



Payment for marketing and distribution rights of Google Adwords Program is taxable as royalty

Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Google India Private Limited¹ (the taxpayer) held that the payment for marketing and distribution rights of Google Adwords Program is taxable as royalty. Under the Adwords Program distribution agreement and the service agreement, the taxpayer was given licence to use the confidential information, technical know-how, trade mark, brand features, derivative works, etc. Though the ownership of these intangibles remains with the foreign company, the taxpayer was given the licence to use it in order to provide better service. The Tribunal observed that it is not merely an agreement to provide advertisement space but it is for facilitating the display and publishing of an advertisement to the targeted customers.

Facts of the case

- The taxpayer is a wholly-owned subsidiary of Google International LLC, U.S. (Google U.S.). The taxpayer is engaged in the business of providing Information Technology (IT) and Information Technology enabled Services (ITES) to its group companies. It also acts as a distributor for Adword Program in India.
- On 1 April 2004, the taxpayer entered into a service agreement with Google U.S. to render software development services. The taxpayer's Research and Development (R&D) units located at different locations in India provide IT services including application development, maintenance and testing services. Similarly, the taxpayer entered into a service agreement with Google Ireland Limited (GIL) to render IT-enabled services. Its service centres at two different locations in India provide ITES service relating to the administration of advertisements in accordance with the guidelines provided by GIL and provide customer support services.
- Under the Google Adwords Program Distribution Agreement dated 12 December 2005 entered into between the taxpayer and GIL, the taxpayer was appointed as a non-exclusive authorised distributor of Adwords Program to the advertisers in India. Subsequently, the taxpayer entered into a Google Reseller Agreement on 1 July 2012, pursuant to which the earlier agreement dated 12 December 2005 was terminated and the taxpayer was appointed as non-exclusive, authorised reseller of online advertising space to advertisers in India under the Google Adwords Program.
- Under the Adwords Program distribution agreement, the taxpayer acquired the marketing and distribution rights of Adwords program for the territory of India from GIL. The taxpayer is remunerated on cost plus market basis for the distribution services under Adwords Program.
- During the Financial Year (FY) 2012-13, the taxpayer has made payments to GIL for marketing and distribution rights of Adword Program without deduction of tax at source. The taxpayer claimed that the amount paid to GIL was not in the nature of royalty under the provisions of the India-Ireland tax treaty (tax treaty).

¹ Google India Private Limited v. JDIT (ITA No. 1190/Bang/2014, dated 11 May 2018) – Taxsutra.com

- The Assessing Officer (AO) held that payment made to GIL towards marketing and distribution rights of Adword Program should be treated as royalty as per provisions of Section 9(1)(vi) of the Income-tax Act, 1961 (the Act). Therefore, the taxpayer was liable to deduct tax under Section 195 of the Act. Since the taxpayer failed to discharge its obligation, proceedings were initiated under Section 201(1) of the Act. The AO also held that GIL was not the beneficial owner of the amounts received from the taxpayer in relation to advertisement space under the agreement on the ground that Google U.S. owns search engine and Adword Program and entitled to share of revenue generated under the Adword Program. Therefore, rate of tax as provided under the tax treaty cannot be applied.
- Aggrieved, the taxpayer preferred an appeal before the Commissioner of Income-tax (Appeal) [CIT(A)] and the CIT(A), on the point of characterisation of the payment made by the taxpayer to GIL has held that it is a royalty payment, following its earlier order for the Assessment Year (AYs) 2006-07 to 2012-13. The order of the CIT(A) for earlier years has already been confirmed by the Tribunal against which an appeal is pending before the Karnataka High Court. The Karnataka High Court passed order that the present appeals are to be disposed-off independently without being influenced with the order of the Tribunal for earlier years.

