

Tax Hotline

April 13, 2022

PAYMENT TO NON-RESIDENT FOR BANNER ADVERTISEMENT NOT TAXABLE IN INDIA

- Payment for banner advertisement does not qualify as royalty or fees for technical services
- Indian resident not required to withhold tax on such payments

Recently, the Mumbai bench of the Income-tax Appellate Tribunal ("**Tribunal**")¹ in appeal filed by Play Games 24X7 Private Limited ("**Taxpayer**"), held that payment for advertisement banner to a non-resident company does not fall under the ambit of royalty or fees for technical services and is not taxable in India.

BACKGROUND

The Taxpayer is engaged in the business of providing a platform for online gaming (particularly rummy). The Taxpayer incurred certain advertisement expenses for display of banner advertisement on a social media website ("**Website**") owned and operated by a foreign company incorporated under the laws of Ireland ("**Foreign Company**"). The Foreign Company has does not have a permanent establishment ("**PE**") in India and has also furnished a tax residency certificate to tax authorities.

During the assessment proceedings, both the Assessing Officer ("**AO**") and the Commissioner of Income-tax (Appeals) ("**CIT(A)**") disallowed the payments made by the Taxpayer to the Foreign Company on account on non-withholding of taxes by the Taxpayer under section 40(a)(i) of the Income-tax Act, 1961 ("**ITA**").

RULING BY THE TRIBUNAL

- The Tribunal held that the decision of the CIT(A) was erred. It specifically took note of the following points of Taxpayer's operation with the Website:
 - a. For the purpose of uploading the banner advertisement on the Website, the advertisement related information is put up at the interface provided by the Foreign Company in the required format. After due verification of the advertisements by the Foreign Company, the advertisements are uploaded on the Website's server;
 - b. While uploading the advertisement on the Website, the Taxpayer does not have any control over the functioning of the interface provided by the Foreign Company;
 - c. The entire operation and maintenance of the server while providing the advertisement platform is under the control of the Foreign Company;
 - d. The Taxpayer makes use of standard facility which is provided for displaying advertisement on the Website;
 - e. The Taxpayer does not have any role to play in either maintaining or involving into any managerial activities with the Website;
 - f. There is no dedicated equipment or any portion of equipment is not earmarked / provided by the Website to the Taxpayer;
 - g. The Taxpayer does not have any economic or possessory right with regard to the server of the Website and the server is not at the disposal of the Taxpayer. The Taxpayer does not get any right to modify / deal with the server in any manner;
 - h. The server through which the advertisement is uploaded is not at all located in India
- The Tribunal further held that the AO and CIT(A) have ignored the facts of the present case (as mentioned above) and have not demonstrated that payment made by the Taxpayer to the Foreign Company qualifies as royalty / fees for technical services.

- The Tribunal upheld the decisions in case of Urban Ladder Home Dīcor Solutions Pvt. Ltd.², Google India Pvt. Ltd.³, M/s Inception Business Services⁴, Carat Lane Trading (P.) Ltd.⁵ and ITO v. Right Florist Pvt. Ltd.⁶ and held that the payment for advertisement to Foreign Company does not qualify as royalty or fees for technical services and is not taxable in India. Courts in the aforesaid cases had held that mere usage of a standard facility does not give rise to provision of any technical service. Further, payments for usage of a standard facility does not render the payments as 'royalty payments', since there is no parting of any 'copyright' attached to the said facilities.

- The Tribunal has held that obligation to withhold tax under section 195 of the ITA arises only in case of payment of any sum chargeable to tax under the ITA.

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ANALYSIS AND COMMENTS

Taxability of advertisement payments is a frequently litigated issue. While the Tribunal has not provided a detailed order, the decision of the Tribunal seems to be in the right direction and in line with past decisions. While jurisprudence on payments for advertisements seems to be favouring the tax payer, it is important to re-visit taxability of advertisement payments in light of the equalization levy ("EL"), significant economic presence ("SEP") provisions and other global developments in digital taxation.

The EL provisions (as introduced by Finance Act, 2016) provides that EL at rate of 6% is applicable on consideration (in excess of INR 100,000 (USD 1,500 approx.)) received or receivable by non-residents for provision of 'specified online advertising services' from Indian residents or non-residents having a PE in India. Please note that in light of the global agreement on the two-pillar solution, India and US have agreed on rollback of EL once Pillar One comes into force.⁷

Further, the SEP provisions deems the SEP of non-residents as business connection in India. In this regard, section 9 of the ITA provides that a non-resident creates SEP in India if the non-resident:

- a. engages in transactions with respect to any goods or services with any person in India, if the aggregate of payment for such transaction exceeds INR 2 crores (approximately USD 2,69,000), or
- b. systematically and continuously solicits business activities or engages in interaction with at least 3 lakh users

Once non-resident creates SEP in India, so much of the income attributable to SEP is taxable in India. The ITA specifically exempts income chargeable to EL from tax under the ITA, therefore, SEP provisions should not be applicable on such income. However, while the policy intent of the SEP and EL provisions seems to render the provisions mutually exclusive, there is no specific exemption under the EL provisions for cases wherein the income is subject to tax in India due to constitution of SEP of non-resident in India. Having said this, the impact of the SEP provisions is confined to only jurisdictions with which India does not have a tax treaty. Further, by way of a deeming fiction, section 9 of the ITA also provides that income attributable to a business connection should also include income from advertisements which targets customers residing in India or a customer who accesses advertisement through internet protocol address located in India.

The political agreement on the key components of Pillar One and Pillar Two to address the tax challenges arising from the digitalising of the economy has paved the way for several changes in international taxation regime.⁸ Pillar One proposal essentially addresses the allocation of taxing rights between jurisdictions and considers various proposals for new profit allocation (Amount A) and nexus rules. Considering the ongoing work by the Organisation for Economic Co-operation and Development to formalise the multilateral convention for implementation of Pillar One, it is also important to examine the impact Pillar One provisions, specifically in relation to sourcing revenue from online advertisement services to market jurisdictions.

Therefore, while the Tribunal ruling provides certainty on past transactions, considering the changing tax landscape, it will be important to re-examine the tax positions for advertisement payments.

– Ipsita Agarwalla & Ashish Sodhani

You can direct your queries or comments to the authors

¹ ITA No. 1533 / Mum / 2019

² ITA No. 615-620 / Bang / 2020

³ ITA No. 503 / Kar / 2018

⁴ ITA No. 2674 / Chny / 2016

⁵ ITA No. 213 / Mds / 2017

⁶ 25 ITR (T) 639 (Kolkata Tribunal)

⁷ Please refer our hotline for more details - <https://www.nishithdesai.com/SectionCategory/33/Technology%20&%20Tax%20Series/12/69/TechnologyTaxSeries/4962/1.html>. The details of the India – US agreement were expected to be finalized by February 1, 2022, however, till date there has been no update in this regard.

⁸ OECD/ G20 Base Erosion and Profit Shifting Project: Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy. Available at:

<https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf>

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