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DIGITAL TAXATION IN INDIA: CONSTITUTIONAL LEGITIMACY OF EQUALISATION LEVY, SIGNIFICANT ECONOMIC PRESENCE AND SEARCH & SEIZURE UNDER INCOME TAX ACT¹.

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Abstract:-

Digital Taxation in India was introduced in the year 2016 by way of the Finance Act, 2016. The Digital Taxation was a core concept authorising the Government of India to tax the e-commerce operators, social media operators, digital virtual space operators and digital platforms in India. Because of the traditional taxation system on foreign companies involved in e-commerce and digital platforms, the Government of India implemented Equalisation Levy in the year 2016 and has dropped the same in the year 2024. At the same time, it has adopted Significant Economic Presence in the year 2018 and it was introduced in Section 9(1)(i) of the Income Tax Act, 1961 and later implemented with some amendments in the present Income Tax Act, 2025. The significant economic presence reveals that, the digital taxation is carried out based on substantial economic presence or economic activity carried out by non-resident entities in India without the physical presence. For the past few years, there were some questions arose regarding the constitutional validity and Legal validity of digital taxation law in India. There were also critics saying that, India is not following right to privacy assured by the Supreme Court of India, under Articles 14 and 21 of the Constitution of India, 1950 in Search and Seizure procedures and it amounts to Executive overreach and violates the doctrine of Proportionality. Hence, under the circumstances of above questions in mind, this study is carried out regarding the legal validity in implementation of Digital Services Taxation in India and its constitutional legitimacy on Equalisation Levy, Significant Economic Presence and some other issues like search and seizure, Double Taxation and adaption of International Treaties regarding Digital Services taxation in India.

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1. Introduction: -

In India, the rapid digitalization of the global economy has interrupted the traditional principles of international taxation, which were built on the concept of physical presence. Several Multi National digital enterprises generated and earned a substantial amount of revenue from the consumers in the market of India. India in response to the same introduced the Equalisation Levy by way of the Finance Act, 2016. The Act imposed 6% levy on online advertisement services and later on expanded it to 2% levy on e-commerce supplies by the resident operators² by 2020. The increase of several E-commerce operators like passenger transport like Uber, Ola, etc. the restaurant services like Zomato, Swiggy, etc., involved a marketing business amounting to several crores of rupees. However, the Laws of the land has to be reshaped in order to impose tax on such digital oriented companies and e-commerce operators. In the beginning India applied unilateral universal methods and introduced Equalisation levy without interpreting the Income Tax Act, 1961 and there were several critics on Equalisation levy I and II and breach of International Treaties on avoidance of double taxation. As a monistic theory supporter, India has adopted Municipal Law in order to strengthen the exchequer and adopted them as a temporary measure. However, by introduction of Income Tax Act, 2025, India has removed several ambiguities related to digital taxation in India and strengthened its Fiscal Sovereignty and Government Exchequer in accordance with the changing needs and circumstances of the digitally developing world. Hence, this study endeavours to analyse and find out the constitutional legitimacy in adopting and dropping the Equalisation levy and adoption of significant economic presence and adapting legal provisions without affecting the international treaties and move along with global trends in digital taxation on digital income and profits.

2. Significance of the Study: -

As constitution of India entrusts the duty upon the State to impose tax only under the authority of law under Article 265 of the Constitution of India, it has become necessary to put in the anvil the competence of Digital Taxation by the Government of India, as the present taxation has transcended from the traditional concepts of Taxation theory to a new technological and innovative theories of taxation on online and digital platforms. Under the Income Tax Act, 1961, section 9 of the Act provides for traditional taxation on non resident

² <https://taxguru.in/income-tax/indias-equalisation-levy-taxing-big-tech-digital-age.html> Kirandeep Kaur, "India's Equalisation Levy : Taxing Big Tech in the Digital Age". 2.3.3026

entities only on the ground of Permanent Establishment in India and physical presence. Hence, the Government could not implement digital tax on that basis and hence, adapted the

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Equalisation Levy and later on significant economic presence. Hence, the various transformations were witness by India and hence, it is significant to have a study on constitutional validity of digital taxation, whereby India has to balance fiscal sovereignty of state and protect the individuals and organisations with proportional theory of Taxation. This article has ventured into analysing the earlier and recent concepts and developments of digital taxation in India.

