

EY Tax Alert

Jaipur Tribunal rules on non-applicability of equalization levy on advertisement services where both advertisers and targeted audience are located outside India

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Executive summary

This Tax Alert summarizes a decision of Jaipur Tribunal (Tribunal) in case of Prakash Chandra Mishra¹ (Taxpayer) wherein the issue before Tribunal was on applicability of advertisement equalization levy (Ad EL) and corresponding expense disallowance on non-deduction of Ad EL at the time of payment.

The Taxpayer, an Indian resident individual and a business constituent of Google Asia Pacific Pte. Ltd., Singapore (Google), had access to Google's advertisement program. He granted access of such Google program to its clients {non-resident (NR) advertisers} using which the NR advertisers ran advertisements targeting audience outside India. The Taxpayer collected ad fees from NR advertisers and remitted to Google and claimed expense deduction of such payments.

Having regard to the facts of the case and, particularly, the factual finding and legal conclusion of the first appellate authority (FAA), the Tribunal accepted that the Taxpayer acted as an agent/conduit between Google and NR advertisers. Basis that, the Tribunal concluded that the Taxpayer merely helped NR advertisers to avail services of Google program and, as an intermediary, was channelizing funds from NR advertisers to Google. The ultimate beneficiary of advertisement services were NR advertisers who have no business in India and their advertisements were also targeted to audience outside India.

In such a case, where advertisers are NRs and target audience are also outside India and Taxpayer is merely making payment to Google on behalf of such NR advertisers, Ad EL provisions are not triggered. Accordingly, the disallowance of expense in hands of Taxpayer was deleted.

¹ ITA No. 305/JPR/2022

Background

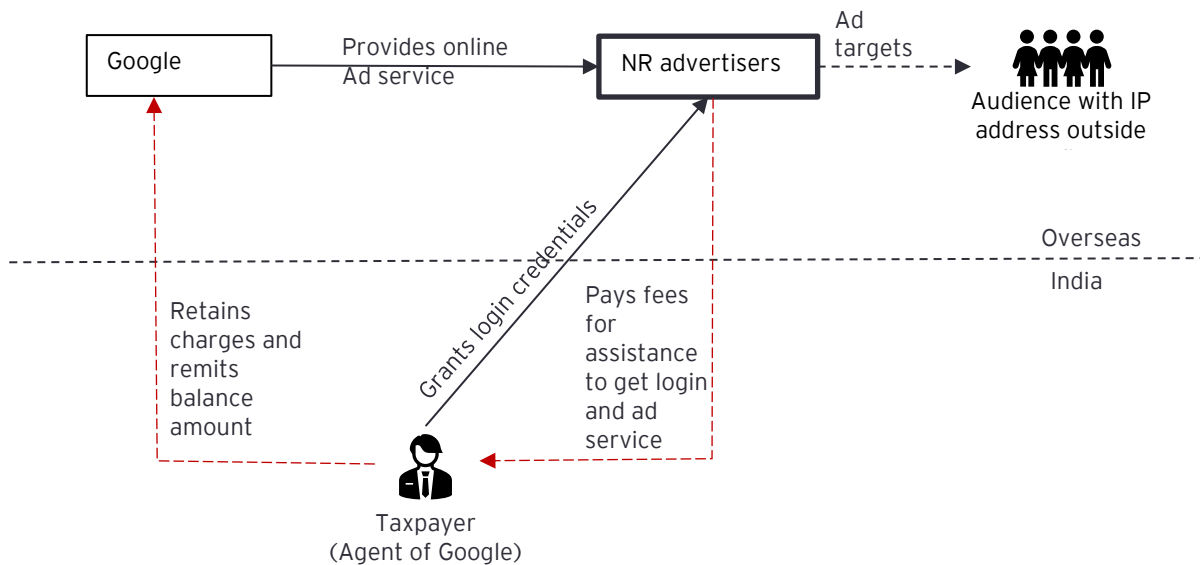
- ▶ The Finance Act (FA) 2016 introduced Ad EL effective from 1 June 2016 as a separate, self-contained code, not forming part of the Income Tax Law (ITL).
- ▶ Ad EL is charged at the rate of 6% on gross consideration received or receivable by an NR service provider (who does not have a permanent establishment (PE) in India) for furnishing “specified services”.
 - ▶ Specified services means online advertisement, provision for digital advertising space, provision for any facility or service for online advertisements and other services as may be notified.
- ▶ The specified payer is under an obligation to deduct Ad EL from the amount paid or payable by it to the NR for specified services.
 - ▶ Specified payer is referred to as a resident of India carrying on business/profession or a NR having a PE in India
- ▶ On failure to discharge Ad EL by specified payer, the provisions of the ITL provides for 100% disallowance of expenses in the hands of the payer while computing taxable business profits.
- ▶ The Taxpayer had no role to play in running the advertisement campaign and NR advertisers had the sole discretion, including (a) on which geographical location should advertisement be run on, (b) who would be the target audience, (c) for how much duration such advertisement is to be done etc.
- ▶ In addition to the consultancy fees received by the Taxpayer for its services, the Taxpayer also received Google advertisement fees from NR advertisers as lumpsum fees. The Taxpayer paid such amount to Google for and on behalf of the NR advertisers^[2]. For instance, if ABC Inc. is an NR advertiser which has paid \$110 to the Taxpayer. Out of \$110 so received, the Taxpayer has remitted \$100 for online advertisements to Google and has retained amount of \$10 as consultancy charges charged by the Taxpayer.
- ▶ The Taxpayer did not deduct Ad EL at the time of making payment to Google and claimed such amount as an expense on the ground that he was not availing online advertisement services but instead he was merely acting as conduit/agent for channelizing the funds from NR advertiser to Google. The advertisement services were availed by NR advertisers for the purpose of advertisements targeted to audience outside India and, hence, Ad EL should not apply on such transaction which was not having any territorial nexus with India.