Tribunal's decision

- The AO examined the distribution/reseller agreement along with the service agreement executed between the taxpayer and GIL in order to arrive at a conclusion with regard to the nature of payment made to GIL. Therefore, it was necessary for the Tribunal to adjudicate as to whether the distribution/reseller agreement and service agreements are two independent and separable agreements or they are interconnected and interdependent agreements, without which the obligation under the distributor agreement cannot be discharged.

Analysis of service agreement dated 1 April 2004

- Under the service agreement, GIL desired to avail services relating to IT, ITES and software development related services from the taxpayer as per terms and conditions of this agreement.
- Under the head 'Ownership', the intellectual property shall be owned by GIL and taxpayer acknowledges and agrees that all such confidential information, intellectual property, software technology and documentation shall

remain the exclusive property of GIL. Similar is the position with regard to derivative works and software embodiment.

- The taxpayer shall keep GIL primarily informed of the developments of any derivative works and software embodiment and irrevocably agrees that such determinative networks and software embodiment shall be the sole and exclusive property of GIL throughout the world from the date of its creation.
- The taxpayer shall provide GIL with assignments, facilitate GIL's perfection of its rights in derivative works and software embodiment in its jurisdiction. Under the head 'confidential information', GIL will disclose certain confidential information to the taxpayer, solely perform its obligation under this agreement.
- The taxpayer agrees that such confidential information shall be kept secret during the term of agreement and it shall not disclose or facilitate disclosure of such confidential information to any person without the prior consent of GIL.
- Upon GIL's request or upon termination of the agreement, all files, loose records, documents, drawings, specifications, equipment and computer programs which incorporate or refer to all or portion of the confidential information shall be promptly returned to GIL. Upon termination of the agreement, GIL shall discontinue all use of confidential information, derivative works and software embodiment, intellectual property and other software technology and shall have no further rights in respect thereto.

Analysis of distributor agreement 12 December 2005

- The amended and restated Google Adword Program distribution agreement was executed on 12 December 2005 between the taxpayer and GIL through which the taxpayer was appointed as Adword Program distributor. This distributor agreement was further renewed under different title of agreement i.e., Google Reseller agreement on 1 July 2012. Though nomenclature of agreement was changed, but the functions and obligations of the taxpayer almost remain the same.

- Distributor will distribute Adword program in accordance with the training provided by GIL. Further, distributor shall be responsible for uploading of advertisers' information that is required by GIL for participation in the Adword Program. The taxpayer shall conduct the business in a manner that reflects favourably at all times on the Adword Program and on Google's goodwill and reputation and agrees to adhere to minimum levels of service and breach of this section will constitute material breach of this agreement.
- It has been clarified that the distributor shall conduct its business for its own account, and not as an agent, employee, partner or franchisee of GIL. It was also made clear that a distributor may not solicit business from and shall not distribute Adword Program to (even if unsolicited) any entity that does not have a principal place of business within the territory, meaning thereby the taxpayer was appointed as distributor of Google Adword Program to conduct its business relating to the said Google Adword Program within the territory of India within the broad guidelines provided with its reasonable commercial expertise, sale force and customer service infrastructure.
- If the advertiser makes a request to distributor to receive user name and password to access such advertisers' individual Adword Program account activity, distributor will grant such request after approval from GIL.
- Under the head 'Brand feature', GIL granted to the taxpayer non-exclusive and non-sublicensable licence during the term to display google brand features solely for the purpose of distributor's marketing and distributing Google Adword Program under the terms and conditions specified in the agreement.
- The distributor will submit all material of any kind containing the brand features of Google for written approval prior to release to the public. Further, distributor agrees to adhere to Google's brand features use guidelines and any content referenced or included therein.
- Under the head 'confidentiality', disclosure of confidential information including the user data (including any aggregated user data), the existence and content of the agreement and any information provided shall be governed by Google standard mutual non-disclosure agreement.
- GIL owns all right, title and interest in and to all information and data, including the user data collected relating to advertisers in connection with the provisions of the Adword Program.
- Under the terms of the agreement, the distributor shall be solely responsible for providing all customer service to advertisers according to the procedures and in compliance with the standards provided. All advertisers shall be instructed by the distributor to contact distributor directly for support and not to communicate directly with GIL. The distributor agrees that it shall provide atleast certain minimum level of services.
- As per the nondisclosure agreement, which is a part of distribution agreement, the party may disclose certain information, which it considers confidential to other party including, but not limited to tangible, intangible, visual, electronics, present or future information such as trade secrets, financial information including pricing, technical information including research, development, etc.
- The party receiving confidential information will only have a duty to protect confidential information disclosed to it by the other party. It was also further agreed that the recipient will use the confidential information only for the purpose described.

