Flash News

27 October 2017

Payment for granting distribution right of 'Adwords program' is taxable as 'royalty' under the Income-tax Act as well as India-Ireland tax treaty

Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Google India Private Limited[1] (the taxpayer/Google India) dealt with the issue whether payment by the taxpayer to Google Ireland Ltd. (GIL) under 'Adwords Program' Distribution agreement is royalty. The Bangalore Tribunal held that the said payment is taxable as royalty under the provisions of the Income-tax Act, 1961 (the Act) as well as under the India-Ireland tax treaty (tax treaty). The Tribunal observed that it is not merely an agreement to provide the advertisement space but is an agreement for facilitating the display and publishing of an advertisement to the targeted customer with the help of various patented tools and software. The taxpayer is having the access to various data and it uses the information for the purposes of selecting the ad campaign and for maximising the impression and conversion of the customers to the ads of the advertisers.

Further the Tribunal held that the taxpayer cannot claim that the royalty is chargeable to tax in the hands of the non-resident on receipt basis. In the present case, though it is not the concern of the taxpayer as to which method is being following by the GIL yet, noting that GIL is following the mercantile method of accounting, the chargeability of tax would be in the year when it is accrued and not in the year when it was received. It is not within the scope of the tax treaty to provide when (i.e. year of accrual or receipt), the income is required to be charged.

With respect to proceeding under Section 201 of the Act, the Tribunal observed that post amendment under Section 201, the period of limitation for initiation of proceedings for resident as well as non-resident should be 6 years from the end of the financial year. The Tribunal observed that the non-resident payee should be treated at par with resident payee under the Act and under the tax treaty. The non-discrimination clause under the tax treaty requires equal treatment of non-resident with resident under the provisions of tax treaty. If the law requires initiation of proceedings within 6 years from the end of financial year for the resident, the same treatment is required to be given to the non-resident.

Facts of the case

- The taxpayer is a wholly owned subsidiary of Google International LLC, U.S. The taxpayer is appointed as a non-exclusive authorized distributor of Adword programs to the advertisers in India by Google Ireland. Google is specialised in internet search engines and related advertising services. Google maintains an index of websites and other online content which is made available through its search engine to anyone with an Internet connection.

- The taxpayer entered into a Google Adword Program Distribution agreement (the agreement) on 12 December 2005 with Google Ireland Limited (GIL) for resale of online advertising space under the advertisers program to advertisers in India. Prior to the agreement, the ITES agreement, providing limited rights to the use of the intellectual property of GIL, was entered on 1 April 2004.

[1] Google India Private Ltd. v. ACIT [IT(TP)A.1511 to 1518/Bang/2013] – Taxsutra.com

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- Under the agreement, the taxpayer was granted the marketing and distribution rights of Adword program to the advertisers in India. It also includes assistance/training to Indian advertisers if needed in order to familiarise that with the features/tools available as part of our Adword product.
- During the years[2] under consideration, the taxpayer had credited a sum of INR 119 crores to GIL without deduction of tax at source. Further, GIL had also not obtained a nil deduction certificate from the tax department. The taxpayer claimed that no rights in the intellectual property of Google were transferred to the taxpayer from GIL. The taxpayer was mere reseller of advertising space made available under the Adword distribution program. The taxpayer is a distributor of advertising space and do not have any access or control over the infrastructure or the process that are involved in running the Adword program, as program runs on software, Algorithm, data center which are owned by Google and its subsidiaries outside India. The Adword platform is running on servers located outside India that belonged to or hired by Google. The taxpayer in India has no control over the server of Google.
- As the taxpayer had not complied with the provisions of Section 195, the Assessing Officer (AO) initiated proceedings under Section 201 of the Act treating the taxpayer as 'assessee in default'. Accordingly, the tax liability under Section 201(1) and 201(1A) for the AY 2007-08 to 2012-13 were determined by considering the amounts payable to GIL as royalty under the Act and under the tax treaty. The Commissioner of Income-tax (Appeals) upheld the order of the AO.

