



## Tribunal rules on the taxability of payments made under a Distribution Agreement for Google's AdWords Program

The Income-tax Appellate Tribunal (Tribunal), Bangalore in the case of Google India Private Ltd. (Google India) held that payments made to Google Ireland Ltd. (Google Ireland) under a distribution agreement for the AdWords Program are in the nature of 'royalty'. Accordingly, it upheld the finding of the Assessing Officer that Google India was an assessee-in-default for not withholding tax on payments made under the agreement.

### Background

Google India and Google Ireland had entered into a distribution agreement in 2005 under which Google India was appointed as a non-exclusive distributor of the AdWords Program to advertisers in India. Under this agreement, Google India purchased advertising space from Google Ireland and resold the same to advertisers in India. It also performed certain marketing activities and provided assistance and training to advertisers in order to familiarize them with the features and tools that are part of the AdWords product.

The Assessing Officer held that the payments made to Google Ireland under the distribution agreement were in the nature of 'royalty' under the Income-tax Act, 1961 (Act) as well as under the India-Ireland tax treaty. In arriving at this conclusion, the Assessing Officer, *inter alia*, held that:

- Google India had been granted a license to use software (i.e. the Google AdWords Program);
- Distribution rights granted to Google India are itself intellectual property rights within the meaning of section 9(1)(vi) of the Act;
- Google India had been granted a right to use Google's trademarks and other brand rights;
- The grant of distribution rights involves a transfer of 'process' and also the right to use industrial, commercial and scientific equipment.



The findings of the Assessing Officer were upheld by the Commissioner (Appeals) and the matter was taken in further appeal to the Tribunal.

### **Summary of the Tribunal's order**

The key findings of the Tribunal in relation to the characterisation of the payments made by Google India to Google Ireland are set out below:

- a) The distribution agreement is not merely an agreement to provide advertising space, but is for facilitating the display and publishing of an advertisement to targeted customers.
- b) The intellectual property of Google vests in the search engine technology, associated software and other features, and hence use of these tools for accepting advertisements, providing pre-and post-sale services, etc. falls within the ambit of 'royalty'.
- c) The customer data made available to Google India under a separate agreement under which Google India provided IT enabled services to Google Ireland was used, not only for rendering such IT enabled services, but also for promoting, marketing and distributing advertisement space on the search engine and website. On account of the use of such data, the amounts paid by Google India to Google Ireland was for the use of patent, invention, model, design, secret formula or process, and hence 'royalty'.
- d) Payments made by Google India was also for the use of the Google trademark and brand names, which are used for promoting and advertising the advertisement space. Hence, for this reason as well, the payment made by Google India to Google Ireland falls within the definition of 'royalty' under the Act as well as the India-Ireland tax treaty.
- e) The marketing and promotion of advertisements by Google India is possible only with the use of the secret formula and confidential customer data. Since the secret formula for targeting customers is not in the public domain, Google India was using a secret process, the payment for which would amount to 'royalty'.

In addition to the above, the Tribunal also addressed two important issues relating to the period of limitation and the extent of withholding obligations in cases where the income was taxable under a treaty only upon actual payment. The relevant findings in this regard are summarised below:

- a) It was contended by Google India that for two of the years in question in the appeal, the proceedings were barred by limitation since they were initiated beyond four years from the end of the relevant financial year. Since the Act did not provide for a specific period of limitation for initiating proceedings for a failure to withhold tax on payments made to non-residents (i.e. in this case Google Ireland), it was contended that a reasonable period of four years should be adopted following the decision of the Delhi High Court in *CIT v. NHK Japan Broadcasting Corporation* (305 ITR 137). However, the Tribunal held that a uniform period of limitation should be applied for payments to residents and non-residents. Hence, it concluded that the time-limit of six years applicable under section 201(3) of the Act to payments made to residents should apply for non-residents as well.



- b) Google India contended that even if the payments were held to be ‘royalty’, they were liable to tax in India only on a ‘receipt’ basis in terms of Article 12 of the India-Ireland tax treaty. The amounts due to Google Ireland had remained unpaid during the years in question, and therefore, they were not ‘chargeable’ to tax in India. Accordingly, it was argued that the question of withholding would arise only at the time of actual remittance and not at the time of credit in the books. This was also rejected by the Tribunal which held that the benefit of the tax treaty was available only to non-residents, and not to Google India, which was a resident payer.

## **Our Comments**

Revenue streams in an increasingly digital economy are often not neatly aligned with the source rules under domestic law and treaties. As a result, there have been many disputes on the taxability of such payments, particularly in an Indian context. Historically, the Indian tax authorities have sought to assert tax on various revenue streams by either alleging the existence of a permanent establishment (on account of websites, computer equipment, etc.) or treating payments for digital goods and services as royalties or fees for technical services. However, from 2016 onwards, advertising is covered by the ‘Equalisation Levy’ introduced pursuant to the OECD’s Report on Action 1. Hence going forward, the taxability and characterisation of payments for online advertisements will no longer be governed by the Act or treaties.

Nonetheless, this decision will have a significant impact on how other digital economy related payments are characterised for tax purposes in India. It will also influence other pre-2016 cases that relate to payments for online advertising.



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