# INTERNATIONAL JOURNAL FOR LEGAL RESEARCH AND ANALYSIS

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ISSN: 2582-6433

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ISSN: 2582-6433

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ISSN: 2582-6433

# TAXATION OF CROSS-BORDER DIGITAL SERVICES: FROM EQUALISATION LEVY TO SIGNIFICANT ECONOMIC PRESENCE

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## Abstract

*The digitalisation of commerce has exposed the structural incapacity of source-based, permanent-establishment-centric international tax law to capture value created through remote, data-driven business models. This paper undertakes a doctrinal and analytical examination of India's journey through three successive - and at times overlapping - unilateral and multilateral responses to this challenge: the Equalisation Levy (2016-2025), the Significant Economic Presence ('SEP') rule under Section 9(1)(i) of the Income-tax Act, 1961, and the emerging Organisation for Economic Co-operation and Development ('OECD')/G20 Two-Pillar Solution, with particular reference to Pillar One's Amount A. Adopting a historical-doctrinal method supplemented by policy and quantitative analysis, the paper traces the legislative genealogy of the Equalisation Levy from its introduction as a 6% tax on online advertising in the Finance Act, 2016, through its 2020 expansion to e-commerce supplies, to its complete withdrawal by the Finance (No. 2) Act, 2024 and the Finance Act, 2025. It critically evaluates the treaty-compatibility concerns, double-taxation risk, and definitional overreach that plagued the levy, and assesses whether the SEP rule - now India's principal domestic nexus doctrine for digital income - is legally and administratively capable of filling the resulting vacuum, particularly given its continued subordination to India's bilateral tax treaty network under Section 90(2). The paper further situates India's experience within the global trajectory of the OECD Inclusive Framework, analysing the Multilateral Convention to Implement Amount A of Pillar One and the continuing stalemate in its ratification as of 2026. Drawing on statutory text, judicial precedent, OECD instruments, and empirical revenue data, the paper argues that India's abrupt withdrawal of the Equalisation Levy - undertaken substantially for trade-diplomatic rather than tax-policy reasons - has created a transitional governance gap that SEP alone cannot address without treaty renegotiation, Mutual Agreement Procedure reform, and domestic administrative capacity-building. The paper* *concludes with a set of calibrated recommendations for Indian policymakers pending global consensus on Pillar One.*

***Keywords:*** *Equalisation Levy; Significant Economic Presence; Digital Services Tax; Base Erosion and Profit Shifting (BEPS); OECD Pillar One; Amount A; Permanent Establishment; Nexus Rules; International Tax Law; Section 9(1)(i), Income-tax Act, 1961.*

## 1. Introduction

The international corporate tax framework erected after the 1920s League of Nations model treaties rests on two foundational premises: that taxable presence requires physical proximity, and that profit ought to be attributed to the jurisdiction where value is created through tangible factors of production.

The international corporate tax framework erected after the 1920s League of Nations fiscal studies rests on two foundational premises: that taxable presence requires physical proximity - the doctrine of the 'permanent establishment' ('PE') - and that profit ought to be attributed to the jurisdiction in which value is created through tangible factors of production.[1]

The digital economy has rendered both premises increasingly fictional. Multinational technology enterprises now generate substantial revenue from a jurisdiction's user base - through targeted advertising, data monetisation, platform intermediation and cloud-hosted services - without any requirement of physical presence, fixed place of business, or dependent agent within that jurisdiction. The OECD's Base Erosion and Profit Shifting ('BEPS') Project identified this mismatch in its Action 1 Report, concluding, somewhat controversially, that the digital economy could not be 'ring-fenced' from the wider economy but that its features nonetheless demanded structural rule changes.[2]

India, home to one of the world's largest internet user bases and a fast-growing digital consumer market, has been amongst the most assertive unilateral actors in this space. Between 2016 and 2021, India enacted three overlapping instruments: (i) the Equalisation Levy ('EL'), a 6% withholding-style levy on online advertisement payments introduced by Chapter VIII of the Finance Act, 2016; (ii) the Significant Economic Presence rule, inserted into Section 9(1)(i) of the Income-tax Act, 1961 ('IT Act') by the Finance Act, 2018 and operationalised through Rule

[1] League of Nations, Report on Double Taxation, Doc. E.F.S.73.F.19 (1923), prepared by Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp; see also Reuven S. Avi-Yonah, "International Tax as International Law", 57 Tax L. Rev. 483 (2004).

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

 ISSN: 2582-6433

11UD in 2021; and (iii) a 2% EL on non-resident e-commerce operators, introduced by the Finance Act, 2020. By 2025, in a dramatic reversal driven substantially by trade-diplomatic pressure from the United States and India's stated commitment to the OECD/G20 Inclusive Framework, both limbs of the EL had been fully withdrawn - the 2% e-commerce levy with effect from 1 August 2024 under the Finance (No. 2) Act, 2024, and the residual 6% advertisement levy with effect from 1 April 2025 under the Finance Act, 2025.

This paper interrogates the resulting regulatory architecture. It asks three connected questions. First, did the Equalisation Levy achieve its stated objectives of levelling the playing field between resident and non-resident digital service providers, and at what doctrinal and diplomatic cost? Second, is the Significant Economic Presence rule - now, by default, India's primary domestic nexus rule for taxing digital income - legally and institutionally equipped to perform this role, given its explicit subordination to India's Double Taxation Avoidance Agreements ('DTAAs') under Section 90(2) of the IT Act and the near-universal absence of a 'digital PE' concept in India's treaty network? Third, does the OECD's Pillar One Amount A framework offer a credible multilateral substitute, and what does the continuing non-ratification of the Multilateral Convention as of 2026 mean for source jurisdictions such as India in the interim?