Tribunal's decision

Royalty

Advertisement/selling of the space or marketing for the product/services of the advertiser with the help of technology

- The agreement between the taxpayer and the GIL was not in the nature of providing the space for advertisement and display the advertisement to the consumers. If the agreement was merely for sale and marketing for providing the space for advertisement, it should be treated as an agreement akin to an agreement for advertisement in newspaper/television.
- On reference to the advertisement module of Adword program stated in the agreement, it can be concluded it is an agreement for facilitating the display and publishing of an advertisement to the targeted customer.
- The advertiser, selects some key words and on the basis of key words, the advertisement is displayed on the website or along with the search result as and when the customer selects the key words relatable to the advertisement. The module does not merely work by providing the space in Google search engine, but it works only with the help of various patented tools and software.
- With the help of the search tool/software/data base, Google is able to identify the targeted consumer/person as per the requirement of the advertiser. If only service rendered by the taxpayer was for providing the space then there is no occasion of either directing/channelising the targeted consumers to the advertisement of the advertiser. In our view truncated search results are displayed keeping in mind the commercial needs of the advertisers.
- The taxpayer is having the access to various data with respect to the age, gender, region, language, taste habits, food habits, cloth preference, the behavior on the website, etc. and it uses this information for the purposes of selecting the ad campaign and for maximising the impression and conversion of the customers to the ads of the advertisers. Thus, the activities of the taxpayer are not merely restricting to display of advertisement but is extended to various other facets as mentioned.
- In other words, by using the patented algorithm, the taxpayer decides which advertisement is to be shown to which consumer visiting millions of website/search engine. Therefore, it is not the advertisement or selling of the space rather it is focused targeted marketing for the product/services of the advertiser by the taxpayer/Google with the help of technology for reaching the targeted persons based on the various parameters information etc.

[2] AY 2008-09, 2009-10, 2010-11, 2011-12

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- Had it been merely providing the space then the other features[3] would not be required. Moreover, the space on search engines/websites are readily available and therefore there was no occasion to market and sell it. Any person with the help of buying the static Internet Protocol (IP) addresses can upload the data/advertisement in the endless web world.

- The Tribunal observed that IP of Google vests in the search engine technology, associated software and other features, and hence use of these tools for performing various activities[4], including accepting advertisements, providing before or after sale services, clearly fall within the ambit of royalty.

- The primary responsibility is on the taxpayer to provide after or before sale services, after having access to user data, Intellectual Property Rights (IPRs), secret formula, process, software and confidential information of GIL, in its own capacity under the agreement.

- Clause 6 of the ITES agreement[5] provides for confidential information, access and use of confidential information and further provides not to disclose confidential information, ownership and return of confidential information and injunctive relief.

- In our view without exercising its right under the agreement dated 1 April 2004, the obligation of the taxpayer under the agreement dated 12 December 2005 and under the taxpayer advertiser agreements cannot be discharged. Therefore, the AO was correct in relying on this agreement dated 1 April 2004, for the purposes of bringing the case under royalty, as per the provisions of Section 9(1)(vi) of the Act read with tax treaty.

- The taxpayer has not sold the storage space on the server outside India nor has it sold the identified/demarcated ad on the web site/search engine. Further, if the ad-space is sold, then the Adword program would be incapable of functioning as the advertisement would be shown to various locations, persons and targeted consumers.

- There is no sale of space, rather it is a continuous targeted advertisement campaign to the targeted and focused consumer in a particular language to a particular region with the help of digital data and other information with respect to the person browsing the search engine or visiting the website.

- Thus, the activities would fall within the ambit of 'royalty' under the Act and under tax treaty.

<u>Interconnection between ITES agreement and Adword distribution agreement</u>

- The taxpayer claimed that it is separately earning revenue from ITES segment, under a separate outsourcing service agreement with GIL which is independent of the distribution of advertising space to the advertisers in India.

- Inputs from ITES are always required in the business model of the taxpayer, without which there cannot be any targeted marketing for advertisements and promotion of sales of advertisers. Therefore, the services rendered under ITES agreement cannot be divorced with the activities undertaken by the taxpayer under the distribution agreement. Both the agreements are connected with naval chord with each other.

- The taxpayer was duty-bound to provide as per the distribution agreement various ITES services, which the taxpayer had wrongly claimed to have been provided not under the distribution agreement, but under the service agreement. This is only a design/structure prepared by the taxpayer to avoid the payment of taxes.

