International Journal of Scientific Research in Engineering and Management (IJSREM)
Volume: 10 Issue: 10 | Oct - 2026 SJIF Rating: 8.659 ISSN: 2582-3930

Taxing the Digital Economy in India: Equalisation Levy, Significant Economic Presence and the Global Minimum Tax

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***Abstract*—India was among the first countries to tax digital businesses that earn money from Indian users without setting up shop in India. It tried two routes. One was the equalisation levy, a stand-alone tax on gross receipts. The other was "significant economic presence" (SEP), which stretches the business connection test inside income tax law itself. Ten years on, the picture looks very different. The 2% levy on e-commerce was withdrawn from 1 August 2024, the 6% levy on online advertising ended on 1 April 2025, and the SEP rule still sits uneasily with India's tax treaties. This paper takes a doctrinal approach. It traces the design of both measures, tests them against treaty law and Supreme Court decisions on permanent establishments and royalties, and then places them next to the OECD two-pillar project, including the side-by-side package agreed on 5 January 2026. The paper argues that India's unilateral tools worked better as bargaining chips than as revenue instruments, and that their withdrawal leaves a real gap in source-based taxation of digital business. It closes with five proposals: a treaty-based digital services clause, a pre-announced review date for any interim measure, clearer profit attribution rules, a considered decision on a domestic minimum tax, and better public data.**

***Index Terms*—Digital economy, Equalisation levy, Global minimum tax, Pillar Two, Significant economic presence, Tax treaties.**

I. INTRODUCTION

For most of the last century, a country's claim to tax a foreign company's business profits turned on physical presence. A branch, a factory, a warehouse or a dependent agent in the country created a permanent establishment (PE), and the source state could tax the profits attributable to it. Without that footprint, the profits stayed with the state of residence. Tax treaties built on the OECD Model Convention locked this bargain in, and India's treaties follow the same pattern.

Digital business breaks the bargain quietly. A streaming service, a search engine or an online marketplace can sell to millions of Indian users, collect advertising money from Indian firms and learn from Indian user data without placing a single employee or server in India. The OECD's report on BEPS Action 1 described this as scale without mass, and pointed to heavy reliance on intangibles and on data supplied by users [1]. It stopped short of prescribing a cure. It listed options that countries might consider, among them a new nexus based on significant economic presence, a withholding tax on digital transactions and an equalisation levy [1]. India used two of the three.

This paper asks what happened next. How were India's two tools built? How did they sit with treaty obligations and with the way courts think about source taxation? And what is left now that the equalisation levy has been wound up? It then asks how the global minimum tax and the unfinished Pillar One project change India's choices. The short answer is that India went from front-runner to cautious bystander in under a decade, and the reasons have as much to do with trade diplomacy and treaty law as with tax design.

II. OBJECTIVES AND METHOD

The paper pursues four objectives: (1) to describe the legal design of the equalisation levy and the SEP rule; (2) to examine how both fit with India's tax treaties and with Supreme Court authority; (3) to assess what the multilateral track offers a market economy like India; and (4) to propose workable reforms.

The method is doctrinal. Primary material includes statutes, rules, notifications and reported judgments. Secondary material includes OECD documents, practitioner commentary and press reports, the last used mainly for dates and for the reasons given for policy changes. The paper does not attempt to quantify revenue. Reliable consolidated figures were not available to the author, and a number guessed from partial data would add little. Readers should also check section numbers under the Income-tax Act, 2025 against the official text, because commentary on the new statute is still settling.

III. THE EQUALISATION LEVY

A. Design

The levy arrived through the Finance Act, 2016, following the report of the Committee on Taxation of E-commerce [2]. It charged 6% on payments made to non-residents without a PE in India for online advertisement and related facilities, collected by the Indian payer through deduction, and it applied only where annual payments crossed a modest threshold [3]. In 2020 Parliament widened it. A further 2% was imposed on consideration received by non-resident e-commerce operators for e-commerce supply or services connected with India, with effect from 1 April 2020 [4]. Income already hit by the levy was exempted from income tax so that the same receipt was not taxed twice [5].

The choice to place the levy outside the Income-tax Act was deliberate and consequential. Treaty limits on taxing business profits attach to taxes on income. A separate levy on gross revenue sat beyond that reach. The price was paid abroad. Because the levy was not part of the Income-tax Act, foreign companies could not claim a credit for it against tax at home [6]. That feature helps explain why the United States Trade Representative, in an investigation in 2021, found the Indian measure discriminatory and out of line with international tax principles [7].