The paper proceeds in seven parts. Part 2 reviews the literature on digital economy taxation, situating the Indian debate within the broader BEPS and unilateralism discourse. Part 3 undertakes a detailed doctrinal analysis of the Equalisation Levy, the SEP rule, and the Pillar One framework, supported by statutory text, case law, and empirical data on levy collections. Part 4 presents the paper's findings. Part 5 offers policy recommendations. Part 6 concludes, and Part 7 sets out references.

## 2. Literature Review

Early Indian commentary on the Equalisation Levy was divided between characterising it as a legitimate, WTO- and treaty-consistent sovereign response to base erosion, and viewing it as a disguised, extra-statutory tariff on foreign digital enterprises masquerading as a tax measure to avoid treaty override obligations.[3]

International scholarship on BEPS Action 1 has been similarly divided. Brauner criticised the BEPS Project's incrementalism, arguing that piecemeal action items could not resolve the structural allocation-of-taxing-rights problem posed by digitalisation, while Christians argued

[3]Arvind P. Datar, "Equalisation Levy: A Critical Analysis", 2 Indian J. Tax L. 45 (2017); see also Mukesh Butani, "Taxing the Digital Economy: An Indian Perspective", 45 Intertax 578 (2017).

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that unilateral measures such as India's EL and the United Kingdom's Diverted Profits Tax reflected a legitimate assertion of source-state fiscal sovereignty in the face of Inclusive Framework paralysis.[4]

On the SEP rule specifically, Chand's comparative study of 'virtual permanent establishment' proposals situates India's SEP provision alongside Israel's and Slovakia's early digital-nexus experiments, noting that all three share a common infirmity: domestic nexus expansion is legally inert unless matching treaty amendments are negotiated, since Section 90(2) of the IT Act (and its equivalents) preserve the more beneficial treaty position for non-residents.[5]

Recent Indian scholarship, published contemporaneously with the EL's withdrawal, has begun to assess the transition empirically. Govindasamy and Srinidhi's 2026 study documents the phased abolition of both EL limbs and observes that SEP has, by default rather than design, become India's 'primary rule' for digital-economy taxation - a development they characterise as legally under-prepared given the absence of corresponding treaty renegotiation.[6]

Similarly, Singh's 2026 working paper argues that the EL's repeal was a 'paradigm shift' driven by India's OECD/G20 commitments rather than by a considered domestic assessment of SEP's adequacy, and calls for urgent clarification of the interaction between SEP, DTAAs, and the pending Pillar One framework.[7]

On the multilateral track, Grinberg's early mapping of the digital tax debate remains foundational, while Cui offers a conceptual defence of digital services taxes as consumption-adjacent levies rather than disguised income taxes - a characterisation India's Ministry of Finance implicitly relied upon in defending the EL's compatibility with DTAAs (on the theory that a levy outside the Income-tax Act is not 'income-tax' for treaty purposes).[8]

The literature is comparatively thin, however, on the interim period between unilateral withdrawal and multilateral ratification - the precise juncture at which India now finds itself. The OECD's own materials acknowledge that the Multilateral Convention to Implement Amount A, released in October 2023, remains a text reflecting 'current consensus' with unresolved footnoted objections from certain jurisdictions, and has not, as of mid-2026, been

[4]Yariv Brauner, "What the BEPS?", 16 Fla. Tax Rev. 55 (2014); Allison Christians, "BEPS and the New International Tax Order", 2016 BYU L. Rev. 1603 (2017).
[5]Vikram Chand, "The Concept of Significant Economic Presence and Virtual Permanent Establishment: Objectives and Guiding Principles", 46 Intertax 380 (2018).
[6]Dr. R. Govindasamy & Srinidhi G., "Digital Taxation in India: An Overview of Equalisation Levy and Significant Economic Presence", 14(2) EPRA Int'l J. Econ. & Bus. Rev. (Feb. 2026).
[7]Anshika Singh, "The Abolition of Equalization Levy and the Future of Digital Taxation in India: An In-Depth Analysis on SEPs, DTAAs and the OECD Global Tax Reforms", SSRN Working Paper No. 5923029 (2026), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5923029.
[8]Itai Grinberg, "International Taxation in an Era of Digital Disruption: Analyzing the Current Debate", 145 Colum. J. Transnat'l L. 1 (2016); Wei Cui, "The Digital Services Tax: A Conceptual Defense", 73 Tax L. Rev. 69 (2019).

opened for signature.[9]

This paper contributes to that gap by offering an integrated doctrinal-empirical account of India's transition - from EL, through SEP, toward an uncertain Pillar One future - and by proposing concrete recommendations calibrated to this interim, treaty-constrained period.