Working of Google Adword Program

- The Google Adword Program is a complex program and has various benefits. It gives advertiser the access to the tools of the Adword Program which can be accessed through the gateway of the taxpayer through the use of patent technology.
- Google's then-current brand features use Adword Program which gives the advertiser to choose the preferred time, season of the year when the ads are to be shown. Once advertiser accepts the terms, the taxpayer gives access to the various tools of Adwords Program. The time zone and display time of the advertisement is identified and allocated by the taxpayer to the advertiser with the help of Google Adword Program.

- Adword Program is more focused and targeted in advertisement campaign which results into more attention, engagement, delivery and conversion which is only possible on the Google network with the access of tools of search engine and google analytics.
- The taxpayer is having the access to IP address at desktop or laptop or IP address of the tablet, photographs, time spent on website, eating habits, wearing preferences. With the help of IP address, Google search engine is having access to various information and data pertaining to the user of the website in the form of name, sex, city, state, country, phone number, religion, etc.
- Besides the above basic information, it is also having the access of the history of the user as well as the behaviour of the person searching in google engine. Whenever one particular keyword is searched, the targeted ad will be shown to the consumer and by clicking on the ad, the consumer will be landed on a webpage.
- The taxpayer being a service provider under the agreement uses its expertise and the information within its domain and control, to suggest the keywords based on recent marketing material and need of the advertiser. The taxpayer also suggests a periodical review of the website homepage, product and services which can be bundled together.
- The display of the advertisement based on the keywords, is dependent upon the auction price paid by the advertiser. The keywords bid at the highest rate by the advertiser would be shown at the top of search result and therefore, is likely to fetch more visibility and attention.
- With the help of tools of Google, the advertiser as well as the taxpayer have an access to the impact of change of keywords on the likely impressions of the advertisement. With the help of keywords matching, various approaches are being adopted by the Google Adword Program i.e., broad match, phrase match and exact match.
- The exact match for example allows the advertiser to focus on the optimization phrase on the individual keywords and it yields the best results possible. Whereas, the phrase match is more processing than broad match and the broad match provides the greatest possibility of coverage of the advertisement.
- The taxpayer facilitates the advertisers to start the campaign of advertising initially with the help of broad match thereafter with the phrase match and thereafter with the exact match. With the help of keyword management, the Google Adword Program takes care of misspelling, singular, plural, abbreviation, acronyms, stemming, etc.
- The taxpayer helps the advertiser with the help of tools of Adword Program to include or delete various variation of keywords in the realm of advertisement campaign and similarly the advertiser may with the help of Google tool can avoid the unnecessary traffic on its website.
- The Google Adword Program is also having Google Analytics which is connected with the Google Adword Program and which is a potential patented tool to target the keywords and the negative keywords. This is the USP of the Google Adword Program, which is maintaining thousands of different keywords used by people to search the website and based on this user behaviour, the Google Analytics suggests the appropriate keywords to be used by the advertiser for encouraging the traffic on the website.
- The taxpayer is using all these tools in conjuncture with the advertisers at the time of granting the backhand services to advertisers, as the taxpayer is having access to all these data, information, etc.
- On the basis of the above, the Tribunal observed that the agreement between the taxpayer and GIL is not only in the nature of providing the space for advertisement and display the advertisement to the consumers. On looking into the advertisement module of the Adword Program, it has been an irresistible conclusion that it is not merely an agreement to provide advertisement space but it is an agreement for facilitating the display and publishing of an advertisement to the targeted customers.
- The obligations cast upon the taxpayer under the Google Adword distribution agreement can only be discharged with the help of the ITES division. Therefore, the Google Adword distributor agreement and the service agreement are to be read together as they are interconnected and without resorting to the service agreement the terms and conditions under the Google Adword Distribution Agreement cannot be complied with. Therefore, in order to understand the function of Google Adword Program, both the agreements are to be read together.

