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A tax that served India's interests – no more

Genesis of the Equalisation Levy

- **Introduction of the Levy**: The 6% equalisation levy on online advertising was introduced in India through the Finance Act of 2016. This was done instead of incorporating it into the Income-tax Act.
- **Unconventional Approach**: By introducing it via the Finance Act, India ensured that companies could not use treaty protections to avoid the tax.
- **Primary Aim**: The primary aim of the levy was to address the low tax rates paid by major digital corporations globally, such as tech giants from the US, and to ensure that they paid a fair share of taxes in India.
- **Corporate Opposition**: Major digital corporations opposed the levy, as it disrupted their tax-saving strategies.
- **India's Proactive Stance**: Despite facing criticism, the levy was seen as India's proactive stance in addressing tax avoidance by global digital firms.

International Tax Challenges and India's Initiative

- **Evolving Global Tax Landscape**: While the global tax landscape was evolving to address tax avoidance, a consensus on how to tax digital companies had not been reached.
- **OECD's BEPS Initiative**: The Organisation for Economic Co-operation and Development (OECD) explored various options to tackle tax avoidance, but no clear international solution emerged.
- **India's Bold Step**: India took a bold step by becoming the first country to introduce the equalisation levy. However, it was viewed by many as a unilateral deviation from international tax norms.
- **Global Reaction**: Critics raised concerns about potential issues like double taxation and additional costs for consumers. Despite this, other countries were inspired by India's approach and began considering similar measures.
- **US Response**: The United States, where most major tech companies are based, took notice of India's digital tax initiative and became involved in the global debate.

The Struggle for a Global Tax Framework

- **Conflicting Positions**: As countries negotiated an international tax framework, significant disputes arose over how to allocate digital company profits between countries.
- **US vs. India**: The US favored taxing only the residual profits of digital companies, whereas India advocated for a more structured apportionment of profits based on where the digital companies operated.
- **Complications in Negotiations**: The negotiations at the OECD became increasingly complex as countries had differing opinions on how profits should be taxed.
- **US Engagement in 2021**: Under President Joe Biden's administration, the US renewed its engagement in global tax discussions, expanding the focus beyond just American tech giants.

India's Position and the Role of the UN

- **India's Commitment to OECD-led Talks**: India remained committed to participating in the OECD-led negotiations, but its influence was limited due to global economic power dynamics.
- **Limited Support for India**: While India received some support from African nations, it struggled to gain broader backing. As disagreements increased, some developing countries began looking for alternative tax frameworks.
- **UN Tax Convention**: In 2024, the United Nations (UN) received strong support from 110 nations for an international tax convention.
- **UN Proposal**: The UN tax committee proposed a simpler withholding tax to prevent double taxation, but like the OECD efforts, reaching a consensus remained difficult.
- **Alternative Models**: The UN initiative demonstrated that alternative models for digital taxation exist, offering countries more flexibility in protecting their tax interests.

Political Shifts and Trade Tensions

- **US Trade Representative Investigation**: In 2020, the US Trade Representative (USTR) investigated India's expanded equalisation levy, deeming it discriminatory against American tech companies.
- **US Retaliatory Threats**: In response, the US threatened retaliatory tariffs, which led India to withdraw its 2% levy.
- **Return of Donald Trump**: The risk of renewed tariffs resurfaced with the return of Donald Trump as president, leading to India's decision to withdraw the 6% equalisation levy in an effort to ease trade tensions with the US.

The Legacy of the Equalisation Levy

- **Criticism of the Levy**: Critics argued that the equalisation levy unfairly targeted specific companies and transferred costs onto consumers. However, without profit-based taxation, these criticisms lost weight.

- **Effect on Consumers**: While any tax can be transferred to consumers, there is no definitive evidence proving that the equalisation levy directly increased costs for consumers.

- **Revenue Generation**: Despite criticisms, the levy generated ₹40 billion in revenue in 2022, showing its effectiveness in raising funds.

