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Digital Taxation: An Evaluation in Indian Perspective

JYOTI PRATAP* AND ANUJ SETHI**

ABSTRACT

Digital taxation is an issue in international economic law today. This is because big companies do business online without having offices in the countries where they operate. India has made some laws and rules to deal with the problems that come with taxation. These include the Equalisation Levy, Significant Economic Presence rules and taxes on services. This article looks at taxation from India's point of view. It talks about what digital taxation's how it has changed and the laws that govern it. The article also discusses how courts have handled taxation cases and the problems that people face when dealing with it. It looks at what's happening internationally especially with the OECD and G20 and how this affects India's digital taxation rules. Digital taxation is an issue and India is working to find ways to tax digital businesses. The article examines the framework of digital taxation and the challenges that come with it. Digital taxation is an issue, for India and the world and this article tries to understand it better.

I. INTRODUCTION

The digital economy is changing the way countries do business with each other. This is affecting how taxes are collected. In the past taxes were based on how businesses used to work. They had factories, offices and employees in places. Now digital companies like those that run e-commerce platforms and social media systems make a lot of money from these things. They do not need to have a lot of buildings or offices in the countries where they are making money. This is a problem for the tax systems. The digital economy is making it hard for countries to collect taxes from companies. Digital companies are using cloud infrastructure and online advertising networks to make money. They are doing this without having a presence, in the countries where they are making money. This is changing how taxes need to be collected from companies.¹

* Author is a Student at Law College Dehradun, Uttarakhand University, Dehradun, Uttarakhand, India.

** Author is an Assistant Professor at Law College Dehradun, Uttarakhand University, Dehradun, Uttarakhand, India.

¹ Klaus Vogel, Double Taxation Conventions 45 (3d ed. 2015).

India is now a digital market. This is because more people are getting internet access using smartphones and making payments. The government is helping with programmes like Digital India and UPI. These programmes are making it easier for people to shop online use banking services learn online get healthcare, travel and enjoy entertainment. As a result global tech companies are making a lot of money from Indians who use their services. The growth of India is good, for the economy. Multinational technology companies are benefiting a lot from users and consumers. The government programmes are helping digital India to grow. India has become one of the digital markets globally. The digital payment infrastructure and fintech systems are also growing in India.²

International tax rules that are really old and based on the idea of an establishment are not working well for companies that do business on the internet. These companies can do a lot of business in a country without being there so they can avoid paying taxes. This is a problem because it means that countries are losing money that they would normally get from taxes. It is especially bad for countries that are still developing. Because of this people started to worry about companies moving their profits to places where they do not have to pay much in taxes and countries losing the tax money they need. So international organisations decided to try to change the tax systems to deal with the problems that the internet is causing. They want to make sure that digital companies, like these pay their share of taxes. International tax rules and digital companies are an issue now.³

II. CONCEPT OF DIGITAL TAXATION

Digital taxation is about taxing the money that people make from things like doing business online using the internet to sell things and making money from technology. Digital businesses are different from businesses because they do not need a lot of physical things like buildings and equipment. Instead digital businesses rely on things you cannot touch like computer programs, formulas, information that users provide online ads and talking to people over the internet. Digital taxation is important for businesses because they make money in a different way than regular businesses do. Digital businesses, like these make money from means and online business models.⁴

The idea of a connection came about because countries with their own rules are starting to think that people using these digital services are really helping to create value. Places like Google,

² Ministry of Electronics and Information Technology, Digital India Programme Report (2024).

³ OECD/G20 Inclusive Framework on BEPS, Statement on a Two-Pillar Solution (2021).

⁴ Reuven S. Avi-Yonah, International Taxation of Electronic Commerce, 52 TAX L. REV. 507 (2016).