Judicial precedence discussed by the Tribunal

- The Tribunal distinguished various decisions² and observed that in all the said decisions, the taxpayer was either an advertiser or act on behalf of some other advertiser and has purchased space from the owner of search engine to display its advertisements online. Therefore, the payment made by the taxpayer to the owner of the search engine was considered to be business profit in the hands of the owner of search engine. However, in the present case, the taxpayer has not purchased the advertisement space for putting its advertisement online from the GIL. The taxpayer has been duly appointed a distributor under the Google Adword Distribution Agreement to distribute and sell the advertisement space obtained from the GIL under the distribution agreement.
- Under the distribution agreement, the taxpayer was under obligation to provide pre-sale and after sale services with the help of ITES division. While providing after sales services/technical services, the taxpayer had access to the intellectual property rights and tools and information, derivative works owned by the GIL. In the present case, the taxpayer is not a simpliciter buyer of Adword Space for putting the advertisement either for himself or for others which was the position in the aforesaid cases referred to by the taxpayer. Therefore, the facts of the decisions referred above are different than the facts of the instant case.
- In the present case the taxpayer was appointed as distributor under the Adword distributor Agreement with the condition that the taxpayer would provide on sale and after sale service which required the involvement of technical know-how, IPRs, derivative works, etc. However, in the case of Taj TV³, the Taj TV has simply appointed the distributor and no licence was given to the distributor to use the technology developed by Taj TV. The distributor was simply allowed to further transmit the programs to the viewers/customers. Therefore, the decision in the case of Taj TV Ltd. is distinguishable from the facts of the present case. Similarly, various decisions⁴ relied on by the taxpayer were also distinguishable on the facts of the present case.

² ITO v. Right Florists Pvt. Ltd. [2013] 25 ITR(T) 639 (Kol), Pinstorm Technology Ltd v. ITO [2012] 54 SOT 78 (Mum), Yahoo India Pvt Ltd v. CIT [2011] 140 TTJ 195 (Mum)

³ ADIT v. Taj TV Ltd (ITA No. 4678/Mum/2007) (Mum)

⁴ DDIT v. Set India Pvt. Ltd. (ITA No. 4372/Mum/2004) (Mum), DIT v. New Sky Satellite [2016] 68 Taxmann.com 8 (Del)

- The Karnataka High Court in the case of Synopsys International Old Ltd⁵ observed that the mode adopted or the terminology given is not decisive to decide the nature of transfer, ultimately it is substance which is to be looked into. Under the terms of agreement, Synopsys International granted licensee a non-exclusive non-transferrable licence without right of sub-licence to use the licenced software in design techniques only in the quantity of authorised by licensee. Even if it is not transfer of exclusive right of copyright, the right to use the confidential information embedded in the software in terms of aforesaid licence makes it clear that there is transfer of certain rights which the owner of a copyright possess in the said computer software programme in respect of copyright owned. Therefore, High Court held that the consideration paid for the use or the right to use the said confidential information in the form of computer programme software constitutes royalty under the tax treaty.
- Similarly, in the present case, under the Adword Distribution Agreement, certain obligations were cast upon taxpayer in order to provide efficient on sale and after sale services and the taxpayer was given licence to use the confidential information, technical know-how, trade mark, brand features, derivative works, etc. Though the ownership of these intangibles remains with the GIL or the Google Inc., but the taxpayer was given the licence to use it in order to provide better service. Therefore, the facts of this case are similar to that case of Synopsys International Ltd. Hence the ratio laid down by the said decision is applicable to the facts of the present case.