- The taxpayer cannot be compensated by the GIL for rendering the services to itself or for rendering the services which the taxpayer is required to render under the distribution agreement. The use of intellectual property is embedded in the Google Adwords programme which is necessary to be used by the taxpayer for rendering the services prior or post sales of the advisement space under the distribution agreement or service agreement.

- The taxpayer was using the customer data not only for rendering the services under ITES but also for promoting marketing and distributing the ad space on the search engine and websites. It is inconceivable to run Google/taxpayer marketing programme without having access to the

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[3] Such as access to various data with respect to the age, gender, region, language, taste habits, food habits, cloth preference, the behavior on the website, etc.

[4] Google is working on various platforms and the said platforms uses various customer data for targeted ads campaign. The files of these customer data are shared for running the campaign by the taxpayer with the advertisers. The popular ad campaigns of Google is 'like- alike ad', 'customer-audience Ads', etc. where details of like-set of users are provided for running the targeted campaign.

[5] Dated 1 April 2004

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customer data. Therefore the argument of the taxpayer that it was only using customer data, IPR etc., for rendering the services relating to ITES is incorrect. Therefore, the amount was being paid by the taxpayer to Google Ireland for the use of patent invention, model, design, secret formula, process, etc.

Patent and trademark

- The taxpayer contended that there is no transfer of the trademark or copy right of Google to the taxpayer and therefore it will not fall within the purview of the royalty. There is no specific transfer of any patent trademark. The use of Google trademark and other brand features referred in the distribution agreement are merely incidental to unable the taxpayer to distribute the ad space in India. The taxpayer relied on various decisions[6].
- The aforesaid decisions relied on by the taxpayer are distinguishable on the facts of the present case. The use of trademark for advertising marketing and booking in the case of Hotel Sheraton as well as in the case of Formula One were incidental activities of the taxpayer therein as the main activities in the cases were providing hotel rooms and organising car racing respectively. However, in the present case the main activity of the taxpayer is to do marketing of advertisement space for Google Adwords Programme.
- As per the Google brand features clause of the agreement, the taxpayer was permitted to use trade name, trademarks, service marks, domains or other distinctive brand features of Google solely for the use under the distribution agreement.
- If we look into the activities of the taxpayer, for the purpose marketing and distribution of Adword programme, then, it is not possible for the taxpayer to undertake these activities, without the use of Google trademark and other brand features. Further, for marketing and distribution of Google Adword programme, the use of Google trademark is essential and pivotal for doing the business of the advertisement on the search engine and the websites.
- In the absence of Google trademark, it is difficult to comprehend that the taxpayer would attract lot of advertisers for its advertisement space on search engine and web site. The taxpayer was getting lot of engagement and clientage only on account of Google trademark. It may not be possible to have this kind of business inflow of advertisements without using the trade mark of Google.
- Therefore, the payments made by the taxpayer under the agreement was not only for marketing and promoting the Adword programmes but was also for the use of Google brand features. The said Google brand features were used by the taxpayer as marketing tool for promoting and advertising the advertisement space, which is main activity of the taxpayer and is not incidental activities.

Secret process

- The taxpayer contended that the Adwords, though a program, cannot be considered as a 'process' within the meaning under Explanation 2(i) to Section 9(1)(vi) of the Act. Adwords Programme cannot be equated to a secret process since information relating to the program is freely available to the public on Google's website along with explanatory videos regarding the same. Hence, Google Ad Words program cannot be considered a secret process and hence, it does not constitute 'process' within the meaning of the term as defined in Clause 2(i) to Section 9(1)(vi) of the Act.
- The Tribunal held that though Adwords programme along with associated videos are available in public domain but how this programme functions, for targeted marketing campaign, promoting advertisements are only possible with the use of secret formula, confidential customer data only. This secret process of targeting the customers, is not in public domain therefore it is concluded that the taxpayer was using the secret process for marketing promoting displaying of the advertisement.