## 3. Analysis and Discussion

### 3.1 The Equalisation Levy: Genesis, Structure and Demise

Chapter VIII of the Finance Act, 2016 introduced a 6% Equalisation Levy on consideration received by non-residents without a permanent establishment in India for online advertisement, or any provision for digital advertising space or facility/service for online advertisement, where the aggregate consideration exceeded ₹1,00,000 in a financial year.[10]

Structurally, the levy was deliberately located outside the charging provisions of the IT Act - a design choice intended to avoid characterisation as 'income-tax' for the purposes of Section 90 and India's DTAAs, and thereby to sidestep treaty override. To prevent double taxation of the same receipts, Parliament simultaneously inserted Section 10(50), exempting EL-taxed income from ordinary income-tax.[11]

The Finance Act, 2020 expanded the levy dramatically through the insertion of Section 165A, imposing a 2% levy on the 'e-commerce supply or services' made or provided or facilitated by a non-resident 'e-commerce operator' to Indian residents, non-residents in specified circumstances, or persons using an Indian internet protocol address, where consideration for the aggregate of such supplies exceeded ₹2 crore in a financial year - irrespective of whether the operator owned the goods or services being transacted.[12]

This 2020 expansion (colloquially 'EL 2.0') attracted the sharpest criticism. Unlike EL 1.0, which was withheld at source by the Indian payer in a manner analogous to tax deducted at source, EL 2.0 required self-assessment and direct remittance by the non-resident e-commerce operator itself - an unusual and administratively fraught compliance model for an entity with no presence in India. Three doctrinal objections dominated the discourse:

1. Extraterritorial reach and definitional overbreadth: the definition of 'e-commerce

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[9]OECD/G20 Inclusive Framework on BEPS, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (1 July 2021); OECD, Multilateral Convention to Implement Amount A of Pillar One (11 October 2023).

[10]The Finance Act, 2016, No. 28 of 2016, Chapter VIII, ss. 163-180 (India).

[11]Income-tax Act, 1961, s. 10(50) (India), inserted by the Finance Act, 2016 and later omitted with effect from Assessment Year 2021-22 in relation to the specified services covered, and finally sunset for all EL-related receipts from Assessment Year 2026-27 by the Finance Act, 2025.

[12]The Finance Act, 2020, No. 12 of 2020, s. 153, inserting s. 165A into the Finance Act, 2016 (India).

supply or services' was broad enough to potentially capture routine business-to-business software-as-a-service, cloud-hosting and even non-digital transactions merely facilitated online, raising concerns about disproportionate compliance burden on entities with no meaningful connection to the digital advertising or platform economy that the levy was originally designed to address.

2. Treaty compatibility and double-taxation risk: because the levy sat outside the IT Act and outside the scope of 'taxes covered' under most of India's DTAAs, non-resident operators could not claim foreign tax credit in their home jurisdictions for EL paid in India, creating a real risk of uncredited double taxation on the same stream of income - notwithstanding the Government's formal position that EL was not an 'income-tax' at all.
3. Trade-retaliatory exposure: the United States Trade Representative ('USTR'), in a Section 301 investigation report of January 2021, concluded that India's 2% EL discriminated against U.S. digital companies and was inconsistent with prevailing principles of international taxation, opening the door to retaliatory tariffs under the Trade Act of 1974.

Facing the threat of tariffs, India and the United States negotiated a transitional compromise in November 2021, under which India agreed to provide MNEs a credit against future Pillar One Amount A liability for EL collected in excess of what would have been due under Amount A during an interim period, originally set to run until the earlier of Pillar One's entry into force or 31 March 2024, and subsequently extended to 30 June 2024 as multilateral negotiations continued to stall.[13]

Rather than await Pillar One's multilateral entry into force, the Union Budget 2024 proposed - and the Finance (No. 2) Act, 2024 enacted - the outright abolition of the 2% e-commerce EL with effect from 1 August 2024, while curiously retaining the 6% advertisement levy for a further transitional period.[14]

The residual 6% advertisement levy was, in turn, withdrawn by the Finance Act, 2025 with effect from 1 April 2025, thereby completing the full unwinding of the Equalisation Levy regime within a period of less than nine years from its introduction. The consequential sunset

[13]Office of the United States Trade Representative, Section 301 Investigation: Report on India's Digital Services Tax (2 January 2021); see also the India-US Joint Statement on the Transitional Approach to the Existing Unilateral Measures While a Multilateral Solution on the Allocation of Taxing Rights is Developed (24 November 2021).

[14]The Finance (No. 2) Act, 2024, No. 15 of 2024, s. 114 (India), omitting s. 165A of the Finance Act, 2016 with effect from 1 August 2024.

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of the Section 10(50) exemption from Assessment Year 2026-27 means that receipts no longer covered by EL must now be examined afresh under ordinary source-taxation principles - Section 9 read with SEP - and the applicable DTAA.[15]