3. Research Methodology:-

The researcher has done doctrinal research on this topic and has utilised the Normative Legal Research Methodology in this study. The researcher has relied upon the primary source of Constitution of India, 1950, Income Tax Act, 1961, Income Tax Act, 2025 and some of the International Treaties related to digital taxation and has employed all the necessary secondary sources like Books, Articles published in Journals, Newspaper information, Internet portals and Statutory provisions. The Conceptual frame works on the theories and doctrines are evolved by the Supreme Court of India and research scholars and on collection of information related to Parliament. The researcher has had an intensive study of decided case laws and employed the method of case analysis and employed some other research tools to arrive at the conclusion and suggestions.

4. Statement of Research Problem:-

As we have entered into the digital era, we could witness that, India has to transcended from physical presence taxation methods to the digital taxation methods. As the digital taxation field is developing and found with various blurred areas, the researcher intended to have an intensive study of various constitutional and legal impacts on validation of Digital Taxing services and the core issues related to constitutional validation. The major issue in digital taxation is the absence of physical presence and its constitutional validity relates to Equalisation Levy imposed by Indian Parliament. The next issue is related to legislative competence, which requires compliance with Article 265 of the Constitution of India, 1950. Thirdly, the legislative competence on the extra-territorial nexus under Article 245 (2) of the Constitution of India and characterisation of Income under section 9 of the Income Tax Act, 1961 and impediment of

Double Tax Avoidance Agreement Treaties. The equalisation levy followed by India was found to be out of scope from the Income Tax Act, 1961 and was viewed as violation of international tax treaties, rules and General Agreement on Trade Services and caused double taxation.

5. Literature Review:-

The Government of India realised that, the digital enterprises in international level have developed and operated their business in virtual space and generated their income and profits by utilising the users or customers in India. As tax imposition is one of the major and primary duty of a state to collect and utilise the same for the development of our country, the Government of India, imposed digital tax by way of Equalisation Levy in the Finance Act, 2016. The Act imposed 6% tax on payments made to beneficial foreign owners providing digital services limited to advertisement services. Thereafter there were several developments in the digital taxation in India.

In a work done by Arun Paul and N. Ramalingam³, "OECD-G-20 framework and Indian digital taxation: A study on equalisation levy in India", the study reveals that, India is one of the fastest-growing digital economies in the world and India is the second largest market for e-commerce activities generated around 644 million users in 2021 alone as per the State of India's Economy Report, 2023. The study got an intensive analysis on the alternative arrangement from Equalization levy based on OECD-G20 two pillar frame-work. The authors observe that, the major issues on equalisation levy can be sorted out by adopting the OCED-G20, which aims at preventing double taxation of foreign entities or residents between the contracting states and it guides how to tax income and capital investment in international Transactions. Articles 4 and 5 of the convention define tax residency and permanent establishment and provides detail for taxation of income and capital in the source country and resident country. While concluding the study the authors are of the view that, foreign digital Multi National Enterprises should not be given excessive burdens by high digital taxes and at the same time, a fair balance should be maintained between national tax laws and international tax treaties. They proposed for the idea of following OECD-G20, two pillar frame-work on digital taxation.

The Supreme Court in the case of Union of India -v- Azadi Bachao Andolan⁴, has held that, the Parliament has got wide legislative competence in fiscal matters. It emphasised that,

³ Arun Paul & N. Ramalingam, " OECD-G-20 framework and Indian digital taxation: A study on equalisation levy in India"- Kerala Economy, Vol 4 No. 3 July-September 2023. Page No. 38

⁴ (2004) 10 SCC 1.: AIR 2004 SC 1107.

the courts should maintain judicial restraint in economic policy decisions. In this case, the Supreme Court set aside the ruling of a Delhi High Court, which quashed the circular issued by the Central Board of Direct Taxes (CBDT) in Circular No. 789, which provided for the assessing cases under the Indo-Mauritius Double Taxation Avoidance Convention (DTAC) and held that Circular No. 789 was valid and effectively issued within the powers of CBDT.

The Equalisation Levy ensures that, the digital profits linked to the Indian users are taxed domestically and foreign enterprises i.e., non-resident entities without local presence. It is to be noted that, under Significant Economic Presence (SEP), under the Income Tax there is nexus between digital interaction and user participation. The Equalisation Levy provides for economic value in digital age through user engagement, data utilisation and digital consumption rather than physical presence. It is considered as a structural transformation in accordance with global commerce. The tax systems in every nation have reshaped in order to cater to the needs of change in physical commerce in to digital commerce and digital economy.