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[6] Sheraton International Inc v. DDIT [2009] 313 ITR 267 (Del), Formula One World Championship Ltd. v. CIT [2016] 76 taxmann.com 6 (Del)

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OECD TAG report

- The taxpayer claimed that revenue earned from advertisement is taxable as business profit and in the absence of Permanent Establishment (PE), it cannot be taxed in India. The taxpayer relied on OECD Technical Advisory Group (TAG) report.
- The Tribunal observed that the taxpayer in the present case makes use of the user data/customer data and the patented technology, with algorithm to advertise/disseminate ads, which was not the case either before the High Powered Committee or in the case of Right Florist P. Ltd.[7].
- The present case is not a case of merely displaying or exhibiting of advertisement by the advertiser on the website. It is a case of use of patented technology, secret process, and use of trade mark. Therefore, decision in the case of Right Florist Private Limited is not applicable to the facts of the present case. Similarly, the decisions[8] relied on by the taxpayer are also distinguishable to the facts of the present case. Therefore, the payment made by the taxpayer to GIL is royalty and not the business profit and therefore chargeable to tax in India.
- As clear from the distribution agreement, the taxpayer is also having right, title and interest over the intellectual property right of Google. Further, as per the standard advertisement with the advertiser, which specifically empowers the taxpayer to delete/remove/withdraw the advertisement. This vesting of power in the taxpayer, clearly demonstrate give the taxpayer in India right to access the portal/Google Adword program at any point of time.

TDS proceedings under Section 201 of the Act

- On reference to the decision of Mahindra & Mahindra Ltd it is clear that the logic and reasoning given by the Special Bench for coming to reasonable period of 4 years was based on analysis of the provisions[9] and absence of time limit under Section 201(1) of the Act. Subsequently, there was an amendment in Section 201 and specific provision is incorporated to deal with limitation or initiation of proceedings under Section 201 of the Act in the case of resident. However, no period of limitation is provided in the case of non-resident.

[7] ITO v. Right Florists (P.) Ltd [2013] 143 ITD 445 (Kol)
[8] Pinstorm Technologies (P.) Ltd v. ITO [2013] 154 TTJ 173 (Mum), Yahoo India (P.) Ltd. v. CIT [2011] 46 SOT 105 (Mum)
[9] Section 143, 147, 148, 149 and 153 of the Act

- Recently, the Allahabad High Court in the case of Mass Awash (P.) Ltd.[10] had occasion to consider all the decisions referred before the Tribunal. The High Court held that since no limitation has been prescribed, it can be executed at any time, especially when the law of limitation for the purpose of this appeal is not there. Where there is statutory rule operating in the field, the implied power of exercise of the right within reasonable limitation does not arise.
- In our view the decision of the Special Bench and other decisions will apply with equal force in favour of both i.e. resident as well as non-resident providing period of limitation of four years from the end of the financial year for initiation of proceedings on the analogy and principle mentioned in section 147, 148, 153, of the Act etc. prior to amendment in law. However, there are contrary decisions in favour of the tax department post amendment which does not provide any limitation for initiation of proceedings under Section 201 of the Act.
- The non-resident payee should be treated at par with resident payee under the Act and under the tax treaty. The non-discrimination clause under the tax treaty requires equal treatment of non-resident with resident under the provisions of tax treaty. It cannot be said that a non-resident would be given special and beneficial treatment in comparison to the resident or treated unequally by providing unlimited time to initiate proceedings under section 201 of the Act.
- If the law requires initiation of proceedings within 6 years from the end of financial year for the resident, the same treatment is required to be given to the non-resident. For this proposition, the Tribunal relied on the decision of Supreme Court in the case of Dr. Subramanian Swamy[11].
- If we examine the scheme of Section 201 Act, the resident of India cannot be discriminated vis-à-vis non-resident. There is no classification given under Section 201 of the Act. Section 201(1) provides that the person who is required to deduct any sum for the payment made. Therefore, borrowing the same reasoning of the special bench[12] it has been held that the same period of limitation should be applied to resident as well as non-resident. The Tribunal held that the limitation for initiation of proceedings for non-resident payee should be 6 years instead of no-limitation as is the limitation for resident-payee.