Interconnection between Adword distribution agreement and service agreement

- Under the service agreement, ownership of intellectual property, confidential information, software technologies, and documentation shall remain the exclusive property of the GIL but the taxpayer was allowed under the licence to use it in order to fulfil the obligations cast upon it under the Adwords distributor agreement.

⁵ CIT v. Synopsys International Ltd [2013] 2012 Taxman 454 (Kar)

- On perusal of the Adword distribution agreement and the service agreement, it has been observed that the taxpayer has not only purchased the advertisement space from the GIL and resold it to the advertisers against certain advertisement charges but the taxpayer was required to provide on sale and post-sale technical services to the advertiser and the GIL, which are not possible without resorting the service agreement. In fact, the taxpayer obtained the advertisement space under the Adword distribution agreement and resell it to different advertisers along with on sale and after sale services.
- With the aid of ITES division, the taxpayer is required to execute the programs and also provide all technical support to the advertisers and GIL. As per the agreement with the advertisers, the advertisers are required to approach only the taxpayer and not the GIL. The taxpayer is in fact required to sort out all glitches to be faced by the advertisers while putting the ads on the Adwords Program. Having examined functioning of the taxpayer, the literatures in the form of book⁶, it has been observed that Google Adwords Program is a complex program.
- While discharging its obligation under the Google Adwords Program and service agreement the taxpayer has an access to the trade marks, IPRs, derivative works, brand features and the confidential information of the GIL. Therefore, it cannot be called that whatever payments were made by the taxpayer to GIL was simpliciter a payment towards the purchase of Adword space from the GIL for its resale to advertisers.
- Therefore the payments of advertisement fees made by the taxpayer after retaining a particular part is royalty in the light of definition of royalty given under Section 9(1)(vi) of the Act and the tax treaty.
- Accordingly, it has been held that the payment made by the taxpayer to GIL is a payment of royalty and as per provisions of Section 9(1)(vi) of the Act, it is an income deemed to accrue or arise in India.

Equalisation levy

- The Legislature has introduced the equalisation levy at 6 per cent vide Finance Act, 2016 to tax the considerations paid by resident to a non-resident who is not having a PE in India. No

doubt, it may be business profit in the hands of the recipient and the Legislature intend to tax the business profit as it has arisen out of the activities performed in India. However, it does not affect other kind of services in which technology, the know-how, copyrights or IPRs are involved.

- The equalisation levy is to be charged only on consideration for specified services and not others where there is use of IPR, copyright and other intangibles. In the present case, under Adword distribution and service agreement, the taxpayer has acquired licence to use IPRs, copyright and other intangibles to provide better services either to GIL or to advertisers. Therefore, the introduction of equalisation levy would not convert the nature of payment made by the taxpayer to GIL.

Use of trade mark

- With regard to another limb of argument of the taxpayer that in providing a space on Google Adword Program to the advertisers, the trade mark or the GIL was not involved therefore consideration paid to GIL is not royalty. The Tribunal observed that the Adword was registered with the Registrar of Trade Marks, Mumbai in the name of Google Inc., under which GIL has provided space to the taxpayer for its sale to the various advertisers.
- The taxpayer contended that if the trade mark is used as incidental to the main activity, it cannot be called that there was a transfer of trade mark or licence to use the trade mark. To support its contentions the taxpayer relied on the decision of Sherton International Inc⁷. However, the Tribunal distinguished the said decision and observed that in the present case, the taxpayer was not engaged in the advertisement, publicity of any particular activities of the GIL. The taxpayer was appointed as a distributor under the Adword distribution agreement with certain obligations towards the advertisers and the GIL. The obligations cannot be fulfilled without the aid of ITES division and having access to the IPRs, technical know-how, trade mark, derivative works and other intangibles of the GIL. The Tribunal also distinguished the decision of the Delhi High Court in the case of Formula One⁷.

