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## Google Case Revives Debate On Tax Treatment Of Advertisement Revenues

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Last week, the Indian tax department emerged victorious in taxing search engine giant Google Inc. The Bangalore Income Tax Appellate Tribunal ruled in favour of the tax authority in a case involving Google India's sale of AdWords programs – a software that enables advertising on the search engine.

The income tax department brought claims against Google India contending that the payment made by Google India to its affiliate, Google Ireland, for distribution of the AdWords program was not a 'technical fee' but in the nature of 'royalty' for use of Google's intellectual property rights.

Digital advertising revenue has been a point of contention between the tax department and internet portals. In the cases of Yahoo, Pinstorm Technology and Rights Florist, the department failed in its effort to substantiate that the amounts they paid to foreign entities for advertising in India were in the nature of technical fees or royalty.

In both Yahoo and Rights Florists, the tribunal held that the payment to the offshore entity was merely payment for putting up an advertisement and there was no element of either ‘fee for technical services’ nor anything in nature of royalty, Abhishek Goenka, tax partner at consulting firm PwC told BloombergQuint in an interview.

“ *In both these leading precedents, the tribunal has held that there is no obligation on the Indian party to withhold tax since the foreign recipient was not liable to tax on these payments.*

Abhishek Goenka, Partner, PwC

Up until now, the precedents were all in the favour of taxpayers, he said.

In each of these precedents, the tribunals have looked at ‘advertisement fee’ as a ‘business income’, which may be taxable in India depending on whether the relevant foreign entity has a permanent establishment in India, Shipra Padhi, senior member of the international tax team at law firm Nishith Desai told BloombergQuint.

“ *Courts have not characterised advertisement fees as royalty income.*

Shipra Padhi, Senior Member – International Tax, Nishith Desai

In the Google case, the appellate tribunal relied on dissimilar facts to differentiate it from the precedents. Google India and its Ireland affiliate had entered a distribution agreement under which Google India had the rights to market and distribute the AdWords program. By virtue of this software, Google India bought advertising space from its affiliate and sold it to advertisers in India and a portion of the consideration from such sale was then remitted to its Irish counterpart. In addition to the distribution agreement, Google India also provided backend services to Google Ireland. For this, Google India had the right to use trademarks, confidential information and other intellectual property of Google.

Tax authorities and the tribunal looked at both these arrangements in aggregate. The tribunal held that distribution rights are intellectual property rights and treated the entire income as ‘royalty’ and not ‘business income’.

But experts did not find any material difference in the facts of this case that may have prompted the tribunal to depart from the precedents.

“ *While no doubt technology has moved on and continues to be very dynamic in nature, in substance the transaction is very similar, which is that of an Indian party placing some advertisement and content on a particular social media platform or website.*

Abhishek Goenka, Partner, PwC

The tribunal based its views on the fact that Google Ireland gave Google India access to intellectual property and confidential information, which was then used for activities relating to the distribution agreement. This, the tribunal held, implies that Google India has the right, title and interest over Google's intellectual property. It concluded that Google's intellectual property 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, falls within the ambit of 'royalty'.

“ *I feel ITAT did take a very aggressive approach here. It doesn't seem like a case of tax avoidance but re-characterisation of income. It's sort of a very new approach that the ITAT has taken.*

**Shipra Padhi, Senior Member – International Tax, Nishith Desai**

Experts were not wholly in agreement with the views of the tribunal.

There are several judicial precedents and internationally acceptable commentaries that say that one needs to look at the substance of the transaction, and if the substance of the transaction is of reseller or distributor, then such incidental rights made available to such company cannot let the overall transaction be characterised as relating to transfer of intellectual property, Goenka said.

“ *I think that's where tribunal ruling goes beyond accepted principles and accepted case laws.*

**Abhishek Goenka, Partner, PwC**

If the appellate tribunal's views are upheld by the higher courts, it may lead large MNCs with similar back-offices and distribution arrangements into rethinking their business models, Padhi opined.

“ *Any regular agreement will typically include use of intellectual property rights and confidential information, in all probability this judgement will affect various businesses which have cross border arrangements.*

**Shipra Padhi, Senior Member – International Tax, Nishith Desai**

Most matters specifically dealing with the tax treatment of advertisement revenues are currently pending before various authorities and until the higher courts rule on this point, there will not be a common principle across jurisdictions.