

# India **Tax** Insights

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In this issue



# Foreword

We are pleased to present the 20th edition of our magazine *India Tax Insights*.

The impact of coronavirus (COVID-19) has been profound. The rapid spread of the virus has strained local medical infrastructures, led to restrictions on travel and social contact, and created unprecedented disruptions to the global economy. Given the significance and speed of the economic impact of the virus, governments have adopted comprehensive policy responses to support the economy and protect people's jobs and incomes. One pressing issue - which has been a priority of the international community for several years - is to reform the international tax system to address the tax challenges arising from the digitalization of the economy, restore stability to the international tax framework and avoid the risk of further uncoordinated, unilateral tax measures which could trigger trade sanctions. The COVID-19 crisis has exacerbated these tax challenges even further by accelerating the digitalization of the economy and increasing pressures on public finances. The current context of the COVID-19 pandemic makes the need for a solution even more compelling than when it was first considered. Governments have responded through increased spending on healthcare and by providing unprecedented levels of financial support to both businesses and workers to cushion them from the economic blow of this crisis.

This edition of our magazine contains insightful articles on recent tax and fiscal policy developments. The articles cover topics ranging from global tax policy reset amidst geopolitical developments, implications for the Union Government's FY 2021-22 Budget arising from the resource gap created by COVID-19 induced fiscal stimulus and production-linked incentives to boost make in India etc.

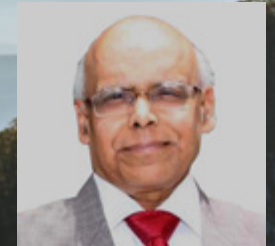
In this shifting tax environment, keeping abreast of changes is essential. We hope this publication helps you monitor the issues and understand the drivers behind key tax and regulatory developments and changes happening in India and around the globe. We look forward to your feedback and suggestions.



# In this issue



# COVID-induced bulge in resource gap: implications for center's FY22 budget



**Dr. D.K. Srivastava**

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## Introduction

The central government's gross tax revenues were affected by three major events during the period FY18 to FY21. Firstly, with the introduction of the Goods and Services Tax (GST) in July 2017. Secondly, when corporate income tax (CIT) reforms were implemented in FY20, and finally, when COVID-19 hit the economy and government tax revenues in FY21. The first two events comprised major tax reforms. However, all these eroded center's tax buoyancy and the tax-to-GDP ratio. The center's non-tax revenues and non-debt capital receipts also fell relative to GDP during these years.

Even as the resource side of the central budget weakened, there has been a greater need to finance fiscal stimulus since the GDP growth rate started falling even before the COVID-19 shock. The real GDP growth which peaked at 8.3% in FY17 steadily fell to 7.0% in FY18, 6.1% in FY19 and further to 4.2% in FY20. With this erosion in growth, the central government was required to uplift its expenditure so as to stimulate growth. In FY18 and FY19, it did not succeed in this endeavor and in fact by FY19, its expenditures fell to 12.2% of GDP from 12.8% in FY17. In these years, the center was focused on keeping the fiscal deficit under control as close to the Fiscal Responsibility and Budget Management (FRBM) norms of 3% of GDP. It relaxed fiscal deficit considerations in FY20 and further in FY21, as per projections, so as to uplift total expenditures to 14.1% of GDP in FY21. Thus, available resources to the central government have fallen while expenditures were increased, giving rise to a large bulge in budgetary resource gap which must be financed by borrowing. EY estimates that this resource gap bulge may be a little less than 7% of GDP in FY21. This has serious implications for the conduct of fiscal policy in the medium term.

## Revenue trends and evolution of resource gap

Table 1 highlights the erosion of buoyancy of center's gross tax revenues during FY17 to FY22. It is shown that the estimated gross tax revenue in FY21 at INR17.2 lakh crore is exactly equal to their level in FY17. This is as if the central government lost the four intervening years effectively showing zero growth in its gross tax revenues. This is also the period in which the GST and CIT reforms took place. These reforms led to some revenue erosion which may be for a limited period.

**Table 1: Actual and estimated magnitude of key fiscal aggregates**

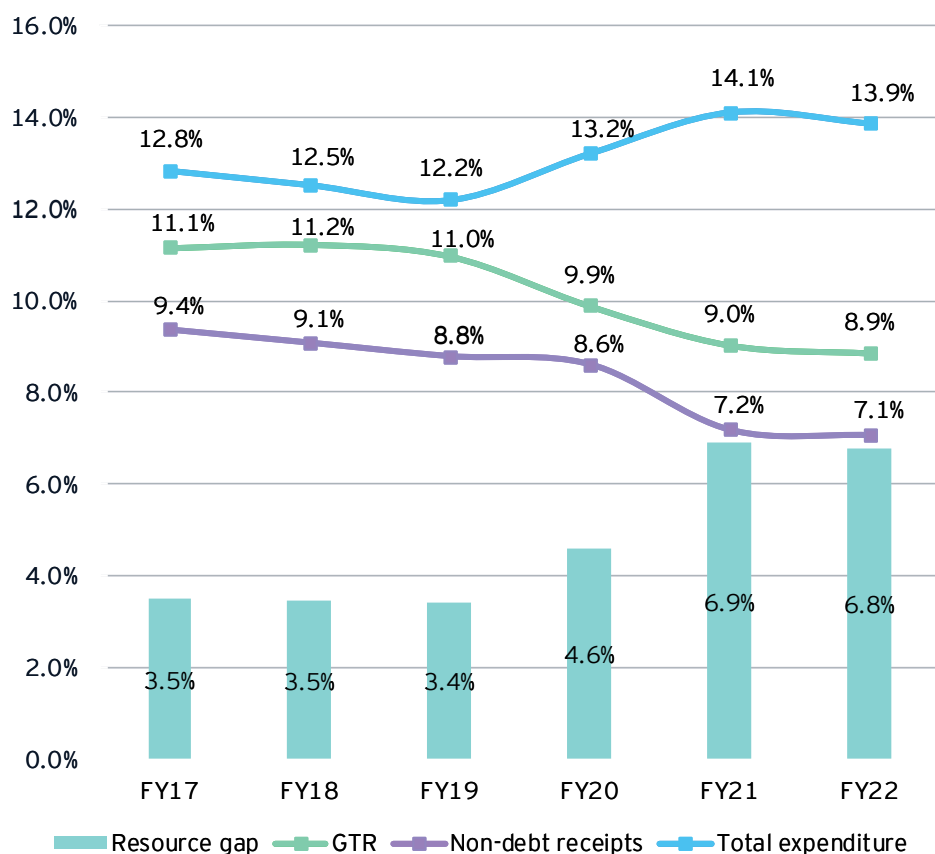
Item	INR lakh crore						% to GDP		
	Gross tax revenues (GTR)	Net tax revenues	Non-tax revenues	Non-debt capital receipts	Total Non-debt receipts	Fiscal deficit	Total budgetary resources = total expenditures	Fiscal deficit	Total budgetary resources
<b>FY17</b>	17.2	11.0	2.7	0.7	14.4	5.4	19.8	3.5%	12.8%
<b>FY18</b>	19.2	12.4	1.9	1.2	15.5	5.9	21.4	3.5%	12.5%
<b>FY19</b>	20.8	13.2	2.4	1.1	16.7	6.5	23.2	3.4%	12.2%
<b>FY20 (CGA)</b>	20.1	13.6	3.3	0.7	17.5	9.4	26.9	4.6%	13.2%
<b>FY21 (E)</b>	17.2	11.6	1.7	0.4	13.7	13.1	26.9	6.9%	14.1%
<b>FY22 (P)</b>	18.9	12.8	1.9	0.5	15.1	14.5	29.5	6.8%	13.8%

Source (basic data): CGA, Union Budget documents and EY estimates; (E = estimated), (P=projected)

The center's non-tax revenues peaked in FY20 at INR3.3 lakh crore but are estimated to be significantly lower in FY21 due to the pandemic and may not do much better in FY22 as well. In FY20, the reason for the increase in non-tax revenues was an ad hoc payment of special dividend by the Reserve Bank of India (RBI) which may not be repeated in future years.

Chart 1 highlights the budgetary resource gap bulge that is estimated to rise to 6.9% of GDP in FY21. If weak revenue growth trends continue, fiscal stimulus based on borrowing might be required to support GDP growth. As such, the budgetary resource gap may continue for some more time calling for continued departure from the FRBM norms.

**Chart 1: Major fiscal aggregates as % of GDP: evolution of resource gap bulge**



Source (basic data): CGA, Union Budget documents and EY estimates

## Union budget prospects of FY22

The FY21 budget outcomes will provide base figures for the FY22 budget. If the government adheres to the already-announced FY21 borrowing target of INR12 lakh crore<sup>1</sup>, amounting to 6.3% of the estimated FY21 nominal GDP<sup>2</sup>, there would be a contraction of (-)4.3% in center's total expenditure with respect to FY20 actuals. Fiscal deficit in FY21 would have to be increased to 6.9% of GDP if center's total expenditure is to be kept at least equal to the FY20 expenditure levels. This implies that there would be no effective fiscal stimulus. For a tangible fiscal stimulus, fiscal deficit would have to be increased further. This large dependence on borrowing results from weak revenue prospects of both tax and non-tax revenues in FY21.

There was a contraction in center's gross tax revenues even before the COVID-19 shock hit the Indian economy. In FY20, these revenues fell by (-)3.4%. In FY21, the contraction is expected to be sharper. Available information for the first seven months in FY21 indicates that there has been a contraction of (-)16.8% in gross tax revenues and (-)48.2% in its non-tax revenues. EY assesses that for the full year, center's net revenue receipts may show a contraction of (-)21.0%. The central government's non-debt receipts have been obtained by adding center's non-debt capital receipts to their net revenue receipts. This is estimated to show a contraction of (-)21.7%. The corresponding magnitudes are given in table 1. These numbers may be considered as estimated base figures for FY22 union budget aggregates. Given structural changes made in the GST and CIT in recent years, nominal tax revenue growth rate may be expected to be less than the nominal GDP growth rate.

