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- Payment of approx. USD 225 million between 2006 – 12 to Google Ireland for purchase of ad space.
- Marketing and distribution (re-sale) of purchased ad space to Indian advertisers.
- Separate ad space sale contracts with advertisers.
- Pre and post sale services
- Training advertiser on use of AdWords program.

- providing assistance and training, where required, to Indian advertisers to familiarize them with the features and tools of the AdWords Program

No information, know-how and skills were imparted to Google Ireland. The Tax Authorities alleged this on the basis of the NDA and confidentiality clause which is intended only to protect confidentiality of the information, if any, which either party gathers during the course of the business. Such clauses are generic to most agreements and cannot per se establish that there is a right to use Google Ireland's intellectual property.

The right to use the Google trademarks and brand features granted to Google India were merely to enable Google India to distribute the ad space in India, and were incidental to the main purpose of the distribution agreement which was the sale of ad space. Google India submitted that the mere use of brand name for procuring ad contracts would not amount to use of trademark.

The distribution rights are commercial rights and cannot be rights in 'similar property' for the purposes of Section 9(1)(vi). In any case, the definition of royalty under the Ireland Treaty does not contain the words 'similar property'.

Google India has no right to use Google Ireland's equipment or servers. The operation, control and maintenance of the servers, located outside India, solely rests with Google Ireland

Google India does not have access to or control over any back-end processes such as databases, software tools etc., under the Distribution Agreement.

Google India neither receives any right nor access to the AdWords Program under the Distribution Agreement and does not use it in any manner whatsoever. The payment to Google Ireland is merely towards purchase of the ad space for resale without access to any underlying computer program.

Accordingly, Google India argued that the payment to Google Ireland is for purchase of ad space which is in the nature of business income. In the absence of a permanent establishment of Google Ireland in India, such income would not be taxable under the ITA read with the Ireland Treaty.

RULING

Whether the amounts credited in Google India's books to Google Ireland's account constituted business income or royalties for use of software, trademarks and other intellectual property rights.

Whether distribution rights amount to license of intellectual property? Based on information regarding the AdWords Platform provided by the Google India, information available on Google's website and in books available in the public domain, the Tribunal concluded that the Distribution Agreement was not merely an agreement to sell ad space but rather is an agreement to provide services to facilitate the display and publication of an advertisement to targeted customers with the help of technology.

The Tribunal was of the view that the AdWords Program gives an advertiser a variety of tools to enable it to maximize attention, engagement, delivery and conversion of its advertisements. The tools are provided using Google's intellectual property, software and database (including data on numerous individual web-users and their name, age, gender, location, phone number, IP address, habits, preferences, online behavior, search history etc.) with Google India acting as a gateway.

The Tribunal was of the view that the use of customer data for providing services under the Service Agreement was also utilized for marketing and distribution functions under the Distribution Agreement. It concluded that the use of customer data and confidential information should be regarded as the use of Google Ireland's intellectual property by Google India.

The Tribunal concluded that it is through use of Google's intellectual property that the AdWords tools for performing various activities are made available to Google India and the advertisers. Therefore, payments made to Google Ireland for use of its intellectual property would therefore clearly fall within the ambit of "Royalty".

Google Ireland's IP not incidental to the activities of Google India: Under the Distribution Agreement, Google India was permitted to use Google trademarks and other distinctive brand features of Google Ireland. The Tribunal concluded that such use was essential and pivotal for Google India to market and distribute the AdWords Program. The Tribunal distinguished the rulings in *Sheraton*² and *Formula One*³ and held that the brand features were used as marketing tool for promoting and advertising the ad space, which is the main activity of Google India and therefore would not be incidental to Google India's business.

Distinguishing from precedents: The Tribunal did not place reliance on the *reports of the OECD Technical Advisory Group ("TAG") and the CBDT's High Powered Committee ("HPC")* which had concluded that payments arising from advertisements would constitute business income.

The Tribunal distinguished the reports on the ground that the fact patterns dealt with therein were vastly different from the facts in the present case. In the present case Google India has been provided access to the IPR, Google brand features, secret process embedded in AdWords Program as tool of the trade for generation of income.

On the same basis, the Tribunal also distinguished this case from earlier Tribunal rulings in *Right Florist*⁴ and *Pinstorm Technologies*⁵ and *Yahoo*⁶ where courts had held that payments made to a foreign company for banner advertisement hosting services would not constitute royalties.

Whether the Services Agreement and the Distribution Agreement should be read together? The Tribunal held that under the Distribution Agreement, Google India was solely responsible for providing all customer support services to the advertisers through use of Google Ireland's data and intellectual property.

While Google India could afford to provide these services to the advertisers under the Services Agreement (under which Google India received a license to Google's data and intellectual property), but services were instead rendered under the Distribution Agreement. In the Tribunal's view, without Google India exercising its rights under the Services Agreement, it could not discharge its obligation under the Distribution Agreement. Thus, the Tribunal concluded the services rendered under Services Agreement cannot be divorced with the activities undertaken by Google India under the Distribution Agreement. The bifurcation of agreements was only a design / structure prepared by Google India to avoid the payment of taxes.

ANALYSIS

The Tribunal appears to have undertaken an intensive fact-finding mission to unearth the technological workings of the Google AdWords Program on the basis of which it has concluded that the distribution rights involved a grant of license to intellectual property and advertisements fees were in the nature of royalties.

The Tribunal's ruling is also of interest for its clear break with earlier positions taken by Tribunals on the characterization of advertisement revenue, and payments made under distribution arrangements. Historically, in case of distribution arrangements, courts have ruled the payments to be in the nature of business income. In these cases, the question is usually whether the foreign entity has a permanent establishment (PE) in India for income to be taxable in India. In fact, the issue in such cases has been on the determination of a PE on account of a fixed place or dependent agent rather than whether such an arrangement will result in royalty income.

Similarly, in the past, Tribunals have held that income from advertisements should be in the nature of business income, not taxable in India in the absence of a PE. In fact, it was for this very reason that the equalization levy was introduced to capture advertising fees within the Indian tax net, in cases where the non-resident does not have a PE in India.

Importantly, the Tribunal has taken an aggressive approach where it has read two independent agreements in relation to services provided by two different units of Google India together to show that there was utilization of IP by the Indian entity and re-characterized the nature of income. The ruling does not provide for reasons of tax avoidance for clubbing the two agreements. Going forward, the taxpayer should expect a fair amount of scrutiny especially considering that the General Anti Avoidance Rules specifically grant the tax department, the power to re-characterize income.

The ruling could have far reaching implications from businesses across the board. Utilization of IP such as customer data, confidential information for performing services is a fairly common industry practice and the ruling raises concerns on these type of arrangements.

Google India has issued a public statement conveying its intention to appeal the ruling. Therefore, the issue is still open and we await the High Court's ruling for further clarity.

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You can direct your queries or comments to the authors

¹ IT(TP)A Nos. 1511 – 1518 / Bangalore / 2013

² *Sheraton International Inc v DDIT*, [2009] 313 ITR 267 (Delhi HC);

³ *Formula One World Championship Ltd. v CIT* [2016] 76 taxmann.com 6 (Delhi HC);

⁴ ITA No. 1336/Kol/2011

⁵ ITA No. 4332/Mum/2009

⁶ *Yahoo India (P.) Ltd. v. Dy. CIT*, [2011] 46 SOT 105

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