6. Constitutional Legitimacy of Digital taxation: -

a) Meaning of Digital Tax: -

In an article published by Ajay Sharma and Nikhil Gupta on 22.10.2019⁵, the authors reveal that, the Digital tax otherwise called Google tax is imposed by source country on the revenue generated by global tech companies in such countries. The digital tax is not defined in any domestic law or in any international treaty. However, we can infer that, any tax collected on income generated through digital services can be defined as Digital Tax.

b) Foundational concept of Equalisation Levy: -

India introduced the concept of equalisation levy as there were no appropriate legislation in India to tax the Multinational companies and global digital enterprises like Google, Facebook, etc., which were earning income as well as profits without any permanent establishment or residence in India, which is a source country. In order to resolve the same, our country by way of Chapter III of the Finance Act, 2016 introduced the Equalisation levy, without considering the permanent establishment and residence. The levy was fixed at 6% of the amount of consideration received or receivable by a non-resident MNE for various specified services provided to a resident in India. It applied to business-to-business transactions. It is to

⁵ Ajay Sharma and Nikhil Gupta, 'Digital Tax': The changing contours of tax structure in India, SCC Times (online)

be noted that only online advertisements were levied under the scheme till 2020. Thereafter, again Equalisation Levy -II was introduced by the Government of India on e-commerce operators in the year 2020. As per the levy, a foreign e-commerce operator without a permanent establishment in India should be taxed on the total amount of revenue generated from Indian users. The rate of 2% tax was fixed and the threshold limit was 2 crore rupees. Several big companies like Amazon, Apple, Flipkart, etc., come under the purview of the taxation and applies to all e-commerce transaction between India and foreign e-commerce operators. This digital taxation was considered as user participation. Thus, the Government of India imposed digital services tax on non-resident companies or operators based on business-to-business transactions and Indian users' participation, which was sometimes contradicted with International Double Taxation Agreements entered with foreign countries. As the International Treaties are not justiciable, some scholars were of the view that, Equalisation levy cannot be implemented for a long time.

c) Foundational concept of Significant Economic Presence: -

Following the implementation of equalisation levy, the Government of India introduced the concept of Significant Economic Presence (SEP) in the year 2018. It was introduced through the memorandum explaining the provisions of the Finance Bill, 2018 to tax the digital entities and to expand the tax base. It was based on OECD-G20 BEPS plan 1 report. As per the plan, the foreign digital entities, who had considerable business in India can be taxed irrespective of permanent establishment. Moreover, the Indian agents, who are doing contracts in favour of foreign entities should be taxed as significant economic presence in India. The concept was discussed in line with Tax related treaties. The scheme was introduced by the Government through the Finance bill, 2018 and came to force on the 1st April, 2019 and applied to the 2019-2020 Assessment years and subsequent years. This method was considered as substantial economic presence of non-resident entities, who have their business income in India, without their physical presence.

d) Constitutional legitimacy of Equalisation Levy and Significant Economic Presence: -

Article 265 of our Indian constitution provides that; no tax shall be levied or collected except by authority of law. Thus, it gives enormous powers to the Parliament of India to authorise collection of tax only by way of legislation and it should be collected by authority permitted under the legislation. The above provision is a protective measure against any arbitrary fiscal exaction from the tax payers. The question of constitutional legitimacy was

discussed when the Government of India imposed equalisation levy in the year 2016 without amending or making provision under the Income Tax Act, 1961. However, the Government was of the view that, it was only a temporary measure and only a meagre level of 2 to 6 percent of tax was imposed with regard to digital advertisements. It is pertinent to note that, the Indian tax system was traditional and not designed to tax digital economy. The major problems are permanent establishment and non-residential and physical presence characters of foreign companies involved in e-commerce operation and digital services among Indian users.

The equalisation levy was justified on the grounds⁶ that, the digital companies were generating substantial revenue from Indian users, without contributing proportionate tax revenue to Indian exchequer. The Indian government acted proactively and adapt tax laws with technical transformation and recognised the market jurisdiction on the user side and it was simple and utilised for immediate revenue generation. The tax thus imposed on digital transaction was business to business based and user participation based.