1 Announced on 8 May 2020 ([https://www.rbi.org.in/Scripts/BS\\_PressReleaseDisplay.aspx?prid=49792](https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=49792))

2 As per the IMF World Economic Outlook, October 2020

The expected buoyancy of center's gross tax revenues in FY22 may be similar to that in FY19 at 0.8. In fact, in FY20, it had fallen to (-)0.5. The International Monetary Fund (IMF) has projected India's FY22 nominal GDP growth at 12%. It would be unrealistic if the Ministry of Finance (MoF) considers growth in center's gross tax revenues at any rate higher than 10%. Thus, center's gross tax revenues may be estimated for FY22 at INR18.9 lakh crores. Given the overall likely profile of non-debt receipts, the center may have to incur a fiscal deficit of 6.8% of GDP in FY22 to ensure growth in central government's total expenditure of 10.0% over FY21. This level of growth in expenditure in FY22 would be required to support the country's growth.

# CONCLUSION

It is almost a compulsion that in order to take real GDP growth closer towards its potential, the center may have to augment its budgetary expenditure relative to GDP. This might be difficult until tax and non-tax buoyancies improve significantly. Until that happens fiscal deficit may have to be kept close to the range of 6%-7% of GDP, nearly 100% more than the FRBM target. Growth may have to be sacrificed if the government attempts to reduce the country's fiscal deficit. This is a difficult choice. The central government may also consider revising the FRBM norms instead of sacrificing the growth.

# Global tax policy reset amidst geopolitical developments

**E**conomic recovery is still shaky, and many governments are taking on additional debts to provide stimulus to economies to recover from the pandemic's impact. At the same time, tensions related to trade and technology continue. Countries are also gaining considerable interest in tax and trade policies of the US post elections.

In this backdrop, EY Tax Leaders from across jurisdictions discussed the emerging tax policy trends at the recent International Tax Conference organized by CII with EY as the technical partner.



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Asia Pacific Transfer  
Pricing Leader, EY

**Ray Beeman**

Co-leader, Washington  
Council, EY

**Matthew Mealey**

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**Sudhir Kapadia**

National Tax Leader,  
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**Sudhir Kapadia:** There are some interesting proposals in the Biden-Harris tax policy. One is an extension of the earlier policy on Global Intangible Low-tax Income (GILTI) regime, where the penal tax is sought to be increased. Second is the increased focus of the government on make in America and the third one is the offshore tax or offshoring penalty which would impact countries like China as well as India because the penalty seeks to cover goods as well as services. It also effectively raises 3% tax on the basic tax rate in the US. What do these proposals mean for companies in the US, and everyone else around the world?



**Ray Beeman:** The outcome of the election really resulted in a divided government in the US. So, the general belief is that some of the more-ambitious Biden campaign tax proposals are probably on ice or status quo for the time being, which includes the increase in the corporate tax rate and some of the more significant changes to the international tax rules that were only enacted back in 2017. But there are some areas where the divided Congress could work together, where there's mutual interest of both parties. These include spending on infrastructure, which I'm sure will involve tax policy, and the whole discussion around supply chains and onshoring/made in America.

The tax policy that Biden introduced is a combination of carrots and sticks. The carrot is providing tax incentives to move activity into the US. For instance, there's investment tax credit of 10%. But the offshoring tax penalty, or stick, is focused on round tripping of manufacturing. Not many details are available, but there's a mention of call centers and services. We are advising people to keep a close eye on whether the two sides decide to work together on some things over the next couple of years.



**Sudhir Kapadia:** Matt, any specific views you have on some of these proposals, and particularly some of these novel kind of concepts like offshoring penalties? Some of the large EU countries seem to have unilaterally gone ahead and come out with measures on taxing digital commerce or digital businesses. Is there a convergence between how Europe is looking at digital taxation and how India and possibly China are looking at it, which is very different from the earlier Organization for Economic Co-operation and Development (OECD) and non-OECD divide between developed and developing markets? There are US companies who are digital giants and there seems to be a friction in terms of tax base of other countries where digital businesses are being consumed. Do you see that there will be a convergence between the US and EU's viewpoints on some of these contentious areas?



**Matt Mealey:** At the moment I don't see that convergence. The European view is that the new US administration will have a different style but not a substantively different policy. I think that anti-globalization or more economic national self-interest measures are expected to continue in the US. I personally predict that they will accelerate and manifest within the EU.

The EU is shifting stands towards a more careful or higher barrier for protection of the European single market from outside access. The way that will manifest itself in the EU is through taxes on borders for importation of products that are not compliant with the EU's green standards. This kind of taxation is based on the principle that we either want something to be made here of, or, if it's made elsewhere, we want it to be made in accordance with our own standards.

Look at what happened in the US after the Base Erosion and Profit shifting (BEPS) initiative. The US mainly adopted the BEPS minimum standards, but they also did two things which were different. Protecting the US taxable base even when there's substance on the other side, and even when there's no tax advantage on the other side.



**Matt Mealey:** And, they have the Global Intangible Low Tax Income (GILTI) regime, which kind of does the same thing. It creeps to the headquarter tax base, even when there's no abuse offshore. In a way, those are precursors to what you see with BEPS 2.0 and the idea of minimum tax proposals.

So, I don't think we will see harmonization. Where it is likely to manifest itself is in the EU's response to digital taxation. BEPS 1.0 was all about artificial or perceived artificial structures. But digital tax is about a fair share of a digital supply chain, particularly when there's very limited market nexus but a lot in market sales. Tax planning or tax avoidance has nothing to do with allocation of profits. The European Union's vision of what needs to change is, coincidentally, highly focused on business models of a small handful of very successful US multinationals. So, the stage is set for a degree of conflict.

**Sudhir Kapadia:** We had a series of reforms in the US in 2017, we have seen BEPS proposals 1.0, 2.0 and we have seen other countries' responses very early. When you have such complex laws, will it not lead to interpretation issues and controversies galore?



**Luis Coronado:** GILTI and BEPS have driven US multinationals to reconsider how and where they are holding some of their businesses. Nearshoring is one of the aspects, but they are also looking at other perspectives. For instance, IP and restructuring of their businesses. They are also looking perhaps at tax rates and countries where they are not going to be subject to penalties and payments before GILTI's inclusion.



**Luis Coronado:** This is the opportunity for some of those governments, that are in the middle of a restructure, to determine issues such as exit taxes or restructuring charges and so on. There would be substance principle, but, income may still be subject to inclusion in another location. Or, as some of the emerging markets have done, there may be non-deductibility of some of those payments if they're not being subject to rate of tax, or, the amount of deductions may be limited. Those certainly are issues that need to be taken into account. Some of the restructurings have led to controversies and clearly, some of these measures are embedded in the BEPS Pillar 1 and particularly Pillar 2.

**Sudhir Kapadia:** Matt, regarding the whole concept of market jurisdiction and articulation of a policy which spells out taxation of digital activities - in principle the digital models should be taxed on the same basis as a bricks and mortar company with permanent establishment or business presence. But from a plain reading, it appears that any kind of digital activity, even of traditional businesses, is sought to be taxed additionally on the basis of market access, etc. The first one itself is going to result in a lot of uncertainty. But we don't know how the second one will play out because that has the specter of a far greater and uncertain tax liability in the hands of regular companies just because they have an add-on digital play. So, on these two pillars, what's the view from Europe and their global implications?



**Matt Mealey:** I find the two pillars ferociously difficult. BEPS 1.0, in a way, was quite simple. We had an international taxing system which did not allow an income to be taxed at all or expenses to be deducted twice. That was not very sensible. We also had an international taxing system that allowed profits to be moved around the world without substance moving around the world and that did not seem very fair. So, countries agreed that that these practices were bad, and consensus was relatively easy to win. That's what BEPS 1.0 is all about - making the international tax world more transparent and more coherent.



**Matt Mealey:** BEPS 2.0 is more difficult for me. New business models have been born which allow a company to participate in the economic life of a country without any substance. You don't get any taxing jurisdiction in traditional ways. That's really what the European view of Pillar 1 is all about. We need to fix that. We can't have businesses participating in economic life of our country without paying any tax.

The international tax framework begins to get difficult for political more than academic reasons. As the US sees it, you are taxing a jurisdiction over a small number of fantastically successful American companies that have innovated, and their innovation has enhanced the whole world. But why shouldn't we enlarge Pillar 1 to bring in all IP rich businesses who make profits in the market and give them a greater market share? It seems to me that this approach has a good, powerful political validity but is divergent from theoretical underpinnings of the first bit of Pillar 1.

As BEPS 2.0 has started with a degree of controversy in it, I feel the speed with which the countries have moved towards consensus has been really slow. A series of documents are in search of a consensus. I feel that Pillar 2 has hardly any intellectual or academic underpinnings. It simply provides for a minimum tax to pay for the reallocation in BEPS 1.0. By way of the income inclusion rule, most of the large business headquarters are in the G7. So, if the G7 gave up some taxable basis with Pillar 1, then they get back on the basis of Pillar 2. In the absence of intellectual underpinnings for the project, I can see why the consensus is slow to emerge. I still feel there are significant divergences between the EU and the US and also the UK and the EU.



**Sudhir Kapadia:** Ray, let's start with divergences on these two pillars between the US and EU. Do we see, in the new administration, more of tactical responses, both tax and non-tax?



**Ray Beeman:** We are in the middle of a transition to a new administration. The personnel in the US who've been involved in this issue for the Trump administration, are all going to be replaced in a few months. The rest of the world recognizes that probably it needs to give the Biden administration some time to fill these positions and bring everybody up to speed. This is one area in tax policy where there's a lot of agreement and even suspicion at the same time.

The US kind of threw everybody for a loop when it decided that it wants Pillar 1 to be a safe harbor. Will the new Biden administration take that kind of a position on Pillar 1 or will they drop that and approach it the way everybody else has been approaching it that remains to be seen. The current OECD project will probably see some stylistic differences, but the tax policy mat remain the same as it was as the Congress does not want the US companies to be targeted. And that raises the whole scoping issue.

Presumably, this whole OECD negotiation will come to conclusion in 2021. The US has already adopted Pillar 2 in the form of GILTI and Base Erosion and Anti-abuse Tax (BEAT). So, we're going to be in a unique position in terms of how that gets implemented. If there is no consensus, countries are going to take unilateral measures on their own and some already have. We have also seen the Trump administration's response by way of tariffs.

A lot of people are hopeful that Biden administration will come up with a different approach that might be more multilateral and focused on resolving these issues rather than immediately going to tariffs. What's ironic about the whole thing is that the US has a federal system where states have their own tax systems. Several of them have already started to adopt digital services taxes. How the Biden administration is going to respond to unilateral measures is uncertain right now because the personnel who will make those kinds of decisions just aren't there yet.