[10] Mass Awash (P.) Ltd. v. CIT [2017] 249 Taxman 532 (All)
[11] Dr. Subramanian Swamy v. Director, CBI [2014] 8 SCC 682 (SC)
[12] Mahindra & Mahindra ltd v. DCIT [2009] 30 SOT 374 (Mum) (SB)

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Taxability of royalty income – receipt v. accrual basis

- The taxpayer contended that income in the nature of royalty is chargeable to tax in the hands of the non-resident only on receipt basis. It was contended that for the taxability of royalty twin conditions i.e. 'arising in India' and 'payment' are required to be satisfied. The taxpayer relied on the decision of the Mumbai Tribunal in the case of National Organic Chemical Industries Lid[13].

- As per service agreement dated 1 April 2014, payment is required to be made by the GIL with 90 days after it receipt the invoice from the taxpayer. Similarly as per the agreement dated 12 December 2005 the payments received and taxes are required to be made as per the terms of the agreement.

- From the conjoint reading of the two provisions it is clear that the distribution fees is payable during the year on the basis of the duly audited accounts of Google. Even as per clause 4 of the service agreement, the GIL will pay the invoices raised by the taxpayer within 90 days of receipt of invoice.

- On the basis of the above, there is no doubt that the payment is due and payable by the taxpayer to GIL within the year it became due. The same principle is applicable for distribution fees (royalty) as well as for services rendered by the taxpayer to GIL.

- The argument that the payment made by the taxpayer to GIL is not chargeable under the Act, is not available for the payer to be raised in the present proceedings. The necessary safe-guards are provided by the Act in the form of Section 195(2) which clearly provides that in case the taxpayer is having any doubt about the chargeability to tax of the payment, then the taxpayer may make an application to the AO for the purpose of determining whether the sum is chargeable to tax or not and if yes, on what proportion.

- In the present case, no such application is made under Section 195(2) to the AO. The taxpayer on its own, without having knowledge, information and privy to the accounting standard and accounting practice of GIL, has treated the said payment as a business profit of GIL in its books of account.

- The uniform policy is required to be adopted for deduction of taxes at source in case, by the person responsible for paying amount to a non-resident. There is no caveat or condition laid down in the Act for the person responsible for paying to non-resident. Whether it is business profit or royalty, in both the circumstances, the taxpayer is duty-bound to deduct the tax at source unless there is an adjudication by the AO to the contrary under Section 195(2) of the Act.

- The argument of the taxpayer that under the provisions of the tax treaty, the royalty is chargeable to tax in the hands of the non-resident on receipt basis needs to be rejected, as the benefit of the tax treaty, is only available to non-resident and not to the resident payer. Moreover, the taxpayer cannot claim that the royalty is chargeable to tax in the hands of the non-resident on receipt basis as the taxpayer has no access to the accounting method followed by GIL.

- On reference to the copy of the return of income for AY 2008-09, it is observed that GIL had been following mercantile system of accounting and not the cash method of accounting. As per the mercantile method of accounting, the GIL should have shown the distribution fees (royalty) on accrual basis and not on receipt basis. Therefore the argument of chargeability of royalty in the hands of non-resident, on receipt basis is required to be rejected.

- The argument of chargeability to tax in the hands of non-resident on receipt basis is also required to be rejected since it is outside the scope and ambit of the tax treaty. The tax treaty can only provide the characterisation of the income, the country where it is to be paid and at what rate the said income is to be taxed. However, it is not within the scope of the tax treaty to provide when (i.e. year of accrual or receipt), the income is required to be charged.

- The Tribunal observed that the literal rule of interpretation is not required to be followed and instead thereof linga or lakshana principle has to be followed, i.e., we have to see the intent and not go by the literal rule as pointed out by Lord Denning in his book, 'The Discipline of Law'. If we go by literal meaning of tax treaty, then unscrupulous persons may misuse the provision and avoid payment of taxes.