⁶ Learning Adword and Google Analytics by Benjamin Mangold and the snap shots provided by respective parties

⁷ DIT v. Sherton International Inc., [2009] 313 ITR 267 (Del)

Bonafide belief

- It has been observed that the agreements relating to Google Adword Program were prepared in such a way to give a different colour of transaction. Under the Google Adword Program, the taxpayer is required to sell the ad space to the advertiser with the technical support on sale and post sale. The technical support to the advertisers are not possible without the use of technical know-how, IPR, derivative works, intangibles, information and copyrights owned by the GIL or its parent holdings.
- The payment made for the same was in the nature of royalty. These facts were known to the taxpayer since the execution of both the agreements. Therefore, it cannot be said that taxpayer was under the bonafide belief for non-deduction of tax at source. The decision of Kotak Securities Ltd.⁸ is distinguishable on facts of the present case.
- Referring to various decisions⁹ it has been observed that the plea of bonafide belief cannot be taken for non-deducting of tax at source when it is clear that tax is required to be deducted as per Section 195 of the Act. The plea of bonafide belief can only be considered while adjudicating the issue of penalty to be levied under Section 271C of the Act.

Taxability of royalty - Receipt v. Accrual basis

- The Bombay High Court in the case of Siemens Aktiengesellschaft¹⁰ held that the royalty and FTS should be taxed on receipt basis. Similarly, in various decisions¹¹ it has been held that under the related tax treaty, tax liability can only arise at the point of payment and the income embedded in the payment is not taxable at the point of time of crediting the amount.
- On reference to the various decisions it has been observed that the royalty has to be taxed on receipt basis but in the instant case, the nature of Adword agreement and the service agreement is quite complex. Under the service agreement, the taxpayer would be paid by the GIL whereas under Adword agreement, the taxpayer is required to make payment of advertisement charges after deducting a particular percentage to the GIL.

⁸ CIT v. Kotak Securities Ltd. [2016] 383 ITR 0001 (SC)

⁹ GE India Technology Cen. Pvt. Ltd. v. CIT [2010] 327 ITR 456 (SC), Transmission Corporation of AP Ltd. v. CIT [1999] 239 ITR 587 (SC)

¹⁰ DIT v. Siemens Aktiengesellschaft (ITA No. 124/2010)

¹¹ Saira Asia Interiors Pvt. Ltd. v. ITO (ITA No. 673/2014), National Organic Chemicals v. DCIT [2006] 5 SOT 317 (Mum)

- In the return of income, GIL has shown its method of accounting as mercantile system of accounting. Once the GIL has itself has declared the method of accounting as mercantile system, it cannot claim that for the purpose of royalty, system of accounting should be on cash/receipt basis.
- The taxpayer could not demonstrate that the royalty was not paid to or received by the GIL and it was simply credited to its accounts in the books of accounts. Therefore, the Tribunal did not find any merit in the contentions of the taxpayer that royalty cannot be taxed in the impugned assessment year as it was not received by the GIL and therefore is not chargeable to tax in India as a deemed income accrued.

Assessee in default Section 201 of the Act

- The consideration paid by the taxpayer is certainly in the nature of payment of royalty and is chargeable to tax under section 9(1)(vi) of the Act and under Article 12 of the tax treaty.
- Since the taxpayer has not deducted the tax as per provisions of Section 195 of the Act, the taxpayer was rightly held to be treated as 'assessee in default' under Section 201(1) of the Act and liable to pay interest under Section 201(1A) of the Act.