B. Withdrawal

The 2% levy on e-commerce was withdrawn for consideration received on or after 1 August 2024. The 6% levy on online advertising followed, abolished from 1 April 2025 by an amendment passed with the Finance Act, 2025 [8], [9]. The Finance Minister presented the move as a response to uncertainty in the international economic climate [10]. Commentators tied it more directly to the threat of reciprocal American tariffs due from 2 April 2025 [8], [7]. Practitioners also observed that the levy had worked in practice as a cost borne by Indian advertisers [10].

There is an irony here. In October 2021 India joined a statement under which parties to the future Pillar One convention would remove digital services taxes and similar measures [11]. The levy was therefore always expected to go once Pillar One arrived. What happened instead is that the levy went first, and Pillar One has not yet followed.

IV. SIGNIFICANT ECONOMIC PRESENCE

SEP took the opposite route. Rather than create a new tax, the Finance Act, 2018 added Explanation 2A to section 9(1)(i) of the 1961 Act so that a non-resident's economic presence itself counts as a business connection in India [12]. Two limbs matter. The first looks at transactions in goods, services or property with persons in India, including downloads of data or software, above a monetary threshold. The second looks at systematic and continuous soliciting of business or interaction with a prescribed number of users in India. The Finance Act, 2020 reworked the provision, and Rule 11UD later fixed the thresholds at INR 2 crore of aggregate payments and 3 lakh users, with effect from 1 April 2022 [4], [13]. Only income attributable to the relevant transactions or activities in India is brought to tax. The Income-tax Act, 2025, which replaces the 1961 Act, carries the concept forward [14].

On paper, SEP is the more orthodox instrument. It is income tax, enacted as income tax, and it adjusts an existing concept rather than inventing a new levy. Its weakness lies elsewhere. Under section 90 of the 1961 Act a taxpayer may opt for the treaty where the treaty is more beneficial [15], a position the Supreme Court accepted long ago in *Azadi Bachao Andolan* [16]. India's treaties define a PE by reference to fixed places and dependent agents, not by user counts or sales volume. SEP is not a PE. Since India has not amended its treaties to add it, the rule bites mainly on residents of non-treaty countries and on those who cannot access treaty benefits [5], [17]. Many of the largest digital providers are resident in treaty states. The author could not locate a reported judicial decision applying the rule, so its practical reach remains untested.

V. WHAT THE COURTS HAVE SAID

Three decisions of the Supreme Court explain why the legislature went looking for a new nexus. In *Formula One World Championship*, the Court read the PE concept strictly, asking whether the foreign enterprise had a fixed place at its disposal through which business was carried on [18]. A website or a cloud service fits that test badly. In *Engineering Analysis*, the Court held that payments for the use of software were not royalty under the relevant treaties, because the user obtained no right in the copyright itself [19]. That narrowed the older route of withholding tax on software payments. Read together, the two decisions show that the existing source rules, applied faithfully, would leave a great deal of digital income untaxed.

The third decision cuts the other way. *Vodafone International Holdings* is remembered for the Court's acceptance of legitimate tax planning, and also for what followed: a retrospective amendment in 2012 and its eventual withdrawal through the Taxation Laws (Amendment) Act, 2021 [20], [21]. The lesson for digital taxation is practical. A state that wants foreign firms to accept a new nexus rule does better with stable, prospective legislation than with measures that appear and vanish within a few budgets.

VI. THE MULTILATERAL TRACK

A. Pillar One

Pillar One was meant to be the permanent answer. Under Amount A, the very largest and most profitable groups, those above EUR 20 billion in turnover and a 10% profit margin, would hand 25% of their residual profit (the part above that margin) to the market jurisdictions where their users and customers sit [11]. The scheme needs a multilateral convention. To the author's knowledge, none has entered into force, so the benefit that India was expected to receive in exchange for dropping its levy has not been delivered.

B. Pillar Two and the 2026 package

Pillar Two works differently. It sets a 15% minimum effective tax rate for groups with consolidated revenue of at least EUR 750 million, collected through a qualified domestic minimum top-up tax (QDMTT), an income inclusion rule (IIR) and an undertaxed profits rule (UTPR) [22]. On 5 January 2026, 147 members of the Inclusive Framework agreed a side-by-side package that adds safe harbours for groups headquartered in jurisdictions whose own minimum-tax regimes are recognised as eligible, along with simplification measures [23], [24]. The package keeps the QDMTT as a primary tool for protecting local tax bases, particularly in developing countries [24].