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[13] National Organic Chemical Industries Lid v. DCIT [2005] 96 TTJ 765 (Mum)

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- In the present case, the distribution fees was credited as accrued by the taxpayer after utilising the benefit under the distribution agreement to the account of GIL, Therefore, the same is chargeable to tax when it was credited to the account of GIL and the taxpayer is duty-bound to deduct tax at the time of crediting it to the account of GIL.
- The taxpayer has used the information, patented technology, etc., from GIL which is royalty and therefore, as per the mandate of Article 12(2), the royalty is to be taxed in the contracting state (India) in accordance with the laws of India. Further, the laws of India provide taxability of royalty on the basis of the accrual (mercantile method) and not on receipt (cash basis). Therefore, as per Article 12(2), the royalty paid by the taxpayer to GIL is taxable as per Indian law.
- The decision in the case of Pizza Hut International LLC[14] relied on by the taxpayer is distinguishable to the facts of the present case since for arriving at the conclusion that the royalty is taxable on cash basis, the coordinate bench neither gone into the method of account nor considered Article 12(2) of the tax treaty which provides that the royalty is taxable in accordance with the laws of India.
- The taxpayer contended that for the purpose of determining whether an amount is chargeable to tax in the hands of a non-resident, the provisions of the relevant tax treaty would also need to be factored and royalty would triggered only when the amount is paid and not when the amount is accrued or even due accordingly, the liability to withhold under Section 195 would arise only when the sum becomes chargeable in the hands of Google Ireland i.e. when the amount is paid. In support the taxpayer relied on the decision of Saira Asia Interiors Pvt Ltd[15].
- The decision of Saira Asia Interiors Pvt Ltd. is distinguishable on facts of the present case since there is no mechanism available with the tax department to know whether the actual amount was paid or credited in the hand of Google Ireland or not in the assessment years under consideration or even before the lapse of time limit to deduct and deposit the tax. Secondly the taxpayer have not sought permission for remittance till November 2011, though the agreement was entered on 12 December 2005, thirdly present case is a case of collusion between the payer and payee.

[14] Pizza Hut International LLC v. DDIT [2012] 54 SOT 425 (Del)
[15] Saira Asia Interiors Pvt Ltd v. ITO [2017] 164 ITD 687 (Ahd)

- The contention of the taxpayer that the decision passed by the Supreme Court in the case of Transmission Corporation of AP is applicable to the facts of the present case is not correct. There was no occasion for the Supreme Court to deal with the argument that the sum paid to non-resident is not chargeable to tax in India. If the taxpayer was having any doubt about chargeability then the taxpayer should have filed an application under Section 195(2) of the Act.
- The scope and ambit of Section 195(2) of the Act is clear and unambiguous. The provisions mandates the AO to decide whether any payment (royalty) paid by the taxpayer to GIL is chargeable to tax on cash/receipt basis or not. However, to trigger 195(2) of the Act, the payer (the taxpayer) was duty-bound to make an application with the AO. Unless an application is made to the AO, there would not be any occasion for him to determine the chargeability of payment of royalty to tax by referring to the tax treaty or under the Act. Therefore, the finding given by the Supreme Court in the case of GE India Technology Centre P. Ltd[16] does not come to the rescue of the taxpayer.
- The applicability of the tax treaty cannot be suo-moto be determined by the AO without there being any application under Section 195(2) of the Act for the purposes of deducting the tax at source. Accordingly, following the decision of Transmission Corporation of AP Ltd.[17] and Vodafone South Ltd.[18] the appeal of the taxpayer on this issue is liable to be dismissed.

Tax avoidance

- Thus, the intention of the taxpayer as well as of the GIL is clear and conspicuous that they wanted to avoid the payment of taxes in India. That is why, despite the duty of the taxpayer to deduct the tax at the time of payment to GIL, no tax was deducted nor was any permission sought for paying the amount. If the permission for paying the amount is taken immediately after entering into agreement, then this argument of not making the late payment of taxes would not have been available to the taxpayer. This is a clear design to skip the liability by both the taxpayer as well as GIL by having mutual understanding.

[16] GE Technology Cen (P.) Ltd v. CIT [2010] 193 Taxman 234 (SC)
[17] Transmission Corporation of AP Ltd. v. CIT [1999] 239 ITR 587 (SC)
[18] Vodafone South Ltd. v. DIT [2015] 53 taxmann.com 441 (Bang)

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- In the case present case conduct of the two parties, which are Associated Enterprises (AEs) clearly indicates that both are trying to misuse the provision of the tax treaty by structuring the transaction with the intention to avoid payment of taxes. The same is not permissible in law. The proviso is being abused by them as a device to defer the tax for any length of time by mutual understanding of the parties, particularly when both the parties are under an obligation to pay and receive the payment for the services rendered and for distribution fees (royalty).