**Sudhir Kapadia:** If we look at Pillar 1 and the objective of dispute resolution, it is a frank acknowledgement that the proposals are complex and there will be disputes which will need to be resolved depending on political factors and democracies around the world. How would the dispute resolution mechanism work? How effective would it be, and will we see more court cases if all of this gets implemented?



**Luis Coronado:** I think tax certainty is very important. The process to prevent and resolve disputes is critically important. We recognized the need for dispute prevention and resolution process up-front even back in BEPS 1.0. Pillar 1 is a much-wider network, trying to bring consensus amongst countries on application of the amounts and how they're going to be split. An important aspect is how much trust there will be in the dispute resolution panels and, once you have those panels in place, whether the countries will all agree to them. The alternative of having a panel to look into controversies and the trust placed in it is the key to reduce dispute.



**Sudhir Kapadia:** Ray, in the US, some of the proposals in the Biden campaign talked about capital gains tax rates being pegged at normal taxation levels and removing concessional rate. Biden proposals contain some wealth tax proposals as well. Do you think that post COVID-19, with debt scenario on the government books playing out, we will see rising taxation in a country like the US?



**Ray Beeman:** Well, we often ask whoever's in power, if we have to raise taxes to cover all the deficits we've accumulated. The pandemic itself has taken our debt-to-GDP ratio above 100%, which economists view as a red line. This issue can be framed in two different parts. First, is there a fiscal trigger for addressing deficits in the US - whether it's through tax increases or spending? The short answer is no. We have big entitlement programs in the US that are not sustainable over the next decade, notwithstanding all the stimulus and relief that's been enacted on top of existing deficits. Interest rates are still zero. Inflation is zero. The bond markets are still functioning here with no expectation. So, from a fiscal standpoint, no price has been paid to this point for running these deficits. Next year, the Congress is likely to increase the statutory debt ceiling.

On the revenue aspect, I still remain skeptical. The divided Congress may agree on raising taxes in a significant way that the Biden campaign had proposed whether it's capital gains or the corporate rate. Frankly, they are dwarfed by the actual size of our deficits and debts. It will be interesting to see as we get around this time of next year, what the discussion looks like in the US. However, I am skeptical that the US will adopt a new tax base. We as a political system, are different - incremental and not dramatic. For instance, we've talked about value-added tax (VAT) for a long time, and it hasn't gone anywhere.





**Sudhir Kapadia:** Matt, post COVID-19, do you think the UK or other countries in Europe will be forced to look at more punitive taxes, going forward?



**Matt Mealey:** I do think we're going to see fiscal tightening after we get through the COVID-19 crisis in Europe. The policy angles are precisely the same as the US. The political situation is different because the Constitution of the different countries is different and some of the countries are more geared up to do big things quickly than the US by virtue of their political systems.

I do think we're going to see fiscal tightening after we get through the COVID-19 crisis in Europe. The policy angles are precisely the same as the US. The political situation is different because the Constitution of the different countries is different and some of the countries are more geared up to do big things quickly than the US by virtue of their political systems.

We will also see more protection of the EU tax base, something closer to an Anti-Tax Avoidance Directive that draws on the thinking in Pillar 2. And then, there could be new taxes to tackle the deficit and support the wider policy objectives. These may include waste taxes, carbon taxes and financial transaction taxes. It could even be wealth taxes, digital taxes, solidarity taxes or one-off taxes on accumulated value for sectors that did well out of the COVID-19 crisis.

It is difficult to predict how many fiscal measures are driven at the EU's level and how many at member state level. The UK, because it's leaving the EU, has exactly the same policy issues. It has to repair its balance sheet in due course. Everybody believes that it is heading towards 100% debt-to-GDP. When do we do that and how do we do it? I feel that there will be increase in taxes and no stone will be left unturned. It will be the same kinds of taxes that the European Union is looking at.

The UK also has a very difficult five-year policy agenda. While they need to repair the balance sheet, there is also a very strong conviction in both civil service and the government that they need to improve their competitiveness, which is eroded by leaving the EU. I think that there's a policy desire to be cheaper than the EU or become less taxed jurisdiction than the EU, or increase the UK's competitiveness, which makes it a very difficult tightrope to walk.



**Sudhir Kapadia:** Luis, we haven't discussed an important country like China in all of this, both in terms of what China's position is when it comes to digital taxation - in specific Pillar 1 and 2 - and what is its situation post COVID-19. Do you see any such measures in China as well which we just discussed for the US and for the EU countries?



**Luis Coronado:** China is a part of BEPS Inclusive Framework, but I'm not sure that the country is fully convinced that this is the way forward. I believe a number of industries in China will be greatly affected by BEPS and they are still in a ramping-up mode. They feel that perhaps some of the measures penalize growth. So, I believe China will make their contributions, but clearly they're not driving any of this discussion. Singapore is much-more involved. It is a hub for many multinationals, it could be a paying location.

The second point regarding the impact of COVID-19, I believe that many countries are preserving at the moment, trying to keep jobs, trying to keep businesses going. The financial responsibility or prudence will eventually get there. Governments need to look at their budgets, replenishing their reserves, and whether they're going to apply new taxes, or retain only the current taxes and be more efficient in expanding the taxpayer base through enforcement. We do expect a lot of controversy with or without new taxes. Something to keep an eye on are the COVID-19 papers being produced by different countries and figuring out where their areas of focus are going to be.

We are awaiting a COVID-19 paper on transfer pricing (TP) from the OECD to give guidance to taxpayers on the issues that they should be looking at in anticipation of the fact that we would be looking at defending this year's TP positions with documentation in a year or two. The taxpayers need some guidance today at what they should be looking into to make those positions defensible. For instance, the benchmarking and the right comparable. So, I believe that there is plenty to do in this space.

*Footnote: The document has been released by the OECD on 18 Dec 2020.*



## Summing up

The global tax policy continues to be fluid with countries responding to the economic and geopolitical developments in their own way, the common focus being protecting their domestic economies, supply chains and tax base. The consensus on BEPS 2.0 remains elusive. Tax reforms in the US, including international tax, are likely to be firmed up in the later part of 2021 as new leadership and administration takes over. However, the US has already adopted some of the Pillar 2 proposals, reflected in GILTI and BEAT provisions. There are significant divergences between the EU and the US and the UK and the EU and a harmonization in their views on tax treatment of MNCs is unlikely in the short term. The EU firmly believes that businesses cannot be participating in the economic life of a country without paying any tax. Globally, as governments look at their budgets, replenish their reserves, and decide whether they should apply new taxes or be more efficient in expanding the taxpayer base through enforcement, an increase in tax controversy is expected. A dispute minimization/resolution panel is to look into the controversies and the trust placed in it by all countries will be the key to make dispute minimization work.

# Global tax policy reset amidst geopolitical developments

# Why participating in DGTR investigations is good for Indian businesses



**Agneshwar Sen**

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**T**he Directorate General of Trade Remedies (DGTR) in India is the nodal governmental agency for conducting trade remedial investigations. It is an investigative body that examines complaints of unfair trade by foreign exporters and recommends imposition of trade remedial measures, such as anti-dumping duty, countervailing duty and safeguard duty, or physical import restraints in case of import surges. The expectation of the DGTR is cooperation from the parties to the investigation in terms of providing requisite data and information that may be needed to fairly arrive at a conclusion on whether trade remedial measures is at all required to correct distortions of trade caused due to any unfair trade practice of foreign exporters.

In any typical trade remedy investigation, the interested parties are the domestic industry manufacturing a product that submits a complaint about an unfair practice, providing data and information as mandated by DGTR evidencing the cause for action on a preliminary basis. Such a complaint after an initial examination by the DGTR is made public in case the investigation is initiated. DGTR seeks information from foreign exporters of that product to India, Indian importers and users, consumer organizations and the interested public at large. A question arises on how to react to the notices from the DGTR seeking participation in the investigation. Should one participate and offer for examinations its data and information that may be confidential in nature or just not respond and react only if the trade remedial measure is finally imposed.