For India this matters in a specific way. As far as the sources consulted show, India has not enacted the Pillar Two rules. Its headline corporate rate under the concessional regime in section 115BAA, roughly 25% once surcharge and cess are included, already sits well above 15% [15]. Exposure to a top-up therefore concentrates in entities enjoying tax incentives, such as units in special zones and the international financial services centre. An Indian QDMTT would mainly capture those, and the choice is really about investment policy, not revenue alone.

C. The UN Model

A third source of ideas is the 2021 update to the UN Model Convention, which added Article 12B to allow source taxation of income from automated digital services [25]. It must be adopted treaty by treaty. Other countries meanwhile chose national digital services taxes, such as the 3% French tax and the 2% British one [26], [27]. Table I summarises where India's own measures stand.

TABLE I
INDIA'S MEASURES ON THE DIGITAL ECONOMY

Measure	Legal source	Status
Equalisation levy, 6% (online advertising)	Finance Act, 2016, Ch. VIII [3]	Abolished from 1 Apr. 2025 [9]
Equalisation levy, 2% (e-commerce)	Finance Act, 2020 [4]	Withdrawn from 1 Aug. 2024 [8]
Significant economic presence	Expl. 2A to s. 9(1)(i); r. 11UD [12], [13]	In force; limited by treaties [5]
Global minimum tax (Pillar Two)	OECD Model Rules, 2021 [22]	No domestic enactment identified

VII. ANALYSIS

Three observations follow from the material above. First, each instrument cured the other's defect, and neither cured both. The levy was simple to administer, because the payer deducts, and it escaped treaty limits by standing outside income tax. That same feature exposed it to the charge of

discrimination and to trade retaliation. SEP was legally mainstream but is largely idle wherever a treaty applies. A measure that is easy to collect but hard to defend, and another that is easy to defend but hard to apply, do not add up to a workable regime.

Second, both tools were more valuable as leverage than as revenue, and leverage is only worth something if it is spent in exchange for something. The levy was surrendered under tariff pressure and not against delivery of Amount A [8], [7]. India now has a statutory nexus rule that treaties neutralise, no interim levy and a Pillar One that has not arrived.

Third, the question of who pays deserves more attention than it received. Where a levy sits on payments that Indian businesses make to foreign advertising platforms, economic theory suggests part of the burden may land on the domestic payer. Practitioners made that point when the levy was repealed [10]. Withdrawal can therefore be defended on incidence grounds even by those who think digital firms should pay more. The caution is that no incidence study is cited here, and the point is offered as a reasoned concern and not a finding.

VIII. SUGGESTIONS

1) *Take SEP to the treaty table.* India should seek protocols with its main digital trading partners that add a digital services clause modelled on Article 12B, or an SEP-style PE rule, so that the statute has something to attach to [25].
2) *Fix a review date for any interim measure.* Parliament could provide that, if Pillar One has not entered into force by a stated date, the government must report on a narrowly drawn interim measure. This keeps some leverage without reviving an open-ended gross levy.
3) *Publish attribution guidance.* The statute taxes income attributable to SEP, but the mechanics deserve clear guidance, ideally with a formula and safe-harbour percentages, to prevent disputes.
4) *Decide on a domestic minimum tax with data.* A QDMTT should be tested against the incentive regimes it would affect, and the decision recorded openly, whichever way it goes.
5) *Collect and release data.* Aggregated figures on SEP assessments, user thresholds and compliance would let researchers and legislators judge whether the rule works.

IX. CONCLUSION

India's early moves on the digital economy were bold, and in their time they were influential. The equalisation levy and SEP both responded to a real failure of the PE concept, a failure the Supreme Court's own reading of that concept helps to explain. But the levy's design drew foreign resistance, SEP's design met the treaty wall, and the policy ended up exposed: the interim tools were retired before the permanent one was agreed.

The way forward is less dramatic than the original levy and probably more durable. It lies in treaty work, in clearer attribution rules, in a deliberate view on the minimum tax and in better data. The multilateral picture is also moving, so any conclusion here is provisional and should be checked against the latest notifications and OECD releases.

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