INDIA: TAXATION AND CROSS-BORDER DIGITAL SERVICES

December 2025

Cross-border digital services pose a novel challenge to international taxation. Not covered by the traditional definition of 'permanent establishment' (PE), digital services have been sought to be taxed alternatively under various 'source-based' approaches: via Digital Service Taxes (or Equalization Levies), via the Significant Economic Presence (SEP) test, as Service PEs, as Dependent Agent PEs, and as Virtual PEs. Each of these relatively recent approaches has attracted critical attention and, in some cases, international retaliation.

As the lead initial international effort, the OECD's 2013 Action Plan on Base Erosion and Profit Shifting (BEPS)—based on a proposed reallocation of taxing rights including for digital services (*Pillar One*) and a global minimum tax of 15% on MNEs over a threshold revenue (*Pillar Two*)—has progressed to cover: *a)* an '*Action 1: 2015 Report*', *b)* the '*2017 BEPS Multilateral Convention*' (now in force), *c)* a '*2021 Statement on the Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*', and *d)* the '*2023 Multilateral Convention to Implement Amount A of Pillar One*' which is under review (not opened for signature), including by the US which holds greater weight under the convention's text given the number of 'Ultimate Parent Entit[ies]' of technology companies in its territory.

Providing initial impetus, the '*Action 1: 2015 Report*' proposed fresh approaches on taxing the digital economy: *a)* a nexus-based concept of SEP based on an entity's 'purposeful and sustained interaction' with a country's economy via 'technology and other automated tools', *b)* a withholding tax on digital transactions (cloud or SAAS services) on certain types of digital transactions to enforce net taxation given the expanded nexus via SEP, and, separately, *c)* an equalization levy (or digital tax) to overcome problems of nexus based attribution.

The *2017 BEPS Multilateral Convention* introduced expanded taxing rights (adopted by parties via amendments to qualifying DTAs) and clarified, among others, that a PE would include Dependent Agents (habitually concluding contracts on behalf of an enterprise) or even a person acting in an independent capacity (but operating almost exclusively on behalf of one or more enterprises). The '*2023 Multilateral Convention to Implement Amount A of Pillar One*' (pending review) proposes modified nexus-based taxation for digital services—requiring MNEs with adjusted revenues greater than €20 billion (and a pre-tax profit margin above 10%) to allocate 25% of profit above 10% to market jurisdictions from which they derive at least €1 million in

revenue (or €250,000 for lower GDP economies) via rules for allocation, and for such allocated amount to be taxed by the relevant market jurisdictions as nexus-based income.

Recognizing that payments for digital services do not qualify as taxable 'royalty' in India under existing DTAs (payments for digital services remain 'business income', see *Engineering Analysis v. CIT*, 2021 Supreme Court) or 'fees for technical services' (as technical know-how is not 'made available' via digital services, see *SFDC Ireland v. CIT*, 2025 Delhi High Court), India enacted an 'Equalization Levy' to tax digital services (dubbed the 'Google Tax') in 2016 shortly after the '*Action 1: 2015 Report*'—covering payments for online advertising (via the Finance Act 2016) and payments for e-commerce subject to certain exceptions (via the Finance Act 2020).

Additionally, in 2018, India amended the Income Tax Act 1961 (IT Act), introducing SEP as a basis for nexus-based taxation (under Section 9 Explanation 2A IT Act), covering payments for downloads of data or software above a threshold amount and/or interacting with a threshold number of users in India—clarifying that a levy under SEP was separate and only applicable mutually exclusively from an Equalization Levy (Section 10(50) IT Act).

However, as they stand currently, both the SEP test and the Equalization Levy have been largely ineffective for taxing cross-border digital services. First, the SEP test is a recent domestic amendment to the IT Act and is consistently overridden by the provisions of DTAs when they are more beneficial (see *Union of India v. Azadi Bachao Andolan*, 2003 Supreme Court). Second, India abolished the Equalization Levy (stage-wise) in August 2024 and April 2025—following US' threatened tariffs and a 'revenge tax' via 'Section 899' (later excluded from the 'One Big Beautiful Bill') and an earlier 'Section 301 US Trade Act 1974' investigation in 2020 that had termed digital taxes as being unilateral and inconsistent with principles of international taxation. Moreover, a revocation of Digital Taxes has reportedly been insisted on as a condition for progressing discussions on *Pillar One*.

Partly in response to the lack of effective tools to tax cross-border digital services, the definition of PE has steadily expanded over the past few years. For instance, in *Galileo International Inc. v. DCIT* (2008, ITAT Delhi), computer terminals installed at the premises of unaffiliated travel agents to carry out travel bookings constituted 'fixed place' PE—covering payments for the provision of digital services accessed via physical infrastructure in India. More recently, in *Hyatt International v ACIT* (2025, Supreme Court), a fixed-place PE was found to be established by a foreign enterprise conducting business via physical premises in India contractually 'at its

disposal'—notwithstanding a lack of ownership or exclusive control. Similarly, previously, in *Formula One World Championship v. CIT* (2017, Supreme Court), temporary access and control over a racing circuit was found to constitute a 'fixed place' PE and termed as 'a projection of the [Formula One enterprise] … on the soil [of India]'. Such expansive interpretation is not necessarily unique to India, and other courts have also found a PE based on minimum control over physical infrastructure (see *Schleswig-Holstein Tax Court (Switzerland)*, II 1224/97–EFG-2001). However, attempts to interpret PE to additionally cover entirely foreign-operated digital businesses (*e.g.*, digital advertising platforms) by terming them 'virtual fixed-place PE' have been rejected by Indian courts (see *IT Officer v. Right Florist*, 2008 Calcutta High Court).

Indian tax authorities have also (unsuccessfully) argued for an expanded interpretation of a 'service PE'—applicable where foreign enterprises render services through personnel physically present in India (see *Morgan Stanley & Co. Inc. v. DIT*, 2007 Supreme Court)—to additionally cover cross-border digital services provided without the physical presence of personnel as a 'virtual service PE'. However, that interpretative attempt has been recently rejected by Indian courts on the basis that it was not borne out by the text of the relevant DTA(s), which would need to be amended to cover/validate the concept of a 'virtual service PE' (see *Clifford Chance Pte Ltd. v. DCIT*, 2025 Delhi High Court).

On a more limited basis, Indian tax authorities have successfully invoked 'agency PE' to tax foreign enterprises that rely on Indian residents to conduct operations or enter into contracts, including contracts for the supply of digital services to Indian customers (see *Amadeus Global Travel Distribution SA v. DCIT*, 2007 Delhi ITAT). While an 'agency PE' exists where an Indian resident habitually acts and/or concludes contracts for a foreign enterprise, that can nevertheless be rebutted via a contract that clearly allots entrepreneurial risks, pricing authority, and IP rights to the foreign enterprise (see *SFDC Ireland v. CIT*, 2024 Delhi High Court).

As domestic interpretative efforts to cover the taxation of digital services remain chequered, the multilateral axis for negotiating/codifying source-state taxing powers appears to have partly shifted to the UN (via UNGA Resolution 79/235, adopted 31 December 2024) and its attempt at a comprehensive *Framework Convention on International Tax Cooperation* with the participation of over a 100 countries, expected to be finalised by 2027. Relevantly, that would reportedly include a protocol on the taxation of cross-border digital services aimed at being 'sufficiently flexible…to ensure equitable results…as technology and business models evolve'.