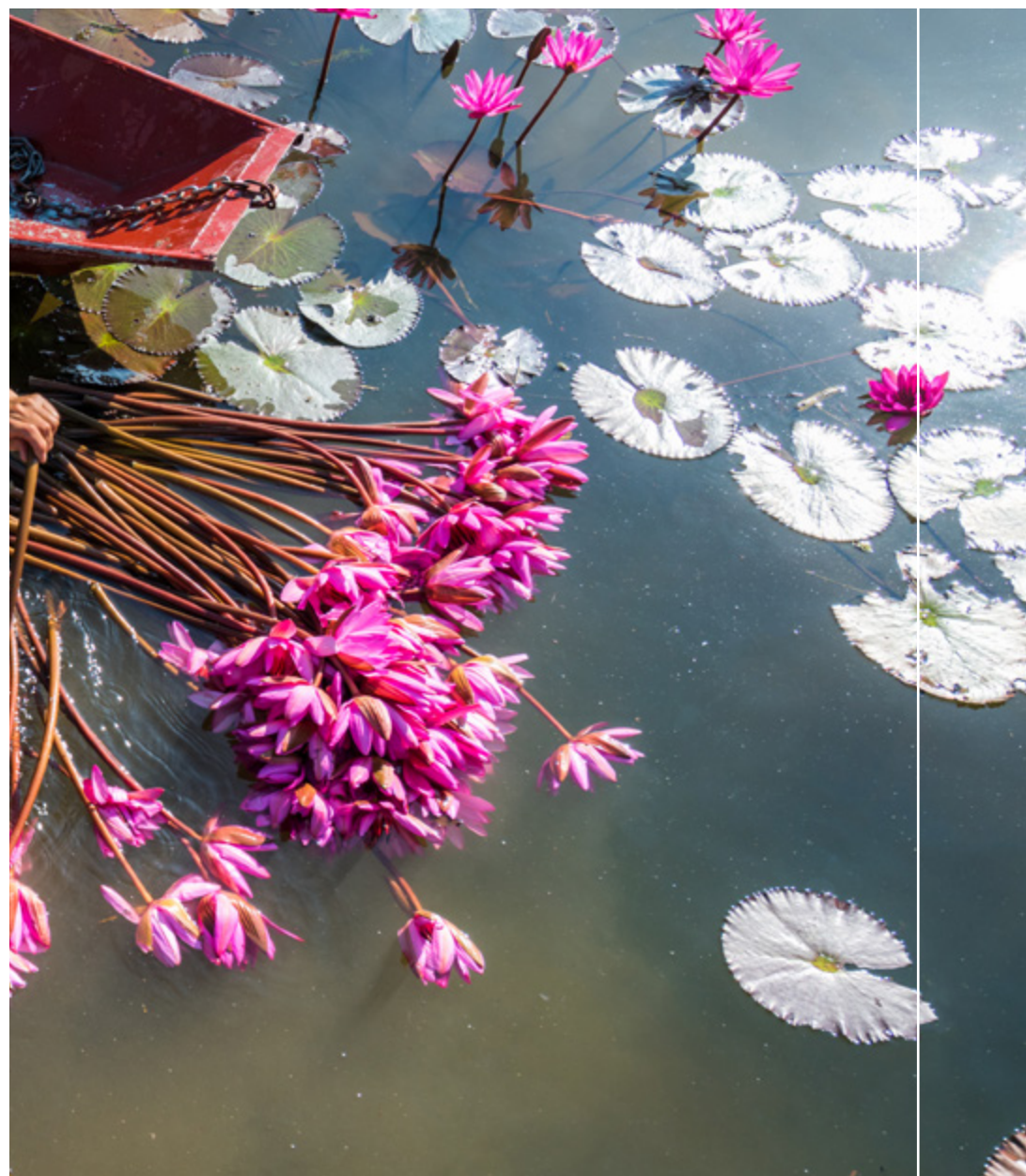


Participation in the investigation offers numerous advantages to the cooperating exporters, producers, importers, users et al. Depending on the nature of interest that a party to the investigation may have, the magnitude of advantages would vary. A participating producer exporter of a product subject to investigation will have the opportunity to prove that it is not involved in dumping or illegal subsidization. In the event of being able to prove nil dumping, a producer-exporter will not be subject to any duty. Even if the exporter has made dumped sales in the country of import, participation confers an opportunity to limit the remedial duty only to the extent of dumping and resultant injury.

In contrast, non-participation may result in significantly higher remedial duty, since the DGTR will rely on the data and information that is provided by the complainant's domestic industry. As a matter of practice, the DGTR presumes that non-participating exporter or producer may have the highest incidence of dumping and consequent injury to the domestic industry. Further, in the absence of contesting claim, the DGTR cannot decline the dumping and injury claims of the domestic industry. Therefore, cooperating exporters and producers can safeguard themselves against the duty determined on the basis of adverse inference.

Notably, a nil or lower duty on a producer or exporter gives comparative advantage over those who are subject to a higher duty. This effectively means that exporter/producer with lower duty will have higher demand and better market access as opposed to those who are subject to relatively higher incidence of duty. Non-participating exporters will lose its market share to cooperating ones with lower duties. Thus, participating parties will have commercial edge over non-participating in terms of capturing the market.

For the participating stakeholders, the legal recourse to the Appellate Authority or the Courts may be easier, whereas the non-participating stakeholders might find it difficult to challenge the decision of the DGTR. Therefore, for uncooperating parties to the investigation, there would be limited escape from duty once levied. There are many precedents where participating parties have challenged the DGTR's decision of duty recommendations and have successfully done away with duties to their advantage. As the recommended duty must be confirmed and ratified eventually by the Department of Revenue, Ministry of Finance ("the DOR") cooperating parties might have better standing to approach the DOR and seek repeal or revision of final duty. However, non-participating parties may be deprived of this specific opportunity. Given that confirmation of duty by the DOR is dependent on diverse economic and political factors related to countries subject to investigation, participating stakeholders can resort to representation to the DOR to be able to capitalize on favourable decision-making factors.





Since the trade remedial investigations are carried out in the manner prescribed by the WTO Agreements, any decision of the DGTR which is inconsistent with the provisions of the applicable Agreement can lead to complaint in the WTO. The aggrieved exporters or producers can approach their governments to address the inconsistent and illegal measures recommended by the DGTR and their governments can, in turn, take the matter to the WTO Dispute Settlement Body for consultation or dispute resolution. The recourse of escalating the order of DGTR is available only to participating exporters and producers of the subject countries to the exclusion of others. In order to persuade their own governments to seek the resolution under the framework of WTO laws, participating exporters and producers must have complied with the requirement of participation in the investigative proceeding. In the event that none of the interested parties from a subject country participates in the investigation, even the government of subject country loses substantial ground to seek resolution in the WTO. Particularly in the context of anti-dumping investigations, the governments of the subject countries are parties to the investigation only for the purposes of the notification of the investigation and are not necessarily privy to the ratio decidendi followed by the DGTR. Therefore, participation of the exporters and producers becomes even more critical to be able to challenge the orders of the DGTR under WTO mechanism for dispute resolution.

Thus, it is apparent that participation has scores of advantages for all the parties having opposing business interest to the complainant. Conversely, the non-participation has serious implications of losing out in existing markets by having to endure trade remedial duties or import quotas with very limited scope of redressal before these measures come to an end, often after several years.

Credits:  
**Sanjay Singh,**  
Senior Manager, EY India

# How businesses need to navigate through the new normal of digital tax administration



**Sameer Gupta**

Tax Markets Leader, EY India



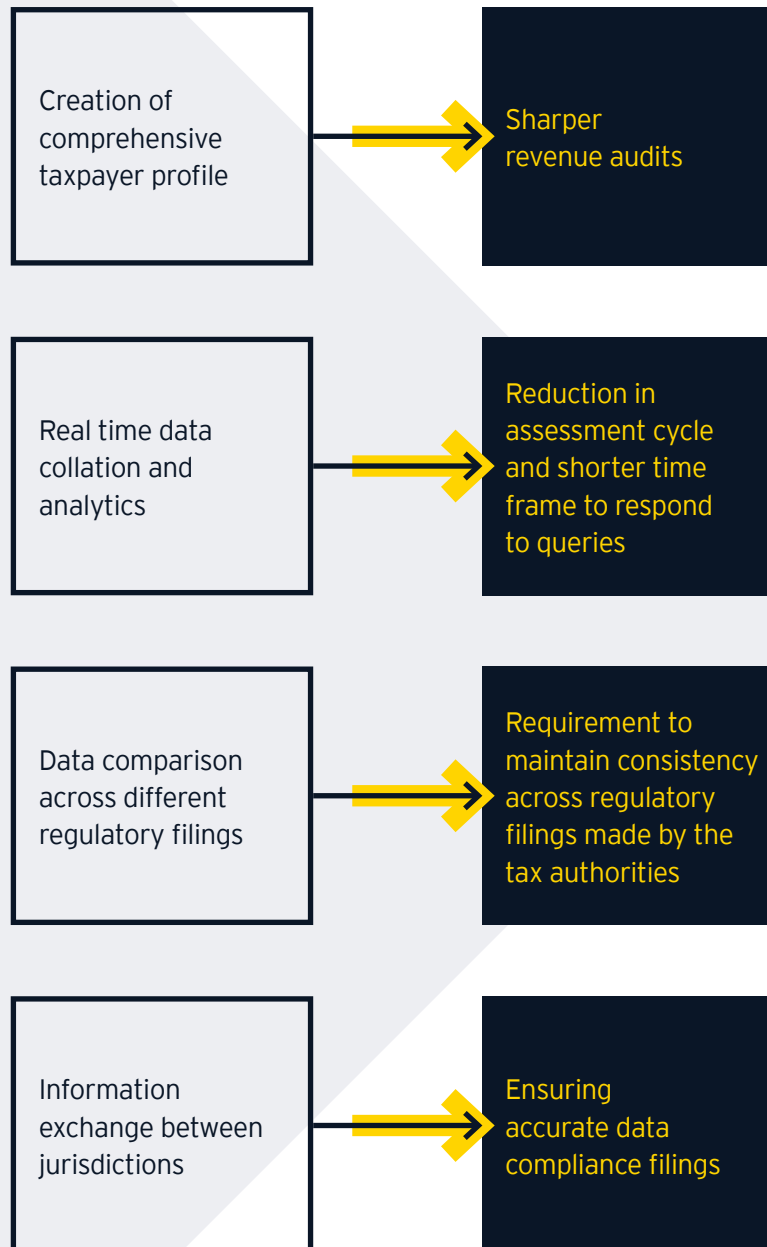
**Rahul Patni**

Digital Tax leader, EY India



**T**he Indian tax administration has expanded its reach through technology in a major way, starting with implementation of GST, further augmented by incorporating e-invoicing for large as well as medium businesses. On the direct tax side, the authorities can be seen taking major steps through a comprehensive overhaul of the policies and the supporting infrastructure. These include a new compliance portal, enabling comprehensive taxpayer profiling through data exchange between regulators and analytics. The depth of this data pool is only expected to deepen, with other data driven initiatives such as amendment to TCS law and the new avatar of Form 26AS which is transforming from a mere income-tax credit statement to a comprehensive tax book capturing significant transactions, GST details, etc. However, the tax administration's recent shift to faceless assessments and appeals is unprecedented since it is a technology-enabled systems and process driven change in a form never seen before.

The above initiatives in India and overseas are essentially linked by the same set of overarching goals: to expand the tax base and help increase compliance levels. Clearly, the Indian tax administration is bracing itself for an era where sharper and intelligent audits would become the new normal. However, the flight from the past to the future could turn out to be turbulent for taxpayers who find themselves off guard with the new rules of the game.



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*The aforementioned issues may amplify in the current circumstances where work from home is a part of the new normal, and the tax, compliance and finance teams are challenged with additional issues of remote working - a feature which is undoubtedly here to stay. CFOs may also need to ensure that the respective teams stay connected, have centralized access to required data including dated documents and maintain digital workflows to ensure consistency in operations.*

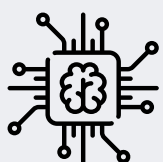
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Captured below is a snapshot of some of the most common problem statements faced by the tax function in the industry, and our experience around how digitally advanced tax teams have handled them.



## Utilization of team bandwidth in repetitive tasks and manual processes

This is an age-old issue, further accentuated with increase in compliances and resource crunch due to COVID.



Smart Tax functions have found a solution in form of robotics process automation ('RPA'), which involves computer program coded to take on tasks which are repetitive in nature, have a fixed process flow and require processing of a very large number of transactions.

