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TAX FLASH NEWS

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Payment for web hosting and promotion services is not taxable as fees for included services under the India-US tax treaty

Recently, the Ahmedabad Bench of Income-tax Appellate Tribunal (the Tribunal) in the case of Esm Sys Pvt Ltd.[1] (the taxpayer) held that web hosting and promotion services do not 'made available' any technical knowledge and know-how and therefore the payment made to the non-resident company is not taxable as 'Fees for Included Services' (FIS) under the India-US tax treaty (the tax treaty).

Facts of the case

The taxpayer, an Indian company, is engaged in the business of web designing Search Engine Optimisation (SEO) services, social media management, bulk SMS, email management, website advertising, online video management, mobile application designing, etc. During the Assessment Year (AY) 2013-14, the taxpayer made payment to Esm Sys LLC (a non-resident company) for obtaining the services of data promotion, social media management, general consulting, web promotion, etc. The non-resident company was managing various on-page and off-page activities which drive traffic to a specific website.

The taxpayer contended that the services availed were not in the nature of technical services or royalty but it was in the nature of business profits. Further ESM Sys LLC had no Permanent Establishment (PE) in India. Therefore, such services were not taxable in India and provisions of Section 195 of the Income-tax Act, 1961 do not apply to the taxpayer.

The AO held that the hiring of server and providing of web hosting services were in the nature of technical services under Section 9(1)(vii). Further the payment made to the non-resident was in the nature of royalty as defined in Explanation 2 to Section 9(1)(vi). Accordingly, the taxpayer was liable to deduct tax at source under Section 195 from the payment made to ESM Sys LLC towards obtaining technical and consultancy services which were utilised by the taxpayer and its client in India.

Tribunal's decision

In the present case, the taxpayer had obtained services of web promotion, social media management from the foreign company and they have used many techniques such as web content development, search engine optimisation to increase the site traffic. The entire transaction had taken place on internet through virtual server. Servers were located worldwide outside not under the control of the payer and it was used for hiring of space for domain hosting and display of advertisement on the server located worldwide.

As per Article 12(4) of the tax treaty the technical services can be said to be FIS only when it has 'made available' technical knowledge or skill to the recipient of services. The Tribunal relied on various decisions[2] to support its case. In the present case, there was no sharing of knowledge or know-how or any technology to the taxpayer as prescribed in Article 12 of the tax treaty. Therefore, tax was not required to be deducted under Section 195.

Our comments

Characterisation of payments for digital goods and services has always been a contentious issue. Sharing of data on internet has become an important advertising and marketing tool for the present-day business. The taxability of such online business has been a subject matter of debate before the Courts/Tribunal.

[1] Esm Sys Pvt Ltd. v. ITO - [ITA No. 350/Ahm/2018, AY- 2013-14]- Taxsutra.com

[2] ITO v. B.A. Research India Pvt. Ltd. (ITA No. 3106/Ahd/2011) (Ahmedabad), ITO v. Cadila Health Care Ltd. (ITA No.2765/Ahd/2013) (Ahmedabad), Mckinsey & Co. Inc. (Philippines) v. ACIT [2006] 99 ITD 549 (Mum), Pinstorm Technologies (P.) Ltd. v. ITO [2012] 24 taxman.com 345 (Mum), ITO v. Right Florists (P.) Ltd. [2013] 32 taxman.com 99 (Kol), Yahoo India (P.) Ltd. v. DCIT [2011] 11 taxman.com 431 (Mum)

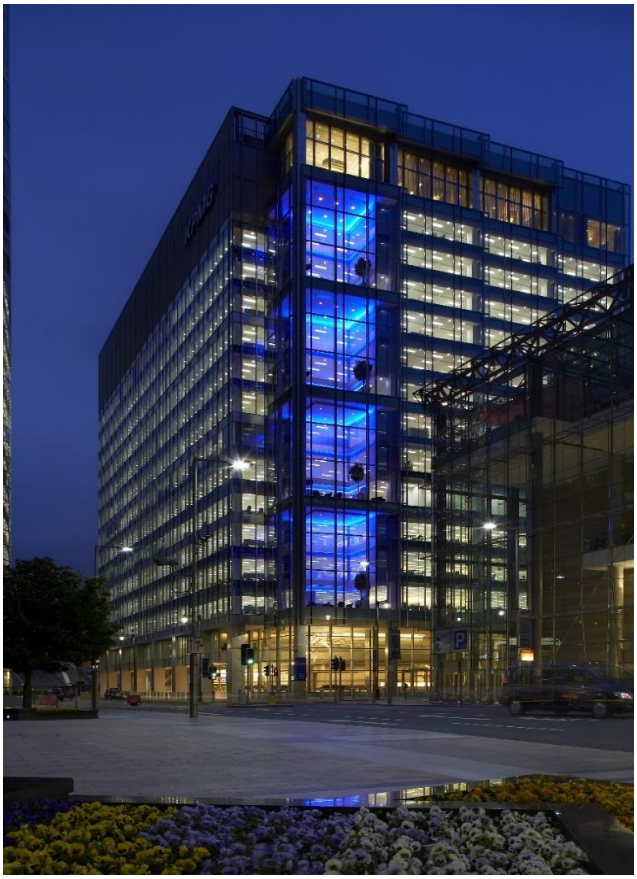
The Mumbai Tribunal in the case of Pinstorm Technologies Pvt. Ltd.[3] held that the payment made to a foreign company for the services rendered for uploading and display of the banner advertisement on its portal was not in the nature of FTS or royalty. Further, the payment was in the nature of business income and in the absence of a PE in India, it is not chargeable to tax in India.

The Kolkata Tribunal in the case of Right Florists Ltd.[4] held that the payment made for online advertisement on search engines of Google and Yahoo were not taxable in India. The Tribunal observed that the search engine which has only its presence through its website cannot be held as a PE unless its web servers are also located in the same jurisdiction.

However, the ratio laid down in the above cases were not followed in the case of Google India Private Ltd.[5], since the Tribunal felt that the facts relating to the working of the AdWords program stood on a different footing. The Tribunal observed that it was not a case of merely displaying or exhibiting of advertisement by the advertiser on the website, but it was a case of use of patented technology, secret process and use of trademark by the taxpayer. Google India was provided access to the IPR, Google Brand features, secret process embedded in Adwords Programme as a tool of trade for generation of income. Therefore, the payment was taxable as royalty.

The Ahmedabad Tribunal in the present case has held that payment for website promotion services cannot be taxed as FIS under the India-US tax treaty. The Tribunal relied on the decisions of Right Florists (P.) Ltd. and Pinstorm Technologies (P.) Ltd.

It is important to note that India has introduced various measures in the Act to tax digital and remote operations. Such measures include expanding the scope of a business connection by introducing Significant Economic Presence (SEP) provisions. In 2016, the government had introduced Equalisation Levy (@ 6 per cent) on online advertisement, digital advertising space or any other such facility or service. Further, in 2020, a new set of Equalisation Levy (@ 2 per cent) has been introduced on the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services.



[3] Pinstorm Technologies (P.) Ltd. v. ITO [2012] 24 taxmann.com 345 (Mum)
[4] ITO v. Right Florists Ltd. (2013) 25 ITR 639 (Kol)
[5] Google India Private Ltd. v. ACIT [2017] 190 TTJ 409 (Bang)

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