Beneficial ownership

- Since there are four layers of holdings of the Adwords Program, it is not clear how much right in license were conferred to different holdings and how the revenue collected on Adwords Program is to be distributed amongst the above holdings.
- On perusal of operating license agreement executed between Google Netherlands Holdings BV (GNHBV) and GIL, it has been observed that GIL has acquired certain right to use certain proprietary technology as well as certain trademark and intangible. Through this license agreement, the license to use, license trademarks, license technology, license improvements was given by GNHBV to GIL.
- It is also clear from a reading of various clauses that the licensee i.e., GIL is not the legal owner of the license trademarks and the license technology which include Adwords Program and GIL has only acquired certain rights in intangibles from GNHBV.

- Though there is a clause for license fee statement, it is not clear as to how much license fees is to be paid by GIL to GNHBV on account of sub-license of Adword Program. On comparison of this agreement with the distributor agreement executed between the taxpayer and GIL, the Tribunal find that in both the agreements, the licensee have admitted that IPRs and the intangibles are owned by licensor.
- The Tribunal examined clarification issued by the Ministry of Finance through Circular No.789¹² and the press release¹³ and also decisions¹⁴ relied upon by the taxpayer. It has been observed that the Tax Residency Certificate (TRC) mentioned that the GIL files its corporate tax return in Ireland on the basis that it is resident for tax purposes in Ireland. GIL is liable to Irish corporation tax on its world-wide income, profit and gains including any income, profits and gains from its sales in India. In the certificate there is no mention with regard to the beneficial ownership of the Google Adword Program of which distributorship was given to the taxpayer.
- In the present case, different layers of holdings were involved in the receipts received by the GIL from the taxpayer, under the Google Adword Program.
- The High Court of Australia¹⁵ also held that Adwords Program is a program which allows advertiser to create, change and monitor the performance of sponsored links. Google provides advertisers with access to the Adwords program through Adwords accounts. Worldwide, hundreds or thousands of advertisers use the Adwords Program. It was also observed that Google derives most of its revenue from its online advertising business, which involves publishing or displaying advertisements as sponsored links on its search results pages. The participation in the Adwords Program is subject to Google's terms of service, the Adwords Program terms and applicable Google policies, etc. From the reading of the decision, it is clear that Google Inc. is the ultimate body which controls the Google Adwords Program and they also share some part of revenue collected on account of Adwords Program.
- Revenue is generated on account of sale of Adwords space to different advertisers is to be distributed amongst all the holdings as they have some beneficial interests therein.
- In the present case, the taxpayer has not filed license agreements executed between Google Inc. U.S. and Google Ireland Holdings (GIH), GIH and GNHBV. Only one license agreement between GNHBV and GIL was filed and from its careful perusal, it has been observed that out of the rights acquired in the Adwords program and intangibles, Google Netherlands has sub-licensed certain rights to GIL for Adwords Program. On the basis of that license, GIL executed Adwords distributor agreement with the taxpayer for selling the Adwords space to advertisers.
- Since other parent holdings of GIL were involved in the Adwords Programs directly or indirectly, they have a right to share the revenue generated under the Adwords distributor agreement. Though the onus is cast upon the taxpayer to place the relevant evidence in order to establish that GIL is the beneficial owner of the royalty received, but it could not place any evidence on record in this regard, except the oral submissions.
- From a reading of the agreement, it is not clear as to how much revenue is shared by different holdings. In the absence of the relevant evidence either in the form of agreement executed between the various holding companies or otherwise, it is not clear as to whether the GIL has full control over the receipt received under Google Adword Program or the GIL was acting as a conduit of its parent holdings.
- The Tribunal held that this aspect requires a fresh look by the AO in the light of all the relevant evidences. Accordingly, the matter is restored to the file of AO after setting aside the order of the CIT(A) in this regard in all these appeals to re-adjudicate the issue of beneficial ownership in the light of the license agreements executed between the parent holdings of the GIL.