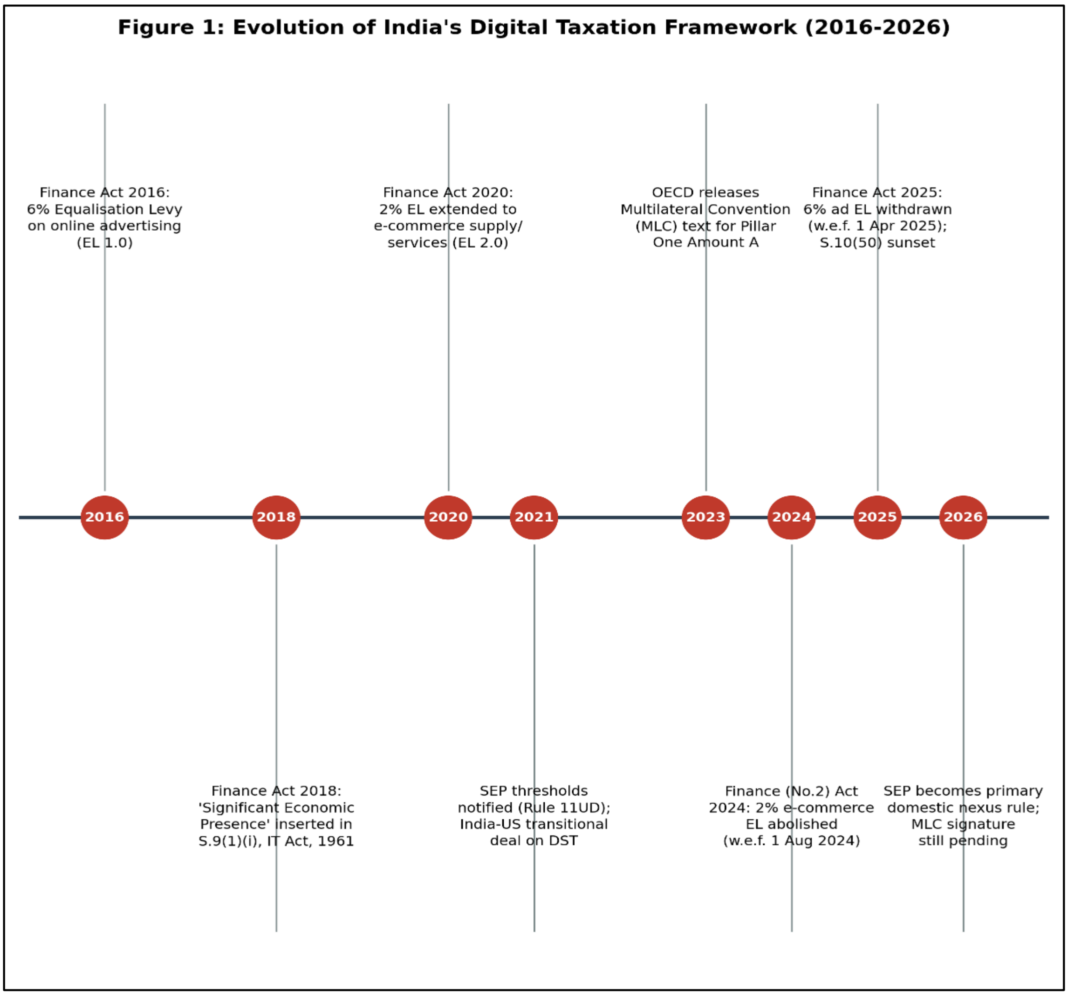


*Figure 1: Evolution of India's digital taxation framework, 2016-2026, showing the parallel and successive introduction of the Equalisation Levy, the SEP rule, and OECD Pillar One negotiations.*

An empirical review of EL collections illustrates both the levy's growing fiscal significance and the magnitude of the revenue now foregone. Collections rose from a modest ₹316.6 crore in the levy's first part-year of operation (2016-17) to approximately ₹1,136 crore in 2019-20, ₹2,057 crore in 2020-21, and a peak of approximately ₹3,900-4,000 crore in 2021-22 - a near ninety percent year-on-year increase attributed to improved compliance and the widened e-commerce base. Collections subsequently plateaued and then declined marginally to

[15]The Finance Act, 2025, No. 7 of 2025, Part IV (India), withdrawing the 6% Equalisation Levy under Chapter VIII of the Finance Act, 2016 with effect from 1 April 2025, and consequentially sunsetting the s. 10(50) exemption from Assessment Year 2026-27.

approximately ₹3,500 crore in 2023-24 and ₹3,300 crore in 2024-25, immediately prior to the levy's full withdrawal. The Ministry of Finance has itself estimated a resulting annual revenue loss in excess of ₹3,000 crore from 2025-26 onward.