RPA offers several advantages such as near 24x7 working capability, very high degree of accuracy, confidentiality, etc with pay back as low as few months in some cases.

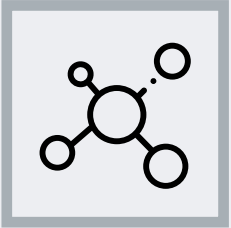
There are also point solutions available which seek to automate the entire life cycle of compliances such as TDS and TCS, and not just return preparation - companies should explore these platform-based solutions and not just quick fix return preparation software. Another example could be to use specialist platforms for areas such as litigation.

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By bringing in bots to take on human-intensive and repetitive work, we have been able to drastically reduce our tax compliance process period and build efficiencies within the tax team to focus more on analytical and strategic driven activities

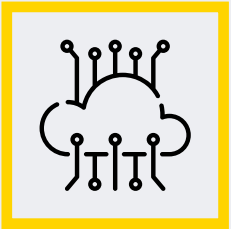
- Tax head, Tata Sky



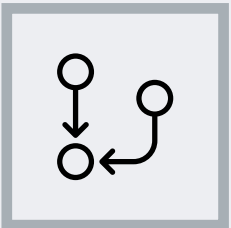


## A “Connected Tax” function needed in the remote working environment

Working remotely, juggling through multiple statutory deadlines, co-ordinating with several stakeholders for data, etc is part of the everyday life of a tax executive.

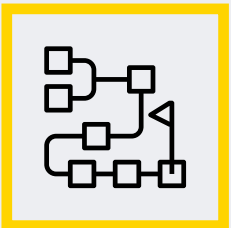


Creation of a “Connected Tax” function by integrating critical compliances, deadlines, tasks and data at one place on a cloud-based platform would go a long way. Tax Directors would not need to constantly worry about missing of deadlines, last minute escalations and reduce individual dependencies.



## Current operating model for Tax Function has not evolved for several years

Whilst the tax world has evolved fast in the past decade or so, operating model of tax functions, especially in large companies, has not kept pace in many cases. This issue is a rather consistent one, with about 90% survey respondents submitting that they are exploring changes in their current operating model.



Resultantly, in last 12-18 months, we have seen several large corporates wanting to re-look at the operating model for tax function. They are looking at creating Tax SSCs and CoEs, either standalone or together with finance function. Special attention is being given to tax finance transformation and ERP implementation projects.

These operating model changes are fundamentally changing how tax function is working and delivering value to business. Tax directors, who can manage to create a business case of inclusion of tax in these change events, may reap medium to long term benefits.

**~90%**  
survey respondents submitted that they are **exploring changes** in their current operating model



## More connected tax regulators – quality of data is an issue

Taxpayers would need to create a common data source for compliance filings, in order to create a single source of truth and ensure consistency in filings.

Leading organizations need to have a vision of a One Tax function, aided by a platform that seeks to achieve this goal - this would include creating a comprehensive leveraged data pool for all compliance and reporting requirements (for example, GSTR 1 and Tax collected at source).



## Building competencies in-house

Rightly so, many businesses prefer to outsource the Tax function to channelize efforts and resources towards partnering with business and adding value. They are increasingly looking towards buying digitally enabled tax services from specialists vs building all capabilities in house.

It creates ample opportunities to transform the tax function at a much faster pace, reduce costs and better risk management.



“

Our decision to outsource tax compliance to EY on a global scale was driven from the need to free up bandwidth of highly skilled internal resources for partnering with business and leaving the routine compliances to specialists like EY


- Nokia APAC Tax Head

*In a world where the quality of data is supreme and regulators are embracing developments to stay ahead in the digital race, businesses need to step up to the new normal. With the emergence of complex business models and unprecedented changes in the global tax environment require sharp focus on transparency. The digital wave is only getting stronger and the best way to thrive might be to embrace the change and ride along.*

Credits:

**Manoj Rathi,**  
Tax Director, EY India

**Nishant Verma,**  
Tax Manager, EY India



# How production-linked incentives can help boost the Indian manufacturing sector



**Bhavesh Thakkar**

Partner, Indirect Tax, EY India

Recent times have brought multiple policy initiatives for promoting the Indian manufacturing sector. The National Manufacturing Policy (NMP) was announced in 2011, aimed at enhancing the manufacturing sector contribution to national GDP. Thereafter, the 'Make in India' initiative of 2014 helped attract fresh investment and improve investor perceptions. A key component of these initiatives are the industrial incentives on offer.

Industrial incentives in India follow a partnered approach between the Central and State governments. While state incentives are comparatively popular, Central Government incentives have recently gained prominence. Initially targeted at select sectors, Central Government incentives schemes offered a capital subsidy/funding assistance equal to a fixed percentage of the investment. For example, the Modified Special Incentives Package Scheme (MSIPS) offered electronics sector investors a 25% capital subsidy. Similar schemes include the Pradhan Mantri Kisan Sampada Yojana (PMKSY) for food processing and the Amended Technology Upgradation Fund Scheme (ATUFS) for the textile sector.



While these initiatives aided a fresh inflow of investments, the following needs became apparent:

Widening the coverage of Central Government incentives to additional sectors for holistic growth



Creation of a large-scale domestic manufacturing ecosystem across priority sectors



The Government of India on March 2020 announced 'Production Linked Incentives' ('PLI') schemes, and they are a step in providing a boost to the manufacturing sector. Considering the vision for each identified sector, these define 'eligibility criteria' for investors through investment commitment, capacity creation and/or incremental turnover. Selected investors are offered a recurring cash subsidy computed as a fixed percentage of the manufactured sales turnover, for a specific duration. For example; the pharmaceutical sector is offered incentives at 5%-20% of sales for 4-6 years.

Operationally, these incentives are administered by the Centre through relevant ministries and typically involve the following steps:



The computation of incentives and related procedures are simplistic. After approval, selected investors are also allowed time to fulfill their investment commitments. The inbuilt evaluation and continuous monitoring mechanism in the schemes will ensure that performance standards are met. Further, there is certainty around the receipt of incentives given their direct linkage to capacity creation and sales.

The PLI initiative is indicative of the government's keen focus on scale and growth. Enabling an ecosystem for large scale players may ensure that the same incentives are available to smaller players and that they automatically draw in ancillary units.

The first tranche of PLI schemes was announced for three sectors in March 2020 with a budgetary allocation of approximately US\$ 7 billion. A second tranche of PLI schemes for ten additional sectors was announced in November 2020 by the Government of India, with a budget outlay of approximately US\$ 20 billion.

- 1 **Medical devices manufacturing**  
<https://pib.nic.in/PressReleasePage.aspx?PRID=1607485>
- 2 **API/DI/KSMs manufacturing**  
<https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1607484>
- 3 **Electronics manufacturing**  
<https://pib.nic.in/PressReleasePage.aspx?PRID=1607487>  
<https://pib.gov.in/PressReleasePage.aspx?PRID=1671912>

**Table 2: Proposed sectors under PLI and approximate budget outlay**

Sector	Budget Outlay
	US\$ billion (approximate)
<b>PLI tranche 1</b>	
Mobile phones and specified electronic components	5.5
Key Starting Molecules/Drug Intermediates/Active Pharmaceutical Ingredients	0.9
Medical devices	0.4
<b>PLI tranche 2</b>	
Advance Chemistry Cell Battery	2.4
Electronics and Technology Project	0.7
Automobiles and Auto Components	7.7
Telecom and Networking Equipment	1.6
Textile Sector	1.4
Food Products	1.5
Pharmaceutical Drugs	2.0
High efficiency solar photovoltaic modules	0.6
White Goods	0.8
Steel Products	0.9

Under tranche 1, 16 investments for large scale electronics (worth over US\$1.5 billion) were approved, with 215 and 28 applications received for pharmaceuticals and medical devices respectively. Detailed schemes for the second tranche are expected shortly.

Launched under the 'Atmanirbhar Bharat' initiative, this announcement comes at an opportune time when global investors are considering diversifying their manufacturing presence outside China (popularly called the China plus one strategy).

Manufacturers in India are also offered incentives packages by the State, allowing them to recoup approximately 30%-100% of their investment. These typically comprise of:

- ▶ Capital linked incentives with subsidy as a percentage of investment
- ▶ Expenditure linked incentives like power tariff subsidies, stamp duty reimbursement
- ▶ Sales linked incentives like SGST reimbursement, turnover based subsidy

States also offer significant investments ('mega' units) customized incentives packages.

Investors can avail incentives from both the Centre and the State simultaneously. The Central government also endeavors to provide financial relief to industry through measures like duty scrips on foreign trade transactions, reduced corporate tax rates etc.

Therefore, investors should extensively evaluate and pursue all incentives avenues to benefit from the holistic support intended by the government.

Since the success of these initiatives hinges on their implementation, the government should ensure swift approvals with timely appraisal and disbursement of funds, for all Centre and State incentives.

Extension of incentives to encompass service providers and globally relevant areas like climate change and sustainability would be a welcome next step. Ultimately, such end to end support from policy makers might position India as a lucrative global manufacturing destination.

Credits:  
**Prutha Pathak,**  
 Manager, Indirect Tax, EY India





# Union Budget 2021

Access relevant insights and in-depth analysis of Budget 2021 by our senior tax and policy professionals

# Global News

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- OECD releases BEPS 2.0 Pillar One and Pillar two Blueprint and invites public comments
- French Administrative Supreme Court rules digital marketing activities creates dependent agent permanent establishment
- Spanish Supreme Court confirms limits to dynamic interpretation of tax treaties on the beneficial ownership concept
- Russian Supreme Court addresses withholding tax on lease payments and classification for tax treaty purposes
- German Ministry of Finance (MoF) publishes guidance on German taxation of extraterritorial intellectual property



## OECD releases BEPS 2.0 Pillar One and Pillar two Blueprint and invites public comments<sup>1</sup>

On 12 October 2020, the OECD released a series of major documents in connection with the ongoing G20/OECD project titled “Addressing the Tax Challenges of the Digitalisation of the Economy” (the BEPS 2.0 project). These documents include the long-awaited report on the Pillar One and Pillar two Blueprint (the Blueprints).