Facts

- ▶ The Taxpayer, an individual resident in India, had a proprietorship concern engaged in providing support services in respect of online advertisement, digital marketing and web designing for which he earned consultancy fees.
- ▶ The Taxpayer entered into agreement with NR advertisers stating that, as an agent of Google^[2], he shall provide them access to Google program for running advertisements. Pursuant to such agreement, the Taxpayer provided login credentials of Google program to the NR advertisers. Using the credentials provided by the Taxpayer, NR advertisers ran their advertisements on Google website targeting audience outside India.

A diagrammatic representation of the structure is given below.

^[2] The order has multiple references as to the taxpayer having acted on behalf of the clients (i.e., NR advertisers). There are also references that the Taxpayer acted as agent of Google. Amidst these, there are references about Taxpayer having acted as conduit/agent between Google and NR advertisers - the latter being the basis of ITAT conclusion without any factual finding on this regard.



Order passed by tax authority:

- ▶ The tax authority argued that the Taxpayer was not an agent of Google basis the following arguments:
 - ▶ Basis the agreement between Google and the Taxpayer, the Taxpayer was the customer of Google utilizing Google's program for placing digital advertisements on his behalf or on behalf of a third party. In fact, the terms specifically stated that there was no agency, partnership or joint venture relationship created between Google and the Taxpayer. Further, the agreement also stated that the Taxpayer shall be solely responsible for creatives, advertisement targeting decisions, redirection to other webpages etc.
 - ▶ The invoices were raised by the Taxpayer on his clients (i.e., NR advertisers) for the service rendered and not by Google.
 - ▶ In Taxpayer's books, the revenue received from NR advertisers were accounted as gross receipts and service fee paid to Google was booked as expense towards the purchase of services.
- ▶ Basis the above contract terms, the tax authority was of view that the Taxpayer availed online advertisement services from Google. Further, there is no specific exclusion provided in Ad EL provisions for the following:
 - ▶ if a resident makes payment for online advertisement to NR service provider out of the amounts received by a result from its NR customers; or
 - ▶ if the targeted customers of online advertisement by resident are located outside India

- ▶ Accordingly, since payments were made by residents to NRs for availing online advertisement services, Taxpayer was obligated to deduct Ad EL @ 6%. On failure to do, expense deduction claimed by the Taxpayer on payment made to Google was disallowed. The amount of expense disallowed in the hands of Taxpayer was approx. INR 89 Mn.

Decision of FAA

- ▶ Aggrieved by Tax authority's order, the Taxpayer appealed to the FAA i.e., National Faceless Appeal Centre which considered the evidences^[3] filed by the Taxpayer digitally. It held as under:
 - ▶ Services of online advertisement were received by clients of the Taxpayer (i.e., NR advertisers) who were all located outside India with their business or profession located outside India. In other words, ultimate beneficiary of such online ads were NR advertisers and not the Taxpayer.
 - ▶ Entire target audience/target location of these online ads was located outside India and had no connection with India
 - ▶ Taxpayer only acted as a conduit/agent of Google while receiving payments from his clients from outside India and, thereafter, made payment to Google on behalf of his clients. In other words, the Taxpayer was working on behalf these ultimate beneficiaries who were his clients.