e) Constitutionality of levy of GST on betting and Gambling transactions: -

The Supreme Court in the case of Directorate General of Goods and Services Tax intelligence (HQS) & others -v- Games kraft Technologies Private limited and others, while discussing with the batch of writ petitions held that, it had got an opportunity to reaffirm certain foundational principles governing the exercise of taxing power within digitally mediated economies. The Court observed strictly that, while the GST framework must possess sufficient flexibility to respond to new and evolving forms of commercial activity, such flexibility cannot come at the cost of constitutional discipline. Though the power to tax remains broad, it is circumscribed by legislative competence, statutory prescription and constitutional structure and hence, only by preserving the balance between technological innovation and constitutional restraint the legal system can maintain both certainty and legitimacy in an increasing digital economy⁷. The Supreme Court held that, the statutory framework in the CGST Act bears a clear nexus with the taxable event identified by the legislature namely the supply of actionable claims arising from betting and gambling transactions. Mere commercial hardship, reduction in profitability or increased tax incidence cannot by itself render a fiscal measure unconstitutional.

In fine, the court held that, the levy of GST on actionable claims arising from betting

⁶ S.M. Vijay, "Taxation of Digital Economy in India: Are Equalisation Levy & Digital Taxation Enough?"- 24.2.2026

⁷ Directorate General of Goods and Services Tax intelligence (HQS) & others -v- Gameskraft Technologies Private limited and others. 2026 INSC 595.

and gambling transactions is constitutionally valid within the competence under Article 246 A of the constitution and consistent with the statutory framework of CGST Act, 2017.

f) Constitutionality of Searching powers under digital taxation: -

The Supreme Court in the case of *Pooran Mal -v- Director of Inspection*⁸, has upheld warrantless searches as "lawful coercion, establishing seized materials admissibility despite procedural irregularities when founded on credible intelligence.

The Income Tax Act, 2025 has come to force on 1.4.2026 in which section 247 (1) (b)(iii) provides for search and seizure power in case of Virtual Digital Space. It authorised and extended the physical searches provided under the Income Tax Act, 1961 and authorised the officer to override access codes to reach any computer system or virtual digital space, when code is not available. At the same time, section 261 (j) of the Act provides for virtual digital space, which means a non-physical space created and accessed through computers, where people interact and perform activities through computer systems, communication devices, cyber space, world wide web, storage and exchange of electronic information and includes social media accounts, remote servers and other similar intent-based platforms, net-works and devices. The Act provides for 'reason to believe' a possession of undisclosed income, assets, documents and information. It extended the search and seizure provisions to VDS. Moreover, Article 249 of the Act provides that, the reason to believe need not be disclosed to any person.

The Supreme Court of India has dismissed a public interest litigation on 9.3.2026 in the matter of *Vishwa Prasad Alva -v- Union of India*⁹, which dealt with the question of search and seizure powers under section 132 of the Income Tax Act, 1961 (now section 247 of Income Tax Act, 2025). The Chief Justice of India Surya Kant's Bench refused to entertain the arguments that warrantless access to cloud servers, smartphones, laptops, emails and encrypted devices violates Article 21, which expands right to Privacy (*Justice (Retd) K.S. Puttaswamy -v- Union of India*¹⁰). The Supreme Court of India applied the Proportionality text and observed that, the cloud access seizure by the Income Tax officers from server data like AWS, Azure, Google cloud cannot be held irrational as the law provides for 'reason to believe' in case of concealment is legal and proper. Like that, the Pass word refusal by a digital operator in case of data encryption will amount to Penalties under section 276D of the Income Tax Act, 2025. In case of emails and social media the search proceedings is authorised by Judicial Magistrate

⁸ (1974) 1 SCC 345

⁹ *Vishwaprasad Alva -v- Union of India*, - Case No. W.P. (C) No. 2026/000123, Date of disposal: 9.3.2026. *Khurana & Khurana.com*.

¹⁰ (2017) 10 SCC 1.

order as like section 91 of earlier Criminal Procedure code and there is provisions for retention of digital copies for 180 days. Hence, the Supreme Court was of the view that, the proportionality test will fail in this case¹¹.

In the case of Principal Director of Income Tax (Investigation) -v- Laljibhai Kanjibhai Mandalia¹², The Supreme Court held that, there should be nexus between material in question and belief. If there is no nexus then the entire search proceedings should be set-aside. The Court was of the view that, the search proceedings were not uncontrolled and it is subject to statutory pre-conditions. The court in this case held that, the search and seizure procedure under Article 132 of the Income Tax Act, 1961 was of administrative character and the opinion of the income tax authorities must be honest and set aside the order of the Gujarat High Court, which set-aside the order of search issued by income tax authorities.