Amazon and Facebook make money from the information people give them how people behave on their sites and the fact that lots of people are using them. So some countries think they should be able to tax these companies based on how money they make from people in their country not just because they have an office there. Digital business models, like these are making a lot of money from user participation. The digital nexus is important because it helps countries understand how to tax businesses.⁵

Digital taxation can be done in a ways. It includes things like the Equalisation Levy and the Digital Services Tax. We also have to think about taxes on payments we make online. Then there is the tax on things we buy from stores.. Sometimes we pay tax without even realizing it like when we pay GST or VAT. The way we do things is changing with technology like cryptocurrency and blockchain. We are also hearing a lot, about intelligence and metaverse platforms. All of this is making people think about how we should tax the money we make from things and the businesses we do online with digital assets.⁶

III. EVOLUTION OF DIGITAL TAXATION IN INDIA

India was one of the countries to take steps on its own to target big digital companies that operate in many countries. The government of India saw that these technology companies were making a lot of money from people, in India. They were not paying taxes because of the way the rules work around the world. So the Central Board of Direct Taxes set up groups of experts to look into the issues of taxing companies that do business online like those that sell things on the internet and other online India systems, especially the India e-commerce and online commercial systems of India.⁷

The Finance Act of 2016 brought in a tax called Equalisation Levy on online advertising services provided by non-resident entities. This levy was initially set at six percent on digital ad payments made to foreign companies. The goal was to make things fair for businesses that pay income tax in India and foreign digital companies that don't have similar tax obligations. The Equalisation Levy aims to level the playing field for all businesses operating in the space whether they are based in India or not and the Finance Act of 2016 introduced this levy to achieve that goal. The six percent levy applies to specified advertisement payments made to foreign enterprises and it is an important step, towards creating a more equitable tax environment.⁸

⁵ OECD, Public Consultation Document on User Participation Proposal (2019).

⁶ IMF, Tax Challenges Arising from Digitalization (2019).

⁷ Central Board of Direct Taxes, Committee on Taxation of E-Commerce Report (2016).

⁸ Finance Act, 2016, ch. VIII, §§ 163–180 (India).

The Finance Act, 2018 changed things by adding the idea of Significant Economic Presence to Section 9 of the Income Tax Act, 1961. This meant that the Income Tax Act, 1961 now included interaction and economic participation as a good enough reason to pay taxes. The Finance Act, 2018 made these changes. The Finance Act 2020 made changes to the Equalisation Levy. It added a two percent tax on e-commerce operators who help people, in India buy things online. This includes the sale of goods and services that involve people who live in India. The Finance Act 2020 did this. The Equalisation Levy now includes this two percent tax.⁹

IV. LEGAL FRAMEWORK IN INDIA

India's laws on taxes are mainly based on the Income Tax Act of 1961 rules on Equalisation Levy and Goods and Services Tax laws. The Equalisation Levy works separately from income tax rules. This separate working causes problems when it comes to understanding treaties and getting foreign tax credits. The Income Tax Act of 1961 and Equalisation Levy provisions and Goods and Services Tax legislation are key to taxation in India. These laws govern how digital businesses are taxed in India. The Equalisation Levy provisions are a part of this. They ensure that digital companies pay their share of taxes. The Income Tax Act of 1961 sets the rules for income tax. The Goods and Services Tax legislation handles GST. All these laws together form India's taxation framework. The Equalisation Levy and income tax rules can sometimes conflict. This conflict can make treaty interpretation and foreign tax credit tricky. India's digital taxation framework is based on these laws. They are crucial, for taxing businesses. The framework helps ensure that digital companies operating in India pay taxes. The laws are a part of India's tax system. They govern taxation. The Income Tax Act, Equalisation Levy and Goods and Services Tax laws are essential.¹⁰

The Economic Presence rules that are part of Section 9 are trying to figure out when to tax companies based on how they interact with people in India online. This is a change from the usual way of doing things because now companies can be taxed even if they do not have a physical office or store in India. The Economic Presence rules are really different because they let India tax companies even if they are not really present, in the country.¹¹

The Government Service Tax laws also say something about Online Information and Database Access or Retrieval Services. These are services that foreign companies give to people in India. So foreign companies that provide these services to people in India have to sign up for the

⁹ Income Tax Act, 1961, § 9 Explanation 2A (India).

