-tax-certainty-revenue-secretary-tarun-bajaj/articleshow/85076489.cms?from=mdr

Annexure – I

This analysis is being made subject to the following assumptions:

- We have relied upon two data sets for covering the Indian companies –
  - **Fortune India 500 List** – It covers data of the Indian listed companies for the year ending March 2020.
  - **Business Standard March 2021 report** – It covers data of the Indian unlisted (public and private) companies for the year ending March 2019 and March 2020.
- We have assumed Euro to INR conversion rate as 1 EUR = 87 INR. Accordingly, the Euro 20 billion threshold and Euro 750 million threshold should be INR 1,74,000 crore and INR 6,525 crores respectively. We have covered all the companies from the above sources which have revenue above INR 6,000 crores in a financial year as these may also be covered in future, being close to the threshold.
- Pillar One thresholds are applied on the Ultimate Parent Entity (**"UPE"**), on basis of consolidated accounts. However, in the data set there are few companies which are subsidiaries and not the parent entity. Due to lack of availability of the data, we have not been able to test such entities at UPE level.
- Even if a UPE does not satisfy the Pillar One thresholds, then also it could be subject to Pillar One on segment basis. Due to limitation of data, we have not undertaken an in-depth analysis for testing the thresholds at segment level. This may require further analysis, particularly with respect to conglomerates that conduct activities in different industries.
- The IF Agreement does not define the scope of regulated financial service or extractive industries. The Pillar One October 2020 blueprint defines these sectors; however, they are in reference to consumer facing business. Hence, we have classified the Indian companies as per our understanding of financial service and extractive industries. The actual classification may depend on the definition finally agreed.
- The analysis done in this note may not be descriptive of all Indian companies and is limited based on the data sets indicated above.

Analysis and Results:

- Only 7 Indian companies may satisfy the revenue threshold of Euro 20 billion. Of these 7 companies , 5 (Reliance Industries[54], IOC, ONGC, SBI, BPCL) may fall under the extractive or financial service industry and hence be out of scope.
- The other 2 companies i.e. Tata Motors and Rajesh Exports may not satisfy the profitability threshold of 10%.
- Hence as per current financial data, none of the Indian companies may be within scope of Pillar One if the threshold for applicability of Pillar One is Euro 20 billion.
- TCS's revenue (INR 1,61,541 crore) is close to the Euro 20 billion threshold (approx. INR 174000 crore). Further, it also satisfies the profitability threshold as it is operating on a 20% margin. Hence, there is a probability that TCS may be in-scope of the Pillar One in near future.

54. Reliance Industries Limited has disclosed 5 segments in its annual report for the year ending March, 2021. Majority of the revenue is from Oil to Chemical segment and it may fall under extractive industry. The Retail segment is second in terms of revenue generation, with annual revenue of INR 1,53,818 crore for year March, 2021 . However even the Retail segment may not satisfy the revenue threshold of Euro 20 billion (INR 1,74,000 crore).

Annexure – I

- Around 314 Indian companies (listed and unlisted) have earned revenue above Euro 750 million (INR 6,525 crores).
- Of these 314 companies, 122 companies should fall under the extractives and financial services industry. Hence, only 192 companies may fall under Pillar One scope, subject to profitability threshold.[55]
- Applying the profitability threshold (10%), only 44 companies may be within scope of Pillar One if the revenue threshold is reduced to Euro 750 million.

55. Please note that as per reports, Indian government is pushing for Euro 1 billion threshold as against the current Euro 20 billion.

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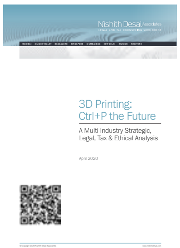

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Cracking The Anti-Dilution Formula	M&A Lab	July 2020
India Takes a Tough Stand on Neighbouring Apps	Regulatory	October 2020
India: Payments in E-Commerce Sector Set for a New Innings	Regulatory	October 2020
High Court in India Reaffirms The Need for an Individual's 'Right to be Forgotten'	Technology Law	December 2020
India: Proposed Unique Data Sharing Framework in the Fintech Sector	Technology Law	November 2020

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Tax, Trade and Investments

An Indian Policy Perspective

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