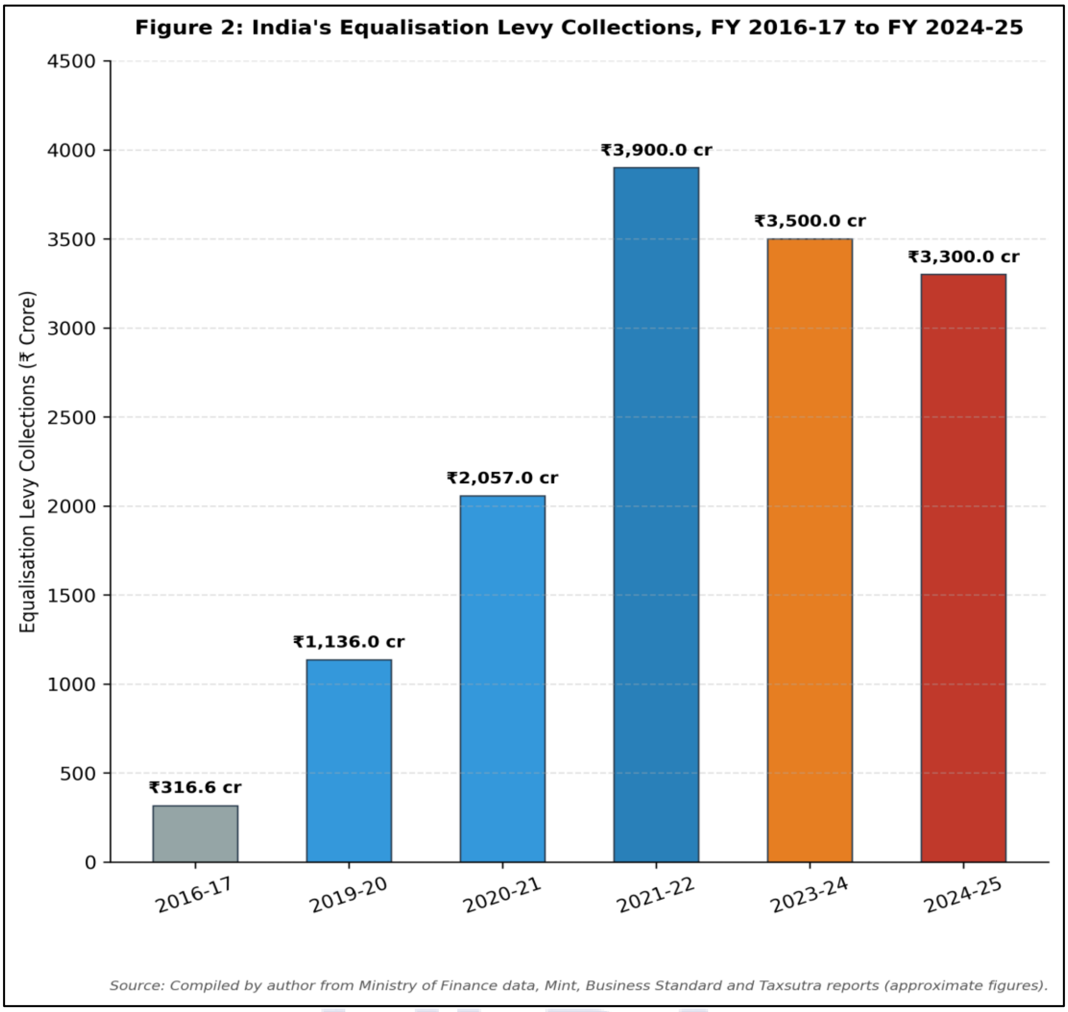


*Figure 2: India's Equalisation Levy collections, FY 2016-17 to FY 2024-25 (₹ crore), showing rapid growth followed by plateau and eventual withdrawal.*

### 3.2 Significant Economic Presence: The New Default Nexus Rule

The Finance Act, 2018 inserted Explanation 2A to Section 9(1)(i) of the IT Act, deeming a non-resident to have a 'business connection' in India - and therefore taxable Indian-source income - where the non-resident has a Significant Economic Presence in India, whether or not the non-resident has any physical presence in India, and whether or not the agreement for the relevant transaction is entered into in India, or the goods or services are actually delivered or provided in India, or the non-resident renders services in India.[16]

SEP is triggered on satisfaction of either of two alternative thresholds, prescribed by Rule

[16]Income-tax Act, 1961, s. 9(1)(i), Explanation 2A, inserted by the Finance Act, 2018, No. 13 of 2018, s. 4 (India).

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11UD: (a) a transactional/revenue test, under which aggregate payments arising from transactions in respect of goods, services or property (including data or software download) carried out by a non-resident with any person in India, including provision of download of data or software, exceed ₹2 crore in the relevant previous year; or (b) a user-based test, under which the non-resident systematically and continuously solicits business activities or engages in interaction with at least 300,000 users in India through digital means.[17]

Three structural features of SEP merit close scrutiny.

First, SEP expands the nexus threshold but leaves the profit-attribution question - how much of a non-resident's global profit is 'attributable to' its SEP in India - entirely unresolved. The statute confines deemed accrual to income 'attributable to the transactions or activities' constituting SEP, but neither the Act nor the Rules prescribe a formulary or fractional apportionment methodology analogous to Pillar One's Amount A formula, leaving attribution to be determined on ordinary Rule 10 principles designed for physical PEs - an awkward fit for a purely digital nexus.[18]

Second, and most significantly, Section 90(2) of the IT Act preserves the application of a DTAA to the extent it is more beneficial to the assessee than the domestic law - a principle affirmed by the Supreme Court of India in Union of India v. Azadi Bachao Andolan. Since the overwhelming majority of India's roughly ninety-five DTAAs continue to define 'permanent establishment' in physical terms (fixed place of business, dependent agent, or specified project/service PE) without any 'significant economic presence' or 'digital PE' equivalent, a non-resident enterprise resident in a treaty jurisdiction can typically still claim treaty protection and escape SEP-based taxation altogether, notwithstanding satisfaction of the domestic SEP thresholds. SEP therefore operates, in practice, principally against non-residents from non-treaty jurisdictions or those unable or unwilling to claim treaty benefit - a materially narrower universe than its statutory language suggests.[19]

This treaty-primacy principle was reinforced, in an adjacent context, by the Supreme Court's landmark decision in Engineering Analysis Centre of Excellence Pvt. Ltd. v. Commissioner of Income Tax, which held that payments for the use of copyrighted software did not amount to

[17]Income-tax Rules, 1962, r. 11UD (India), inserted by the Income-tax (11th Amendment) Rules, 2021, notified vide Notification No. 41/2021, dated 3 May 2021; CBDT Notification prescribing a revenue threshold of ₹20,000,000 (₹2 crore) and a user threshold of 300,000.

[18]Income-tax Act, 1961, s. 9(1)(i), Explanation 2A, proviso (India) ("...only such income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India").

[19]Income-tax Act, 1961, s. 90(2) (India); see also Union of India v. Azadi Bachao Andolan, (2004) 10 SCC 1 (Supreme Court of India), holding that a beneficial treaty provision overrides a less beneficial domestic provision unless Parliament expressly legislates to the contrary.