¹² Circular No.789, dated 13 April 2000

¹³ Press release dated 1 March 2013

¹⁴ ADIT v. Universal International Music BV [2011] 45 SOT 219 (Mum), Authority of Authority of Advanced Ruling, New Delhi P.No.13 of 1995 [1997] 94 Taxman 171 (AAR), Alibaba.com ecommerce Pvt. Ltd v. ADIT (ITA No.3332 to 3334/Mum/2015, dated 30 November 2016), Ex. Ltd. [1996] 86 Taxman 292 (AAR)

¹⁵ Google Inc. v. Australian Competition and Consumers Commission [2013] HCA 1 249 CLR 435

Our comments

Online advertising on website/search engines like Google, etc. has become an important advertising and marketing tool for present day businesses. The issue with respect to the taxability of income from online advertisement on Google or Yahoo portals has been a subject matter of debate before the Courts/Tribunal. The Mumbai Tribunal in the case of Yahoo India P. Ltd held that the banner advertisement hosting services did not involve use or right to use 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 the absence of a PE of the foreign company in India, it was not chargeable to tax in India. This decision has been relied upon in various cases¹⁶.

The Bangalore Tribunal in taxpayer's case¹⁷ held that payment for granting distribution right of 'Adwords program' is taxable as royalty. On similar lines, in the instant case, the Bangalore Tribunal distinguished the above-referred decisions and held that the payment for marketing and distribution rights of Google Adword Program is taxable as royalty. Under the Adword Agreement and the service agreement, the taxpayer was given the licence to use the confidential information, technical know-how, trade mark, etc. Though the ownership of these intangibles remains with the foreign company, the taxpayer was given the licence to use it in order to provide better services.

The Tribunal in the instant case dealt with the equalisation levy and observed that this levy is charged only on consideration for specified services and not on others where there is use of IPR, copyright and other intangibles. In the present case, the taxpayer has acquired licence to use IPRs, copyright and other intangibles to provide better services.

Unlike the earlier decision, the Tribunal in the instant case has dealt with the beneficial ownership concept and observed that since other parent holdings of recipient foreign company were involved in the Adwords Programs directly or indirectly, they have a right to share the revenue generated under the Adwords distributor agreement. The taxpayer was not able to establish that recipient foreign company is the beneficial owner of the royalty received. . Accordingly, the matter has been restored to the AO to re-adjudicate this issue.

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/Tribunal¹⁸ 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/Tribunal¹⁹ have held that the assessment of royalty or fees for technical services should be made in the year in which the amounts are received and not otherwise²⁰. The Tribunal in the instant case observed that the taxpayer could not demonstrate that the royalty was not paid to or received by the foreign company and it was simply credited in the books of accounts. Therefore, taxpayer's contention that royalty cannot be taxed in the relevant assessment year as it was not received by the foreign company has not been accepted by the Tribunal.

¹⁶ Pinstorm Technologies Pvt Ltd v. ITO [2012] 54 SOT 78 (Mum), ITO v. Right Florists (P.) Ltd [2013] 143 ITD 445 (Kol)

¹⁷ For AYs 2006-07 to 2012-13

¹⁸ Trishla Jain v. ITO [2009] 310 ITR 274 (P&H), AEG Aktiengesellschaft v. ACIT [1994] 48 ITD 359 (Bang)

¹⁹ 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 TJJ 765 (Mum)

²⁰ The Supreme Court has recently admitted the SLP filed by the tax department against the Bombay High Court decision in the case of Siemens Aktiengesellschaft

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Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000

Chandigarh

SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai

KRM Towers,
Ground Floor, 1, 2 & 3 Floor,
Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram

Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad

Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur

Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur – 302 018.
Tel: +91 141 – 7103224

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata

Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai

1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi, Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune

9th floor, Business Plaza,
Westin Hotel Campus,
36/3-B, Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara

Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

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