- **Timing of Withdrawal**: The timing of the withdrawal is noteworthy, considering the lack of a global tax deal. Although India will no longer benefit from this revenue, the levy remains a significant example of how a developing country can assert its tax rights independently.

Conclusion

- **End of a Bold Measure**: The withdrawal of the 6% equalisation levy marks the end of a bold and independent digital taxation initiative by India. While it generated revenue, the measure faced significant international resistance.

- **Balancing National and Global Interests**: The decision highlights the challenge of balancing national tax interests with global trade and diplomatic pressures.

- **India's Ability to Assert Tax Rights**: Despite the withdrawal, India's equalisation levy demonstrated its ability to implement progressive tax policies to tackle the global issue of tax avoidance by digital corporations, without waiting for international consensus.

Source: https://www.thehindu.com/opinion/op-ed/should-the-free-movement-regime-between-india-and-myanmar-remain/article69383147.ece

In India, labour needs as much focus as capital

Employment Deficit and Its Implications

- Since 2017-18, India's working-age population grew by 9 crore, but formal sector jobs only increased by 6 crore, leading to a shortfall of 50 lakh jobs annually.

- This gap is filled by self-employment in rural areas and informal service jobs, raising concerns about job quality.

- Expanding formal sector jobs is becoming more urgent as the working-age population grows.

The Role of Technology in Reducing Labour Intensity

- Technological advancements are reducing labour intensity in production, with industries shifting to capital-intensive methods, even in traditionally labour-heavy sectors.

- AI and automation are expected to limit employment opportunities, especially for unskilled and semi-skilled workers.

Rising Capital Intensity in a Labour-Abundant Economy

- **Demand-Side**: Industries adopt capital-intensive techniques to improve productivity and reduce costs.
- **Supply-Side**: A shortage of skilled labour is driving automation. Only 10% of India's workforce has formal technical training, and many educated youth lack job-ready skills.

Impact of Capital Cost Reduction on Employment

- Technological advancements have reduced the cost of capital, making automation more affordable.
- Real wages have not risen significantly, making it cheaper for firms to invest in technology instead of hiring more workers.
- This shift has increased the services sector's contribution to GDP, while manufacturing stagnates and agriculture declines.

Skill-Biased Technological Change and Job Displacement

- New technologies favour workers with specific skills, leading to job displacement for those without these skills.
- Continuous skilling and upskilling are necessary to complement emerging technologies and machinery.

Government Initiatives to Bridge the Employment Gap

- **Expanding Production Capacity**: The government is promoting manufacturing output through initiatives like the Production Linked Incentive (PLI) scheme.
- **Incentivizing Labour Hiring**: The Employment Linked Incentive (ELI) scheme and internship programs encourage private firms to hire and train workers.

Challenges in the Implementation of the PLI Scheme

- Over 50% of PLI funding goes to specialized sectors like electronics and IT hardware, which require highly skilled labour, whereas job creation is highest in food processing and pharmaceuticals.

- The mismatch between budget allocation and employment potential in high-end sectors may limit job growth.

Effectiveness and Limitations of the ELI Scheme

- The ELI scheme subsidizes labour costs for private firms to encourage formal sector employment.
- However, the subsidies are short-term (2-3 years), raising concerns about long-term sustainability and whether the scheme leads to lasting employment and skill development.

The Need for an Integrated Policy Approach

- Policymakers must align production and skilling strategies for effective job creation.
- Coordination between ministries, revising the ELI scheme with graded incentives, and strengthening vocational training institutions are essential steps.

Role of Labour Regulations in Employment Generation

- Rigid labour laws encourage capital-intensive production.
- State governments need flexible labour policies to lower employment costs and incentivize hiring.

Conclusion

- To move up the global production value chain, India must invest in both the quantity and quality of its workforce.
- A dynamic policy framework focused on skill development and job creation is key to achieving a "Viksit Bharat."

Source: https://indianexpress.com/article/opinion/columns/in-india-labour-needs-as-much-focus-as-capital-9917022/