The Supreme Court considered the proportionality test in some cases and held that the legitimate aim of the parliament was to curtail tax evasions and to reduce undisclosed taxable income and regarding suitability test, as absorbed in Ritesh Sinha -v- State of Uttar Pradesh¹³ case the fundamental rights are not absolute but subject to compelling public interest provided there should be limitation on the powers of authorities, which should not be arbitrary or excessive in nature. Finally, regarding the necessity test, the law provides for 'reason to believe', which shows that, the authorities should be satisfied before exceeding the intrusion of evidence. It is also subject to judicial scrutiny. However, some scholars are contending that, the procedure of search and seizure under section 137 of the Income tax act 1961 and its extension under section 247 of the Income Tax Act, 2025 is contrary to the Judgment made in Justice. Puttaswamy case and some procedural safeguards to be provided under the Act with some Judicial prior authorisation before search and seizure procedure.

g) Digital Tax and OECD adaption by India:-

The adaptation of the OECD- (Organisation for Economic Co-operation and Development) G-20 (Group -20) two pillar frame work 2021 has paved the way for a proper solution for many problems of digital taxation. The Digital tax base determination would be based on financial accounting income which will reduce the burden of multinational companies as it will reduce the compliance costs and the final burden to consumers. It is stated that, the Pillar 2 was widely accepted by all countries as corporate tax avoidance costs countries an

¹¹ Amrita Pradhan, "India's Digital Tax Search Powers: Supreme Court Rejects PIL, Affirms Section 132 Jurisprudence" - downloaded from Khurana & khurana.com - Advocates and IP Attorney.

¹² 2022 INSC 719

¹³ AIR 2019 SC 3592: (2019) 8 SCC 1.

estimated amount between USD 100- 240 billion annually which is around 4- 10% of global GDP (OECD, 2021). The authors clarified that, implementation of OECD-G20 (two pillar) frame work will get a global minimum tax will create a strong digital tax environment and competition¹⁴. It is to be noted that, now the Parliament has passed legislation in accordance with some principles of OECD-G20 Two Pillar framework and has aligned itself with global digital economy and altering some bilateral treaties and multi-lateral treaties with foreign countries to avoid the problem of Double - Taxation and strengthen its revenue exchequer in accordance with the principles and limitations imposed by the Constitution of India.

8. Conclusions and Suggestions: -

In fine, from the above-said discussions, circumstances and analysis of various articles and case studies, we can conclude that the constitutional legitimacy of the Income-tax Act, 2025 has been established and there is no doubt that, the Parliament has undoubted legislative competence to enact the Act and it rests mainly on Article 265 and Entry 82 of the Union List. Entry 82 of the Union list, in VII Schedule of the constitution of India, 1950 provides for "Taxes on income other than agricultural income". Article 246 empowers the Parliament an exclusive power to legislate and levy taxes on non-agricultural income, such as personal income tax and corporate-related income tax. As digital taxation is a recent development when compared to traditional imposition of tax imposition laws, the Parliament has modified, expanded and included the present requirements under law of the land. There was deficient in Permanent Establishment and physical presence to tax foreign companies involved in e-commerce and digital platforms, whom generated huge revenue and profits from the Indian users. Hence, the present Act has fully legitimised within the constitutional bounds and cleared the blur areas of temporary Equalisation Levy and significant economic presence. We can say the Equalisation levy though dropped; it shows a transformation of global commerce in India and affirmed that, the Digital economy cannot be put outside the tax net and fiscal sovereignty of India.

With regard to doctrine of Proportionality, as discussed above, articles 14 and 21 of the constitution of India, will not hit or contradict with Justice. (Redt.,) Puttaswamy case¹⁵ and the Supreme Court has already rejected this contention and yet to finalise regarding some issues on search and seizure requirements under Digital goods and services taxation like Providing

¹⁴ Arun Paul & N. Ramalingam," OECD-G-20 framework and Indian digital Taxation: A study on equalisation levy in India. Kerala Economy, GIFT, Vol.4 No. 3 July-September, 2023.

¹⁵ (2017) 10 SCC 1.

passwords, provide data encryption, intrusion into data privacy.

We should not forget the fact that, the passing and implementation of the Income Tax Act, 2025 will strengthen the tax revenue base of Indian Government for the development of our country, which is going to serve the contemporary needs of digital services taxation in digital space and digital platforms. Moreover, the passing of the Act has fulfilled the Equalisation levy adopted as an interim measure.