Our comments

Royalty

Online advertising on internet search engines like Google, etc. has become an important advertising and marketing tool for the present day business. The issue with respect to taxability of income from online advertisement on Google or Yahoo portals has been a matter of debate before the Tribunal. The Mumbai Tribunal in the case of Yahoo India P. Ltd[19] held that the banner advertisement hosting services did not involve use or right to use by the taxpayer of any industrial, commercial or scientific equipment. Uploading and display of banner advertisement on its portal was entirely the responsibility of the foreign company and the taxpayer was only required to provide the banner ad to the foreign company for uploading the same on its portal. The taxpayer thus had no right to access the portal of the foreign company and there is nothing to show any positive act of utilisation or employment of the portal of the foreign company by the taxpayer. Accordingly, such payment was not in the nature of royalty but it was in the nature of business profit. In absence of any PE of the foreign company in India, it was not chargeable to tax in India. Relying on this decision the Tribunal in various cases[20] held on similar lines.

However, the Bangalore Tribunal in this case distinguished the above referred decisions. The Tribunal observed that the present case is not a case of merely displaying or exhibiting of advertisement by the advertiser on the website, but is a case of use of patented technology, secret process, use of trademark by the taxpayer. Google India has been provided access to the IPR, Google Brand features, secret process embedded in Adwords Programme as tool of the trade for generation of income. Therefore the payment made by the taxpayer to GIL is royalty. The taxpayer is having the right to access not only to the patented technology but also to the customer data, information (like telephone number, user behaviours, region, gender, language, colour, photographs, place of visit, mobile device used, time spent, etc.) and which was not the case in the decisions of Yahoo India, Pinstorm and Right Florist.

The Finance Act, 2016 has introduced an 'Equalisation Levy' (Chapter VIII) in line with the recommendation of the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project to tax e-commerce transactions. It provides that the equalisation levy is to be charged on specified services (online advertising, any provision for digital advertising space or facilities/service for the purpose of online advertisement, etc.) at 6 per cent of the amount of consideration for specified services received or receivable by a non-resident payee not having a PE in India. The Equalisation Levy Rules, 2016 have also been issued by Central Board of Direct Taxes (CBDT)[21] to lay down the compliance procedure to be followed for such levy. The Rules came into effect from 1 June 2016.

Further income from such specified services shall be exempt under Section 10(50) of the Act. Accordingly, with effect from Assessment Year 2017-18, such income will not be taxed as royalty or business income but it would be subject to equalisation levy.

In view of above, one needs to carefully examine the services provided by the foreign company with respect to online advertising, etc. vis-à-vis applicability of equalisation levy.

Taxation of royalty on receipt basis or accrual basis

There are conflicting decisions on the issue with respect to taxability of royalty payment to non-resident on receipt basis vs. accrual basis. Some of the Courts/Tribunal[22] have held that royalty is charged on accrual basis and the actual receipt of the same by the recipient is immaterial for the purpose of deduction of taxes. On the other hand, some of the Courts/Tribunal[23] have held that the assessment of royalty or fees for technical services under India-Germany tax treaty should be made in the year in which the amounts are received and not otherwise.

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[19] Yahoo India Pvt Ltd v. DCIT [2011] 140 TTJ 195 (Mum)
[20] Pinstorm Technologies Pvt Ltd v. ITO [2012] 54 SOT 78 (Mum), ITO v. Right Florists Pvt Ltd (ITA No. 1336/Kol/ 2011)
[21] Notification No. 37 and 38/2016, dated 27 May 2016
[22] Trishla Jain v. ITO [2009] 310 ITR 274 (P&H), AEG Aktiengesellschaft v. ACIT [1994] 48 ITD 359 (Bang)
[23] DIT v. Siemens Aktiengesellschaft (ITA No. 124/2010) (Bom), Saira Asia Interiors (P.) Ltd v. ITO [2017] 79 taxmann.com 460 (Ahd), National Organic Chemical Industries Ltd. v. DCIT [2005] 96 TTJ 765 (Mum)

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The Tribunal in the instant case observed that the royalty is to be taxed on accrual basis. It is not within the scope of the tax treaty to provide when (i.e. year of accrual or receipt), the income is required to be charged.