¹⁰ Equalisation Levy Rules, 2016, Rule 3.

¹¹ Income Tax Act, 1961, § 9 Explanation 2A

Government Service Tax system. They have to follow the rules about paying taxes on things like subscriptions and cloud services and digital streaming platforms and software supplies. The Government Service Tax laws are very clear, about this. Foreign companies have to do what the Government Service Tax laws say when it comes to subscriptions and cloud services and digital streaming platforms and software supplies.¹²

V. INTERNATIONAL DEVELOPMENTS

The Organisation for Economic Cooperation and Development and the G20 started the Base Erosion and Profit Shifting Project. This project is about stopping companies from avoiding taxes. The Organisation for Economic Cooperation and Development and the G20 want to make sure these companies pay their share. The Base Erosion and Profit Shifting Project has an Action Plan 1. This plan looks at the problems that come with digitalisation of activities. The Organisation for Economic Cooperation and Development and the G20 think that because of digitalisation the current tax rules are not working well. So they proposed some reforms to update the taxation rules. The Base Erosion and Profit Shifting Project is important for the Organisation, for Economic Cooperation and Development and the G20 because they want to make sure that multinational corporations pay taxes where they do business.¹³

The Organization for Economic Cooperation and Development then came up with the Two-Pillar Solution. The Organization for Economic Cooperation and Development Two-Pillar Solution has the Organization for Economic Cooperation and Development Pillar One and the Organization for Economic Cooperation and Development Pillar Two. The Organization for Economic Cooperation and Development Pillar One is about making sure that the Organization for Economic Cooperation and Development taxing rights are given to the places where people are actually using things and where the Organization for Economic Cooperation and Development economy is really happening. On the hand the Organization for Economic Cooperation and Development Pillar Two is about making a global minimum corporate tax so that the Organization, for Economic Cooperation and Development companies cannot just move their money to places that do not tax very much.¹⁴

Several countries like France, Italy, Austria, Spain and the UK have introduced their Digital Services Taxes. These taxes are aimed at ads, social media platforms and digital marketplaces. These taxes have caused trade tensions. The United States says these taxes unfairly target tech

¹² Central Goods and Services Tax Act, 2017, § 2(17).

¹³ OECD, Base Erosion and Profit Shifting Project Explanatory Statement (2015).

¹⁴ OECD/G20 Inclusive Framework on BEPS, Pillar One Blueprint Report (2020).

companies. The US thinks these taxes are unfair to their technology corporations. These countries introduced these taxes to target advertisements, social media and digital marketplaces. The United States is, against these taxes.¹⁵

VI. JUDICIAL APPROACH

Indian courts have done a job of figuring out issues with digital transactions and software payments. They have also made some decisions about taxing technology services. These decisions have really helped people understand things like royalty and business connection when it comes to taxation law. The Indian courts have also helped clarify what a permanent establishment is in the context of taxation law. Indian courts and their decisions, on taxation law have been very important.¹⁶

In the *Engineering Analysis Centre of Excellence Pvt. Ltd. V. Commissioner of Income Tax* case the Supreme Court made it clear that when we buy software it does not mean we are paying royalty payments every time. The Supreme Court said royalty payments are only made when the actual rights to the software are given to someone. This decision by the Supreme Court helped to clear up some confusion, about how software transactions and digital supplies are taxed. The *Engineering Analysis Centre of Excellence Pvt. Ltd. V. Commissioner of Income Tax* case is important because it talks about software transactions and digital supplies.¹⁷

In the case of *Formula One World Championship Ltd. V. Commissioner of Income Tax* the Supreme Court looked at the rules for an establishment and said that it is really important to have a fixed place to do business when it comes to international taxation law for *Formula One World Championship Ltd.* The Supreme Court made it clear that *Formula One World Championship Ltd.* Needs to follow these rules. The rules for an establishment are significant, for *Formula One World Championship Ltd.* Because they help figure out how *Formula One World Championship Ltd.* Is taxed.¹⁸

VII. CHALLENGES OF DIGITAL TAXATION

One of the problems with taxing digital things is figuring out what digital taxation is taxable when a company does not have a physical office in a country. The old rules, for taxing companies still depend a lot on the idea of a permanent establishment and physical buildings

¹⁵ European Commission, *Fair Taxation of the Digital Economy* (2018).