The aim of Pillar One is to reach a global agreement on changing the allocation of taxing rights on business profits in a way that expands the taxing rights of market jurisdictions. Pillar Two addresses the development of global minimum tax rules with the objective of ensuring that global business income is subject to at least an agreed minimum rate of tax. The proposals under Pillar Two represent a substantial change to the tax architecture and go well beyond digital businesses or digital business models. These proposals could lead to significant changes to the overall international tax rules under which businesses operate. With regards to Pillar One, the Blueprints indicate that the follow up work on Pillar One will focus on resolving the remaining political and technical issues, which include essential elements of Pillar One, such as issues around scope, quantum, the choice between mandatory and safe harbor implementation, and aspects of the new tax certainty procedures.

As per OECD, the Blueprints does not reflect agreement by the member jurisdictions of the Inclusive Framework (IF) on BEPS because there are political and technical issues that still need to be resolved. However, the cover statement of the IF refers to the Blueprints as a “solid basis for future agreement” and states that the member jurisdictions have agreed to keep working “to swiftly address the remaining issues with a view to bringing the process to a successful conclusion by mid-2021.”

With the release of the Blueprints, the OECD also announced plans for consultations with stakeholders. It invited comments on all aspects of the Blueprints by 14 December 2020, with specific questions of particular interest laid out in a public consultation document. Over 250 MNEs and stakeholders’ comments were received on OECD’s Pillar 1 and Pillar 2 blueprints which are published by the OECD<sup>2</sup>. OECD is planning to host virtual public consultation meetings in mid-January 2021 to assist members of the IF in further refining the package and addressing remaining issues.

<sup>1</sup> Refer EY Global Alerts dated 19 October 2020 titled “OECD releases BEPS 2.0 Pillar One Blueprint and invites public comments” and OECD releases BEPS 2.0 Pillar Two Blueprint and invites public comments”

<sup>2</sup> Source - [www.oecd.org](http://www.oecd.org)



## French Administrative Supreme Court rules digital marketing activities creates dependent agent permanent establishment<sup>3</sup>

On 11 December 2020, the French Administrative Supreme Court ruled that an Irish tax resident entity (Irish Co) performing digital marketing activities through its French affiliate had a French permanent establishment (PE), even though contracts with clients were not formerly concluded in France by the affiliate.

In the facts, the Irish Co carried out digital marketing activities in Europe through local entities. It concluded for the French market an intercompany service agreement with a French related company (French Co). The latter was paid on cost plus basis for marketing assistance as well as management services, back office and administrative assistance.

The French Tax Authorities (FTA) performed a tax audit which resulted in the characterization of a taxable presence in France of the Irish Co through a dependent agent PE constituted by the French affiliate.

The Supreme Administrative Court concluded that the French Co, which habitually used its authority to decide on client transactions that were thereafter automatically ratified by Irish Co, was legally binding, and was therefore a dependent agent constituting a PE, even though that French Co did not formally sign contracts with clients in the name of Irish Co. The Court considered that while the template of client contracts, as well as pricing conditions, were determined by Irish Co, the decision to conclude a contract with a client, as well as all related tasks, were actually made and performed by the employees of French Co, with Irish Co merely rubber-stamping the contracts.

It is worth noting that the Supreme Court explicitly grounded its decision on the OECD comments published after the date of signature of the double tax treaty (DTT) concluded between Ireland and France (OECD comments, paragraphs 32.1 and 33, respectively published on 28 January 2003 and 15 January 2005). This may appear inconsistent with the Court's traditional position of only allowing reference to comments already published on the date of signature of the interpreted DTT.

This decision seems to be consistent with the OECD's Multilateral Instrument approach on dependent agent PE. In a digital economy context, this decision seems to pave the way to expand the interpretation of the concept "agent habitually exercising the authority to conclude contracts" by extending it to a situations where "the agent plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise" as per Article 5 of the OECD Model Tax Convention 2017.

<sup>3</sup> Refer EY Global Alert dated 18 December 2020 on "French Administrative Supreme Court expands its definition of dependent agent constitutive of a permanent establishment"



## Spanish Supreme Court confirms limits to dynamic interpretation of tax treaties on the beneficial ownership concept<sup>4</sup>

As a result of a tax audit dealing with the transfer pricing policies of a multinational group, a Spanish company (SpainCo) was deemed as paying royalty income to a related party in Switzerland. The Spanish tax audit considered that the 5% withholding tax rate applicable on royalty payments under the Spain-Switzerland Tax Treaty, signed in 1966, did not apply because the income recipient was not the beneficial owner, although article 12 of the Spain-Switzerland Tax Treaty dealing with royalty income does not require that the recipient of the royalty income is the beneficial owner. The Spanish tax audit in the tax assessment took a stand that the concept of beneficial ownership is applicable since treaties must be interpreted following the spirit of the Commentaries to the OECD Model tax Convention.

In addition to above, the Spanish tax audit also rejected the application of the 10% withholding tax rate to the royalty payments in accordance with the Spain-United States (US) Tax Treaty applicable at the time, on the grounds that no evidence was provided that a US entity was the actual beneficial owner.

The Supreme Court decided in favor of taxpayer (Spain Co) allowing the withholding rate under Spain-Switzerland treaty on the basis of following:

- ▶ The Commentaries are soft law, it cannot apply retroactively to a case where a prior rule was applicable. The Commentaries can be used as guidance as long as they refer to wording which has been expressly accepted by the signatories to the relevant tax treaty and to the extent they are not in contradiction to the “authentic interpretation” of such treaty.
- ▶ While beneficial ownership requirement was included in articles 10 and 11 of the Spain-Switzerland Tax Treaty (dealing with dividends and interest payments, respectively) in the 2006 Protocol, it was not included with respect to royalty payments, in article 12. The Supreme Court sees this as evidence that the signatories to the Treaty did not intend to require beneficial ownership for royalty payments.
- ▶ The approach that beneficial ownership is always applicable (as if it was “embedded” in the taxation system) is rejected as it could potentially override the actual intention of the states entering into a tax treaty.
- ▶ It is not acceptable to deny the benefits of a tax treaty based on lack of beneficial ownership and the indicia that the actual beneficial owner is resident in a third jurisdiction (the US) and then deny the application of the tax treaty with that third jurisdiction on the grounds that such beneficial ownership has not been evidenced.

This decision is extremely relevant for the interpretation and application of tax treaties that have not been amended in line with the latest versions of the OECD Model Tax Convention.

<sup>4</sup> Refer EY Global Alert dated 21 October 2020 on “Spanish Supreme Court confirms case law on limits to dynamic interpretation of tax treaties”

## Russian Supreme Court addresses withholding tax on lease payments and classification for tax treaty purpose<sup>5</sup>

In this case, the taxpayer (a lessee) did not withhold tax in Russia on the lease payments to lessor based in Belarus under Article 7 of the double taxation treaty between Russia and Belarus (the Treaty) dealing with Business Profits. The Russian tax authorities asserted that the taxpayer was obliged to withhold tax at source on the lease payments since income under the leasing agreement must be regarded as “other income” not exempt from taxation in Russia in accordance with Article 18 of the Treaty.

The lower courts in Russia supported the tax authority’s position, maintaining that since the Russian Tax Code treats lease payments as income that is taxable at source in Russia, while the Treaty does not contain specific rules concerning the taxation of such payments, the income in question should be treated as other income not expressly mentioned in the Treaty, taxed at 20% in Russia.

The Supreme Court rejected the lower courts’ conclusions regarding the classification of lease payments for the purposes of the Treaty, citing the following grounds:

- ▶ On Article 7 relating to Business Profits: This article establishes that an enterprise should be taxed in the state in which it carries on business. Exceptions are made for certain categories of income for which the Treaty sets forth special taxation rules. It follows that Articles 8 to 17 of the Treaty (dividends, interest, royalties, etc.) must be regarded as special rules that have priority over the general rule of Article 7 of the Treaty. The Supreme Court also points out that a similar approach is provided in the Russian Tax Code as far as the taxation of passive income is concerned.
- ▶ On Article 18 relating to Other Income: In order for this article to be applicable, it is essential to make sure that the payments in question are not among the particular types of income expressly mentioned in the Treaty. Since the courts did not make a proper assessment of the terms of the leasing agreement and the possibility of the lease payments being covered by Articles 8 to 17 of the Treaty, the classification of payments under the leasing agreement as other income cannot be considered justified.
- ▶ The courts must establish to which category of income covered by the Treaty, the lessor’s income belongs. In particular, the Supreme Court notes the article of the Treaty on the taxation of “interest” as potentially applicable to the disputed amounts of lease payments, which constitute income of the lessor from the provision of financing.

This is a landmark ruling in terms of understanding the Supreme Court’s approach to the taxation of “passive income,” and in particular income from leasing activities. The retrial should result in a definitive clarification of the courts’ position regarding the classification of lease payments as interest or other income for the purposes of the application of double taxation treaties.

<sup>5</sup> Refer EY Global Alert dated 22 October 2020 on “Russian Supreme Court addresses withholding tax on lease payments and classification for tax treaty purposes”

## German Ministry of Finance (MoF) publishes guidance on German taxation of extraterritorial intellectual property<sup>6</sup>

As per the German domestic law, where a non-German resident person licenses or sells Intellectual Property (IP) that is either registered in a German public register or where IP is exploited in a German permanent establishment (PE), Germany can claim a taxing right on such transaction. Both categories are referred to as “German-nexus IP.”

Under the plain language of the statute, a German taxation right may cover German-nexus IP right licensing or sale transactions which take place solely between German non-resident parties. However, in the past, the taxation of such extraterritorial IP right transactions was never enforced or addressed by German tax authorities, and until now, no administrative pronouncements, court cases or other authorities existed which would have addressed this area.

On 6 November 2020, the German MoF issued a “letter guidance” concerning the German non-resident taxation of income from rights which are registered in a German public register. The letter briefly states that the registration of IP rights in a German register is sufficient to trigger non-resident taxation of license or capital gains income derived from such rights, and that it is not required for any of the parties involved to be a German tax resident. According to the MoF, the payor of royalties derived from the licensing of such rights has to deduct and pay withholding tax and file a tax return with the German Tax Office. Also, the payee of licensing fees has to file a tax return with the competent local tax office, if the registered IP rights were licensed over an indefinite period of time, resulting in a sale of rights transaction which is not subject to withholding, but potentially to capital gains taxation.

The letter guidance abstains from discussing any other technical aspects which arise in the context of German nonresident taxation of IP rights, including the reach of any tax treaty protections.

The letter guidance raises various issues on its application. It is anticipated that the MoF may issue more detailed guidance in the future, in particular concerning the German rights transfer pricing allocation methodology.