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royalty under India's DTAAs even though the wider domestic definition of royalty (as amended in 2012) might have captured such payments. The decision is instructive by analogy: it confirms that unilateral domestic expansion of a tax base - whether of 'royalty' or of 'business connection' via SEP - cannot, without treaty amendment, override a narrower treaty definition beneficial to the non-resident taxpayer.[20]

Third, the withdrawal of the EL - itself deliberately structured outside the IT Act specifically to avoid the treaty-override problem that now confronts SEP - means that India has, in effect, exchanged a fiscally effective but diplomatically contentious instrument for a doctrinally cleaner but practically narrower one. The Formula One World Championship line of authority on the meaning of a 'fixed place' PE illustrates just how factually contingent and litigation-prone physical-presence PE determinations remain even in conventional contexts, underscoring the difficulty Indian tax authorities are likely to face in applying analogous attribution reasoning to the fundamentally different fact pattern of digital SEP.[21]

### 3.3 The OECD Two-Pillar Solution: Amount A and the Unfinished Multilateral Bargain

Pillar One reallocates a defined share of the residual profit of the very largest and most profitable multinational enterprise groups - those with global revenue exceeding €20 billion and profitability (profit before tax to revenue) exceeding 10% - to 'market jurisdictions' where the group has in-scope revenue, irrespective of physical presence. Under Amount A, 25% of profit in excess of the 10% profitability threshold is reallocated and apportioned amongst eligible market jurisdictions using a revenue-based allocation key, subject to a marketing and distribution profits safe harbour and an elimination-of-double-taxation mechanism.[22]

The OECD released the text of a Multilateral Convention to Implement Amount A ('MLC') on 11 October 2023, describing it as reflecting 'the current consensus' among Inclusive Framework members, while candidly noting - through footnoted reservations - unresolved objections from a small number of jurisdictions on specific technical points.[23]

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[20] Engineering Analysis Centre of Excellence Pvt. Ltd. v. Commissioner of Income Tax, (2021) 3 SCC 1 (Supreme Court of India), holding that payments for software licences did not constitute 'royalty' under the applicable DTAAs absent transfer of copyright, and that beneficial DTAA definitions prevail over the wider domestic definition of royalty.

[21] CBDT Circular No. 41/2016, dated 23 December 2016, clarifying the scope of the Equalisation Levy (India); for the treaty-override debate more generally, see Formula One World Championship Ltd. v. CIT, (2017) 15 SCC 602 (Supreme Court of India), on the meaning of a 'fixed place' PE in the context of digitally coordinated events.

[22] OECD/G20 Inclusive Framework on BEPS, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (1 July 2021), endorsed by 136 (subsequently 138+) member jurisdictions; OECD, Tax Challenges Arising from Digitalisation - Report on Pillar One Blueprint (OECD/G20 BEPS Project, 2020).

[23] OECD, Multilateral Convention to Implement Amount A of Pillar One, together with its Explanatory Statement and Understanding on the Application of Certainty for Amount A (11 October 2023).

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Successive Co-Chair statements in January 2024 and January 2025 have confirmed that consensus on the final text of the MLC, and on a corresponding Amount B safe-harbour framework for baseline marketing and distribution activities, remains elusive.[24]

As of mid-2026, the MLC has still not been opened for signature, let alone ratified by the requisite critical mass of jurisdictions needed to bring Amount A into force. The consequence for India, and for other source/market states, is stark: the MLC's central bargain - reallocation of taxing rights in exchange for the permanent repeal and standstill of unilateral digital services taxes - has not materialised, even as India (and, differently, several European states) have already repealed or curtailed their unilateral measures in anticipatory good faith or under bilateral trade pressure. Figure 3 below situates India's post-EL position (having repealed its unilateral measure) against a sample of jurisdictions that continue to operate active digital services taxes ranging from 1.5% to 7.5% of in-scope digital revenue, illustrating the asymmetric bargain India has struck relative to some peer economies.