¹⁶ Nani Palkhivala & B.A. Palkhivala, *The Law and Practice of Income Tax* (10th ed. 2019).

¹⁷ *Engineering Analysis Centre of Excellence Pvt. Ltd. v. CIT*, (2021) 432 ITR 471 (SC).

¹⁸ *Formula One World Championship Ltd. v. CIT*, (2017) 394 ITR 80 (SC).

even though the way business is done has changed a lot with technology and digital taxation. Digital taxation is something that's still hard to understand and it is related to digital taxation.¹⁹

The problem of taxation is a big issue. This happens because countries are making their rules about taxing digital stuff and these rules do not always follow the agreements they have with other countries. As a result big companies that work in countries may have to pay taxes in several places for the same thing and they do not always get any help to avoid paying twice. Double taxation is a concern, for these companies because they have to deal with paying taxes in many different places.²⁰

The world of technology is moving fast with things like blockchain systems, cryptocurrency transactions, metaverse platforms, artificial intelligence and decentralised finance. These new technologies create problems for the people who deal with taxes. The laws we have now often have a time keeping up with the new ways that businesses are working in the digital world. Blockchain systems and cryptocurrency transactions and metaverse platforms and artificial intelligence and decentralised finance are all changing quickly. This means that the people who make the rules, about taxes have to figure out how to deal with blockchain systems and cryptocurrency transactions and metaverse platforms and artificial intelligence and decentralised finance.²¹

VIII. CONCLUSION AND SUGGESTIONS

Digital taxation is a big deal in international economic law right now. This is because digital business models have changed everything about how commerce and territory and sovereignty work India is taking an active approach to deal with this. They have things like the Equalisation Levy and the Significant Economic Presence rules. They also have rules for GST on services and ways to stop people from avoiding taxes. All of these things are meant to protect the money that India makes. Digital taxation is very important, for India. They are doing a lot to make sure they get the money they need from digital business models.²²

There are still a lot of problems with treaty conflicts and double taxation. We also have to deal with compliance burdens and administrative complexity.. Then there is technological innovation. The thing is, we need countries to work together more to make sure taxing rights are fair and to stop trade disputes between places. International coordination is really important

¹⁹ Jinyan Li, *Protecting the Tax Base in the Digital Economy*, 9 *WORLD TAX J.* 123 (2017).

²⁰ Deloitte India, *Equalisation Levy and E-Commerce Taxation Report* (2022).

²¹ World Bank, *Digital Economy for Development Report* (2021).

²² Law Commission of India, *Taxation of Digital Economy in India: Issues and Challenges*, Working Paper (2023).

for this. We need it to make sure everything is fair and to prevent problems, between countries. Treaty conflicts and double taxation are issues that we have to address.²³

India should keep taking part in the OECD and G20 talks. At the time India needs to make its laws clearer and make its administration work better. When it comes to taxing things in the future the rules have to be fair to everyone. They need to bring in money for the country. Also let new technology happen let other countries invest and help the economy grow. The digital economy is a thing and it is always changing. So the people, in charge need to work with other countries to make sure everything runs smoothly. India and other countries need to find a way to make rules that work for everyone so that the digital economy can keep growing and changing. The OECD and G20 negotiations are important for India and the country should keep working with them to make sure the digital economy is fair and works well for everyone.²⁴

²³ United Nations Committee of Experts on International Cooperation in Tax Matters, *Digital Economy Taxation Report* (2022).

²⁴ Arthur J. Cockfield, *The Rise of the OECD as Informal World Tax Organization*, 8 *YALE J.L. & TECH.* 136 (2006).