<sup>6</sup> Refer EY Global Alert dated 6 November 2020 on “German Ministry of Finance publishes guidance on German taxation of extraterritorial intellectual property”



# EconoMeter

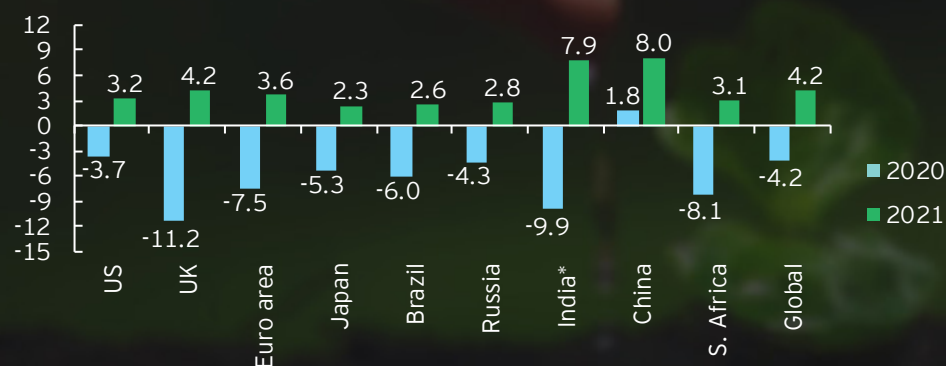
macro-fiscal trends



**1** Organization for Economic Co-operation and Development (OECD) projected a global contraction of (-)4.2% in 2020, with a contraction of (-)9.9% forecasted for India.

- ▶ The OECD has projected a global contraction of (-)4.2% in 2020 and a recovery of 4.2% in 2021 based on the assumption that the second COVID-19 outbreak would remain contained and the prospect of a widely-available vaccine towards the end of 2021 would help support confidence.
- ▶ The OECD assessed that by the end of 2021, the magnitude of global GDP would reach pre-crisis levels, helped by a strong recovery in China, but growth prospects differ significantly across major economies.
- ▶ Among selected Emerging Market Economies(EMEs) the sharpest contraction in 2020 is projected for India at (-)9.9%. The OECD assesses that there would be limited scope for additional fiscal measures and further reductions in policy interest rates would remain contingent on the inflation outlook. Growth is projected to increase to 7.9% in 2021 on a low base.
- ▶ China is projected to grow by 1.8% in 2020 and by 8.0% in 2021 led by strong investment in real estate and infrastructure, supported by policy stimulus and stronger credit growth, and improved export performance.

**Chart 1: Real GDP growth projections (in %, annual)**



Source: The OECD Economic Outlook, December 2020  
\*data for India pertains to fiscal year

**2** Real GDP contracted for the second successive quarter in 2QFY21 implying that the economy has entered into a technical recession.

- ▶ Real GDP contracted at a slower pace of (-)7.5% in 2QFY21 as compared to (-)23.9% in 1QFY21 due to phased relaxation of COVID-19 related restrictions leading to gradual resumption of economic activities.
- ▶ On the demand side, all the three components of domestic demand, namely, private final consumption expenditure (PFCE), government final consumption expenditure (GFCE) and gross fixed capital formation (GFCF) contracted in 2QFY21.
- ▶ Both PFCE and GFCF contracted at a slower pace of (-)11.3% and (-)7.3%, respectively, in 2QFY21 (Table 1).
- ▶ GFCE, which posted a growth of 16.4% in 1QFY21, contracted sharply by (-)22.2% in 2QFY21.
- ▶ In 2QFY21, both exports and imports contracted at a slower pace relative to that in 1QFY21. However, imports contracted at a sharper rate of (-)17.2% as compared to the contraction of (-)1.5% in exports in 2QFY21.

**Table 1: Real GDP growth (in %)**

Aggregate demand	2Q FY19	3Q FY19	4Q FY19	1Q FY20	2Q FY20	3Q FY20	4Q FY20	1Q FY21	2Q FY21
PFCE	8.8	7.0	6.2	5.5	6.4	6.6	2.7	-26.7	<b>-11.3</b>
GFCE	10.8	7.0	14.4	6.2	14.2	13.4	13.6	16.4	<b>-22.2</b>
GFCF	11.5	11.4	4.4	4.6	-3.9	-5.2	-6.5	-47.1	<b>-7.3</b>
EXP	12.5	15.8	11.6	3.2	-2.2	-6.1	-8.5	-19.8	<b>-1.5</b>
IMP	18.7	10.0	0.8	2.1	-9.4	-12.4	-7.0	-40.4	<b>-17.2</b>
<b>GDP</b>	<b>6.2</b>	<b>5.6</b>	<b>5.7</b>	<b>5.2</b>	<b>4.4</b>	<b>4.1</b>	<b>3.1</b>	<b>-23.9</b>	<b>-7.5</b>

Source: Central Statistical Organization (CSO), the Ministry of Statistics and Programme Implementation (MoSPI), Government of India; \*2nd advance estimates

AD: aggregate demand; PFCE: private final consumption expenditure; GCE: government final consumption expenditure; GFCF: gross fixed capital formation; EXP: exports; IMP: imports; GDPMP: GDP at market prices

3

*Real gross value added (GVA) contracted at a slower pace of (-)7.0% in 2QFY21.*

- ▶ On the output side, contraction in real GVA was lower at (-)7.0% in 2QFY21 as compared to (-)22.8% in 1QFY21.
- ▶ Three GVA sectors, namely agriculture, manufacturing and electricity et.al., together accounting for about 36% of the overall output, showed a positive growth in 2QFY21. While the agricultural GVA grew by 3.4% in 2QFY21, the GVA in manufacturing and electricity grew by 0.6% and 4.4%, respectively, in 2QFY21 as compared to a sharp contraction in 1QFY21.
- ▶ Contraction in construction and trade, hotels, transport, communication and services related to broadcasting was lower at (-)8.6% and (-)15.6%, respectively, in 2QFY21.
- ▶ Growth in public administration, defence and other services, and financial, real estate and professional services contracted at a higher pace of (-)12.2% and (-)8.1%, respectively, in 2QFY21 as compared to (-)10.3% and (-)5.3%, respectively, in 1QFY21.
- ▶ Nominal GDP contracted by (-)4.0% in 2QFY21, significantly improving from (-)22.6% in 1QFY21.

**Table 2: Sectoral real GVA growth (in %)**

GDP and GVA growth									
Aggregate output	2Q FY19	3Q FY19	4Q FY19	1Q FY20	2Q FY20	3Q FY20	4Q FY20	1Q FY21	2Q FY21
Agr.	2.5	2.0	1.6	3.0	3.5	3.6	5.9	3.4	3.4
Ming.	-7.0	-4.4	-4.8	4.7	-1.1	2.2	5.2	-23.3	-9.1
Mfg.	5.6	5.2	2.1	3.0	-0.6	-0.8	-1.4	-39.3	0.6
Elec.	9.9	9.5	5.5	8.8	3.9	-0.7	4.5	-7.0	4.4
Cons.	5.2	6.6	6.0	5.2	2.6	0.0	-2.2	-50.3	-8.6
Trans.	7.8	7.8	6.9	3.5	4.1	4.3	2.6	-47.0	-15.6
Fin.	6.5	6.5	8.7	6.0	6.0	3.3	2.4	-5.3	-8.1
Publ.	8.9	8.1	11.6	7.7	10.9	10.9	10.1	-10.3	-12.2
<b>GVA</b>	<b>6.1</b>	<b>5.6</b>	<b>5.6</b>	<b>4.8</b>	<b>4.3</b>	<b>3.5</b>	<b>3.0</b>	<b>-22.8</b>	<b>-7.0</b>

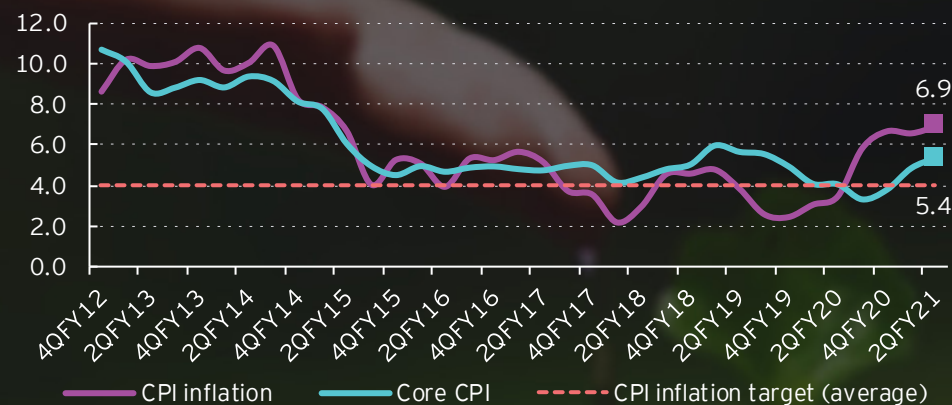
Source (Basic data): MoSPI

GVA: gross value added; Agr: agriculture and allied activities; Ming: mining and quarrying; Mfg: manufacturing; Elec: electricity, gas, water supply and other utility services; Cons: construction; Trans: trade, hotels, transport, communication and services relating to broadcasting; Fin: financial, real estate and professional services; publ: public administration, defence and other services

**4** The RBI retained its policy repo rate at 4.0% while maintaining an accommodative policy stance in its December 2020 monetary policy review due to upward pressure on CPI inflation.

- ▶ Consumer Price Index (CPI) inflation increased to a 25-quarter high of 6.9% in 2QFY21 from 6.6%<sup>1</sup> in 1QFY21 mainly due to rising inflation in fuel and transportation services.
- ▶ On a monthly basis, CPI inflation breached RBI's upper tolerance limit of 6% for the eighth successive month at 6.9% in December 2020.
- ▶ Core CPI inflation<sup>2</sup>, increased to a seven-quarter high of 5.4% in 2QFY21 largely reflecting increased taxes on fuel used for transportation.
- ▶ The RBI projects CPI inflation at 6.8% for 3QFY21, 5.8% for 4QFY21 and within a range of 4.6%-5.2% for 1HFY22.