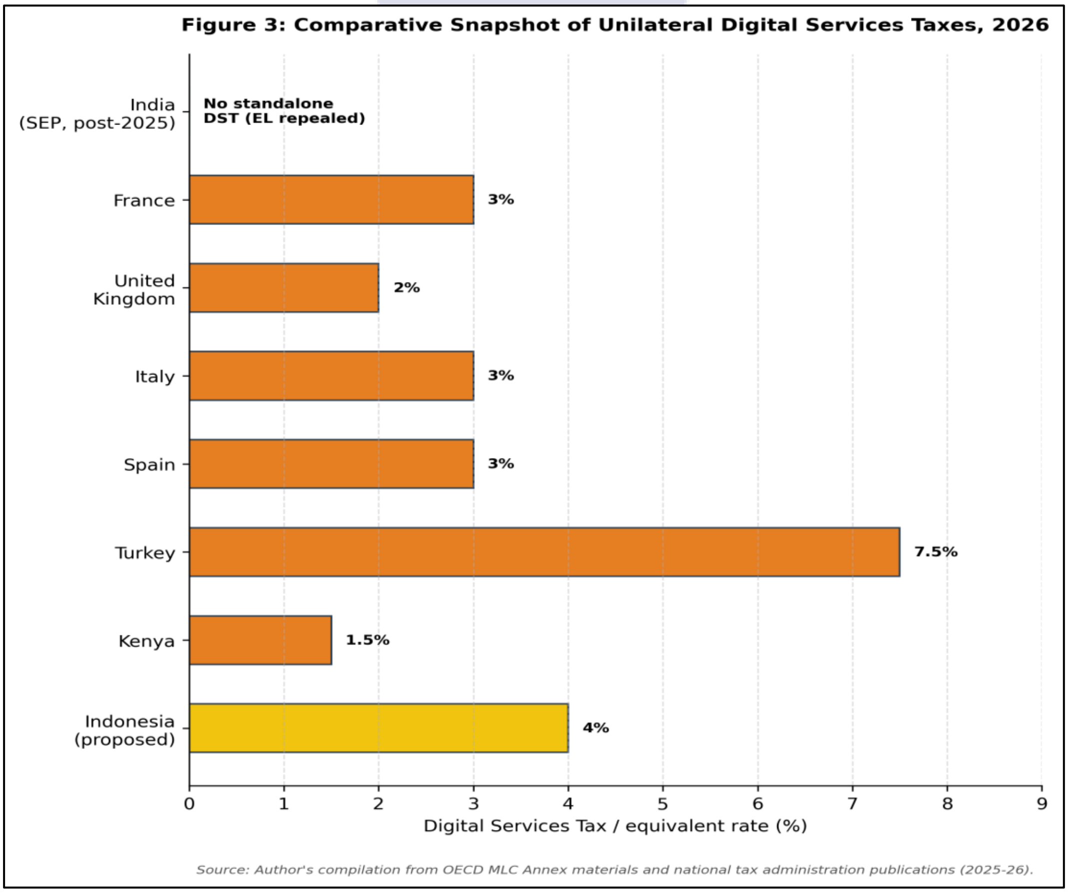


*Figure 3: Comparative snapshot of unilateral digital services tax / equivalent rates across select jurisdictions, 2026, highlighting India's post-repeal position.*

[24]OECD/G20 Inclusive Framework on BEPS, Statement by the Co-Chairs of the Inclusive Framework's Task Force on the Digital Economy (13 January 2025), noting continuing negotiations on outstanding MLC issues and on the Amount B framework.

Figure 4 depicts the intended mechanics of the Amount A bargain and the conditionality - repeal of unilateral measures in exchange for treaty-based reallocation - upon which its legitimacy rests. The diagram also captures the present impasse: the reallocation mechanism (the upper tiers) remains inoperative pending ratification, while the standstill/repeal condition (the lower tiers) has, for India, already been unilaterally satisfied.


*Figure 4: Mechanics of OECD Pillar One - Amount A profit reallocation and its conditional linkage to the repeal of unilateral digital services taxes and equalisation levies.*

Commentators have long cautioned that developing and emerging economies - including India - may be structurally disadvantaged under Amount A relative to the revenue-generating potential of a well-designed unilateral levy, given Amount A's narrow scope (confined to the largest ~100-150 MNE groups globally), its formulaic and comparatively modest 25%

reallocation of only supra-10%-margin profit, and the elimination-of-double-taxation marketing and distribution safe harbour, which may return a smaller effective tax base to market jurisdictions than an unconstrained digital services tax.[25]

### 3.4 The Transitional Governance Gap

The combined effect of Sections 3.1 to 3.3 above is a transitional governance gap of considerable practical significance for the 2025-2028 period. India has withdrawn a fiscally productive, if doctrinally contested, unilateral instrument (the EL) in anticipation of a multilateral solution (Amount A) that remains unratified, while its intended domestic substitute (SEP) is, for the majority of in-scope non-resident enterprises resident in treaty jurisdictions, rendered largely inoperative by Section 90(2) and the absence of a corresponding 'digital PE' definition in India's treaty network. Three consequences follow.

1. Revenue and enforcement gap: transactions previously captured by EL 2.0 (particularly business-to-consumer e-commerce and SaaS/cloud transactions below the physical-PE threshold but above the EL threshold) may now escape Indian tax altogether where the non-resident is treaty-protected, since SEP cannot be invoked against such a non-resident and no alternative charging provision exists.
2. Straddle and transition disputes: the withdrawal of EL is not retrospective, meaning pre-transition receipts remain subject to the erstwhile levy regime (including pending assessments, Form 1 compliance, and refund claims), while post-transition receipts fall to be examined afresh under Section 9/SEP and the applicable DTAA - creating a straddle-period 'date of consideration' test that is likely to generate significant interpretational disputes and litigation.
3. Foreign tax credit mismatch: because several trading partners maintain their own digital services taxes on the same underlying digital revenue streams (as depicted in Figure 3), and because such foreign DSTs are frequently non-creditable against Indian tax liability (and vice versa), a residual and largely unaddressed double-taxation exposure persists even after India's own EL withdrawal.

These three consequences form the empirical and doctrinal basis for the findings and recommendations that follow.

[25] Reuven S. Avi-Yonah & Young Ran (Christine) Kim, "The Rise and Fall of the Digital Services Tax", 47 Fla. St. U. L. Rev. 549 (2020); see also Wei Cui, "Pillar One from a Developing Country Perspective", (2022) Bull. Int'l Tax'n 1.

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## 4. Findings

1. The Equalisation Levy achieved measurable fiscal success - collections grew from ₹316.6 crore (2016-17) to a peak of approximately ₹3,900-4,000 crore (2021-22) - but its structural placement outside the Income-tax Act, while doctrinally designed to avoid treaty override, simultaneously precluded foreign tax credit relief for non-resident taxpayers, generating a genuine (if politically under-acknowledged) double-taxation problem.
2. The 2020 expansion of EL to e-commerce supplies (EL 2.0) was the levy's most vulnerable feature: its broad definitional sweep, self-assessment compliance model for non-resident operators, and characterisation by the USTR as discriminatory under Section 301 directly precipitated the trade-diplomatic pressure that led to its eventual withdrawal.
3. India's withdrawal of the EL (completed by 1 April 2025) was driven substantially by external trade-policy considerations - principally the desire to avert U.S. retaliatory tariffs and to signal good-faith commitment to the OECD Inclusive Framework - rather than by a domestically generated conclusion that SEP could adequately substitute for EL's revenue and enforcement functions.
4. The Significant Economic Presence rule, notwithstanding its facially wide revenue (₹2 crore) and user (300,000) thresholds, is legally constrained by Section 90(2) of the Income-tax Act, 1961 and by the continued absence of a 'digital permanent establishment' concept in the substantial majority of India's DTAAs, meaning SEP is, in practical effect, enforceable primarily against non-residents from non-treaty or treaty-disadvantaged jurisdictions.
5. Neither the Income-tax Act nor Rule 11UD prescribes a workable profit-attribution methodology for income deemed to accrue via SEP, leaving Indian tax authorities to rely on physical-PE-oriented attribution principles ill-suited to purely digital nexus determinations - a gap that is likely to generate significant assessment and litigation uncertainty.
6. The OECD's Multilateral Convention to Implement Amount A of Pillar One, released in October 2023, remains unsigned and unratified as of 2026, meaning the intended multilateral 'bargain' - reallocation of taxing rights in exchange for permanent repeal of unilateral digital measures - remains one-sided for India, which has already repealed its unilateral measure without receiving the anticipated multilateral reallocation in return.
7. A comparative review shows several major economies (France, the United Kingdom,