In various decisions[24] relying on the language of royalty article of a tax treaty it has been held that the amount which has accrued as income to a foreign company cannot be taxed in the source country, unless the amount has been received by the foreign company. In spite of these decisions, the Tribunal has observed that it is not within the scope of the tax treaty to provide when the income is required to be charged (i.e. year of accrual or receipt).

The Supreme Court has recently admitted the Special Leave Petition (SLP) filed by the tax department against the Bombay High Court decision in the case of Siemens Aktiengesellschaft[25]. The Supreme Court decision may provide clarity on this issue.

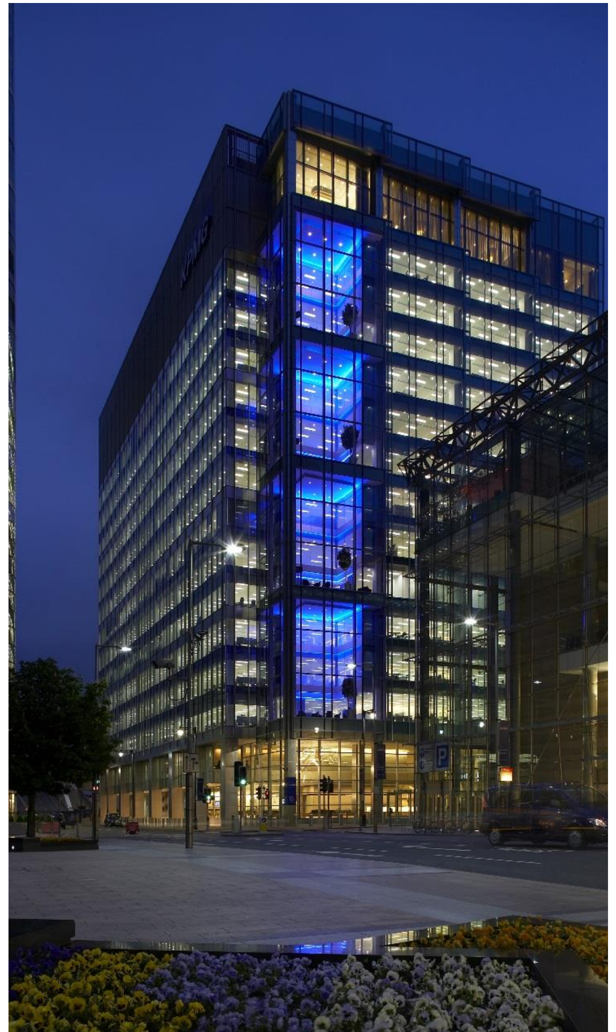
Tax avoidance

In the instant case, the Tribunal observed that both the Associated Enterprises (AEs) are trying to misuse the provision of tax treaty by structuring the transaction with the intention to avoid payment of taxes. This is a clear design to skip the liability by both the taxpayer as well as GIL by having mutual understanding. It is not permissible in law.

In view of General Anti Avoidance Rules (GAAR) provision under the Act and India's commitment to implement Multilateral Instrument (MLI) under the BEPS initiative, the taxpayers should take appropriate caution before entering into any arrangement/structure especially if it is to avail tax benefit under the Act or under the tax treaty.

Google's international experience

On a different note, In the United Kingdom, Google argued that the Irish company does not have a PE in the UK because its £4.6bn of sales to UK advertisers are conducted by Irish Company. The tax inspectors have tested whether, in law, Google UK is acting as a front for the business activities of its sister company in Ireland. HMRC accepted Google's claims that its UK staff only play a supporting role to Google's main European operation in Dublin/Ireland. Google entered into settlement with HMRC of £117 million in back taxes and £13 million in interest related to a period from 2005 to 2015.



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[24] DCIT v. Uhde GMBH [1996] 54 TTJ 355 (Mum), National Organic Chemical Industries Ltd. v. DCIT [2005] 96 TTJ 765 (Mum),
[25] DIT v. Siemens Aktiengesellschaft [SLP (C) No(s). 21383/2013]

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