**Chart 2: Inflation (y-o-y; in %)**



Source: MoSPI; Note: CPI stands for Consumer Price Index

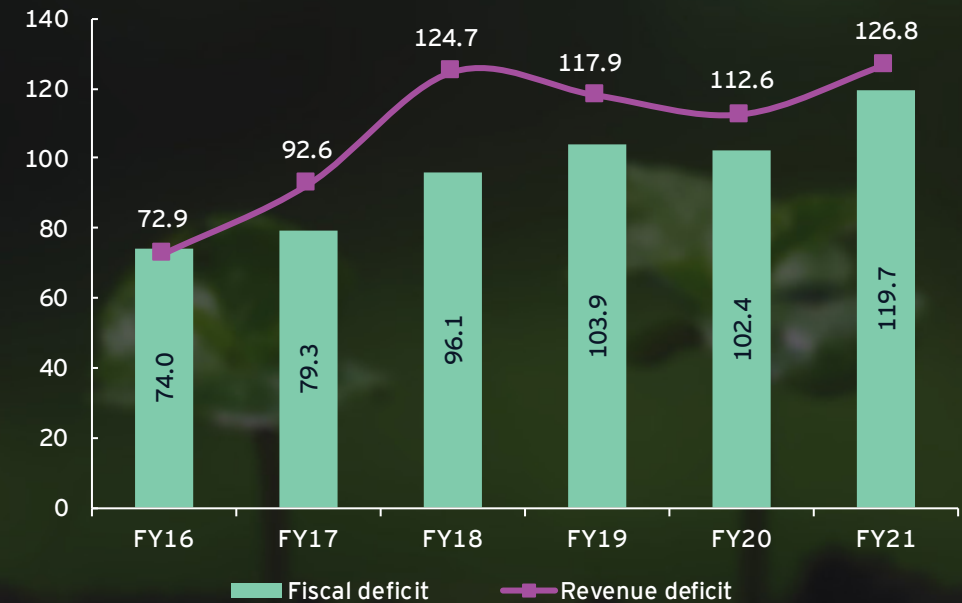
1 Headline CPI inflation for April 2020 and May 2020 have been imputed by the MoSPI; [http://www.mospi.gov.in/sites/default/files/press\\_release/CPI%20Technical%20Note%20on%20Imputation.pdf](http://www.mospi.gov.in/sites/default/files/press_release/CPI%20Technical%20Note%20on%20Imputation.pdf)

2 Core CPI inflation is measured in different ways by different organizations/agencies. Here, it has been calculated by excluding food and fuel and light from the overall index.

**5** Center's fiscal deficit during April-October FY21 stood at 119.7% of the budgeted target

- ▶ Center's fiscal deficit during April-October FY21 stood at 119.7% of the annual budgeted target as compared to 102.4% during the corresponding period of FY20.
- ▶ Center's revenue deficit during April-October FY21 stood at 126.8% of the annual budgeted target as compared to 112.6% in the corresponding period of FY20.
- ▶ In 1HFY21, center's fiscal and revenue deficits relative to GDP stood at 10.7% and 8.9%, respectively.

**Chart 3: Fiscal and revenue deficit as a % of budgeted target**



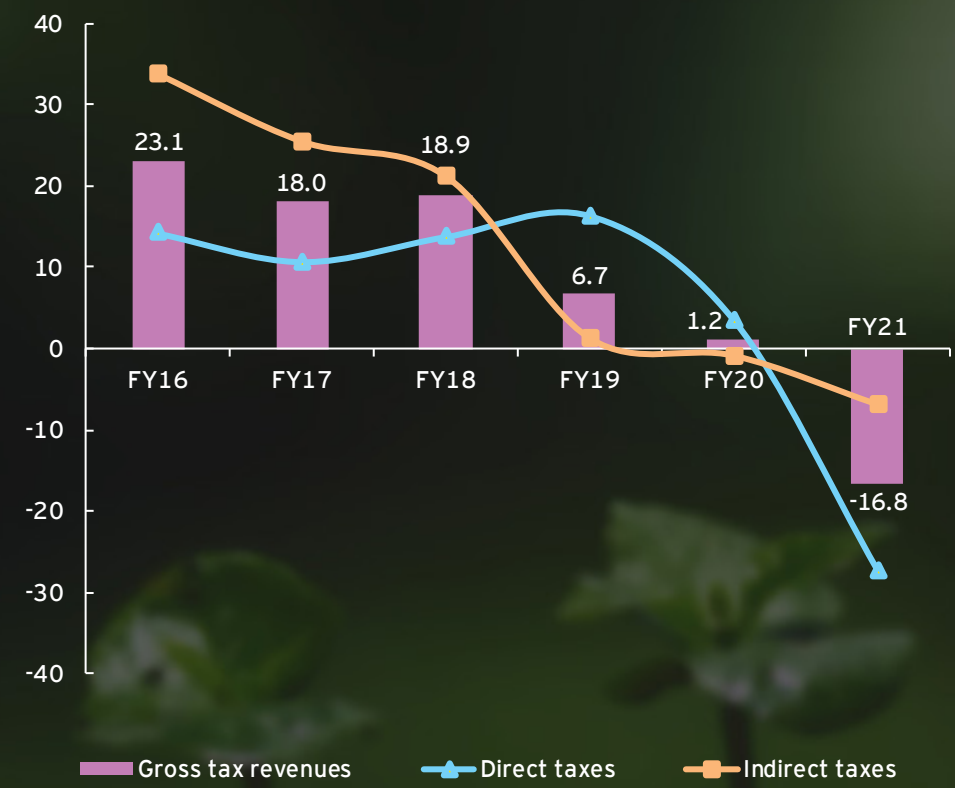
Source: Monthly Accounts, Controller General of Accounts, Government of India; Union Budget documents, various years

6

Gross central taxes witnessed a contraction of (-) 16.8% during April-October FY21

- ▶ Gross central taxes during April-October FY21 contracted by (-)16.8% as compared to a growth of 1.2% during April-October FY20. Both direct and indirect taxes contracted on a y-o-y basis during the first seven months of FY21.
- ▶ Direct tax revenues contracted by (-)27.3% during April-October FY21 as compared to a growth of 3.5% in the corresponding period of FY20.
- ▶ Indirect taxes (comprising union excise duties, service tax, customs duty, Central Good and Services Tax(CGST), Union Territory Goods and Services Tax (UTGST), Integrated Goods and Services tax (IGST) and Goods and Services Tax (GST) compensation cess) showed a contraction of (-)7.0% during April-October FY21 as compared to (-)1.0% during the corresponding period of the previous year.
- ▶ Center’s gross tax to GDP ratio stood at 8.5% in 1HFY21 as compared to the three-year corresponding average of 9.8%.

Chart 4: Growth in central tax revenues during April-January (in %, y-o-y)



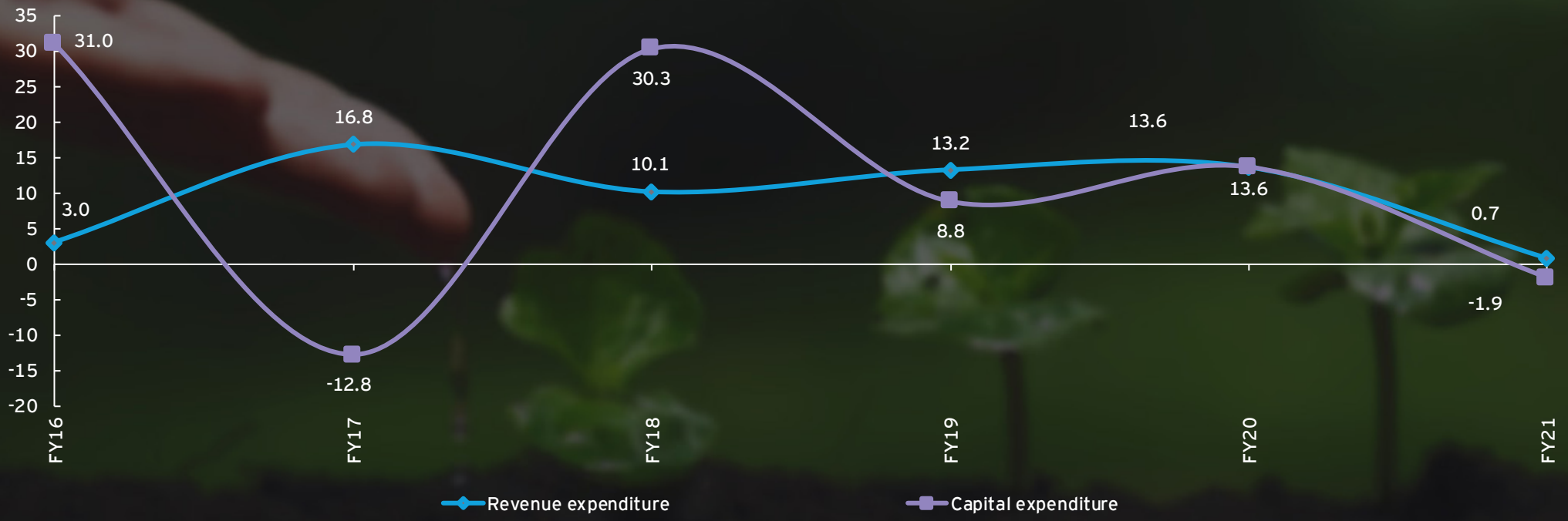
Source: Monthly Accounts, Controller General of Accounts (CGA), Government of India  
 Notes: (1) Direct taxes include personal income tax and corporation tax, and indirect taxes include union excise duties, service tax, customs duty, CGST, UTGST, IGST and GST compensation cess from July 2017 onwards; (2) IGST revenues are subject to final settlement; (3) other taxes (securities transaction tax, wealth tax, fringe benefit tax, banking cash transaction tax, etc.) are included in center’s gross tax revenues along with direct and indirect taxes.

7

During April-October FY21, center's capital expenditure contracted by (-)1.9% while revenue expenditure showed a subdued growth of 0.7%.

- ▶ Center's total expenditure during April-October FY21 grew by only 0.4% as compared to a growth of 13.6% during the corresponding period of FY20.
- ▶ Revenue expenditure grew by a meagre 0.7% during April-October FY21 as compared to 13.6% during the corresponding period of FY20.
- ▶ Center's capital expenditure showed a contraction of (-)1.9% during April-October FY21 as compared to a growth of 13.6% in the corresponding period of previous year.

Chart 5: Growth in central expenditures during April-October (in %, y-o-y)



Source: Monthly Accounts, Controller General of Accounts, Government of India

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