ISSN: 2582-6433

Italy, Spain, Turkey) continue to operate active digital services taxes notwithstanding the same MLC standstill commitments that influenced India's own policy calculus, creating a residual and unaddressed international tax-competition asymmetry.

8. The transition creates identifiable straddle-period compliance risks - including unresolved pending EL assessments, refund claims, and a 'date of consideration' test for transactions spanning the EL-to-SEP transition - that current guidance from the Central Board of Direct Taxes has not comprehensively addressed.

## 5. Recommendations

1. **Prioritise renegotiation of the 'digital PE' gap in key DTAAs.** The Central Board of Direct Taxes ('CBDT'), through the Ministry of Finance, should prioritise protocol-level renegotiation of DTAAs with jurisdictions from which significant digital revenue originates, to insert a treaty-level significant-economic-presence or digital-PE definition consistent with domestic Explanation 2A. Absent such renegotiation, SEP will remain substantially inoperative against treaty-protected non-residents, regardless of further domestic legislative refinement.
2. **Issue binding CBDT guidance on SEP profit attribution.** The CBDT should issue a detailed circular - ideally accompanied by draft rules under Section 295 - prescribing a formulary or fractional apportionment methodology for attributing profit to a non-resident's SEP, drawing on Pillar One Amount A's revenue-based allocation-key logic even in advance of Amount A's own entry into force, so as to reduce assessment-stage discretion and consequent litigation.
3. **Issue comprehensive straddle-period transition guidance.** The CBDT should issue clarificatory guidance addressing the EL-to-SEP transition, including a clear 'date of consideration' or 'date of supply' test for straddle transactions, an explicit statement on the continued applicability of Section 10(50) to pre-transition receipts, and a defined administrative pathway for pending EL assessments, refunds and Form 1 compliance.
4. **Maintain, and periodically publish, digital-economy tax intelligence.** In view of the enforcement gap created by SEP's treaty subordination, the Income Tax Department should strengthen automatic and spontaneous exchange-of-information mechanisms (under Article 26 of the OECD Model and India's DTAAs) and continue publishing periodic digital-economy tax statistics, both to support evidence-based policymaking and to preserve institutional memory of the revenue base at risk.

5. **Maintain conditional, WTO- and treaty-consistent unilateral safeguard authority.** India should consider retaining - through carefully drafted, sunset-clause-bound enabling legislation rather than an active levy - a reserve statutory power to reintroduce a calibrated digital equalisation measure in the event the MLC is not ratified within a defined further period (e.g., by 2028), so as to preserve credible negotiating leverage without immediately reactivating trade tensions.
6. **Engage constructively but assertively within the Inclusive Framework on Amount A's developing-country adequacy.** India, together with other large market-jurisdiction economies in the Inclusive Framework, should continue to press for recalibration of Amount A's profitability and revenue-reallocation parameters (the 10% profitability and 25% reallocation thresholds) to ensure that ratification, when it occurs, delivers a fiscal outcome not materially inferior to the unilateral measures India and comparable jurisdictions have already relinquished or constrained.
7. **Invest in capacity-building for digital-economy transfer pricing and audit.** Given the attribution and evidentiary challenges inherent in SEP assessments (user-count verification, IP-address-based sourcing, and platform-level revenue disaggregation), the Income Tax Department should invest in specialised digital-forensic and data-analytics capacity within its International Taxation Directorates, potentially in collaboration with the National Informatics Centre and empanelled technical experts.

## 6. Conclusion

India's decade-long experiment with unilateral digital taxation - from the Equalisation Levy's introduction in 2016 to its complete withdrawal by 2025 - offers a instructive case study in the limits of unilateral fiscal sovereignty in a globally interconnected digital economy. The Equalisation Levy was fiscally productive and doctrinally inventive in its attempt to avoid treaty override, but its 2020 expansion proved definitionally overbroad and diplomatically unsustainable, ultimately yielding to trade pressure well before the multilateral alternative it was meant to bridge towards - OECD Pillar One's Amount A - had matured into binding international law. The Significant Economic Presence rule, now India's default domestic nexus doctrine for digital income, is a legally sound but institutionally incomplete successor: sound in its conceptual departure from physical-presence orthodoxy, incomplete in its continued subordination to a treaty network that has not caught up with that conceptual shift. Until India renegotiates its key DTAAs to incorporate a digital-PE equivalent, issues clear profit-attribution guidance, and either secures Amount A's ratification or maintains credible reserve

ISSN: 2582-6433

unilateral authority, the country occupies an uneasy interim space - having relinquished a working, if contested, unilateral tool without yet obtaining the multilateral one it was promised in exchange. The recommendations advanced in this paper are offered as a calibrated, treaty-conscious roadmap for navigating that interim space in a manner that protects India's legitimate revenue interests without reigniting the trade tensions that precipitated the Equalisation Levy's demise.

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