^[3] Taxpayer submitted various evidences such as (i) Tabulated information providing details of NR advertisers, address, amount received from NR advertisers, amount paid to Google, location of target audience (ii) Copies of remittance certificates indicating purpose of remittance for online advertisement and (iii) Sample campaign reports giving target locations, number of clicks, screenshots of login ID. etc.

- ▶ Accordingly, the FAA held that payments made by Taxpayer to Google were not chargeable to Ad EL and reversed the disallowance of expenses in the hands of the Taxpayer.
- ▶ Aggrieved, the tax authority appealed before the Tribunal.

Issue before Tribunal

The issue before the Jaipur Tribunal was whether the payment made to Google should be disallowed in the hands of the Taxpayer due to non-deduction on Ad EL on such payment?

Additional arguments put forth by the Taxpayer before Tribunal

- ▶ The provisions of Ad EL is applicable on “consideration” earned from person resident in India. Relying on the definition of “consideration” under the Indian Contract Act, 1872^[4], it was stated that there was no promisor-promisee relationship between the Taxpayer and Google. In the present case, NR advertisers who wanted to get their advertisement done on Google was the “promisor” and Google was the “promisee”. The Taxpayer is merely channelizing the payments and not paying any consideration to Google on its own account.
- ▶ The consideration should be paid by the resident in India for the purposes of “carrying of business in India”. In the present case, the NR advertisers who are located outside India are the ultimate beneficiary of the ad service of Google. The online advertisement services are availed by NR advertisers from Google on a principal-to-principal basis.
- ▶ EL was introduced with an intent to tax advertisement revenue generated by the online platforms from businesses run in India. Thus, the primary requirement for such taxability is that the business for which the online advertisement is being run should be in India or the target audience of such advertisement should be in India. However, in the present case, neither of the two elements are based in India. The Taxpayer, in the present case, only acted as one of the means to effectuate the online advertisements for NR advertisers targeting overseas audience.

^[4] As per Section 2(d) of the Indian Contract Act, 1872, when, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such an act or abstinence or promise is called a consideration for the promise.

- ▶ In 2020, the scope of EL provisions was expanded to cover gross consideration received by NR e-commerce operators from e-commerce supply and service made or provided or facilitated to a resident in India or person a person who buys such goods or services or both, using Internet Protocol Address. The expanded scope of EL provisions also indicate that the intention of the statute is to bring within the purview of EL only those transactions which have some connection with India. The connection should be in relation to the business carried out in India or services rendered in India. In this case, the NR advertisers and target audience are located outside India.
- ▶ The reason for channelizing the invoice through the Taxpayer was that the Taxpayer was the premier partner^[5] for Google and being such partner, the NR advertisers could use the User ID allotted to the Taxpayer. The ultimate beneficiary of the Google advertisement services were NR advertisers. The role of the Taxpayer was merely to provide access of Google program to NR advertisers. The entire decision making of advertisement as to how much amount is to be spent on each campaign and who were the target audience were decided by the client of the NR advertisers.
- ▶ While the Taxpayer has accounted for gross revenue earned from NR advertisers and claimed deduction of payment made to Google, mere manner of accounting may not establish principal-to-principal relationship between the Taxpayer and Google. It is a settled judicial proposition that entries in books of accounts are not decisive of the nature of expense.

Tribunal’s conclusion

Noting the arguments of the Taxpayer and the rationale of FAA, the Tribunal upheld the order of FAA ruled in favor of the Taxpayer basis the following supplemental reasons:

- ▶ The role of the Taxpayer is that of an agent of Google. Being an agent of Google, the Taxpayer provides its login credentials to its customers (NR advertisers) and these NR advertisers decide how the advertisement is to be run. The Taxpayer is merely a conduit who helps NR advertisers avail services of Google program for the purpose of their online advertisement.

^[5] A terminology to reflect a special business relationship and not a partnership as generally understood

- ▶ The Taxpayer is merely acting as an intermediary for receiving payments from his clients from outside India and thereafter making payment to Google on their behalf.
- ▶ The ultimate beneficiary of services were NR advertisers who have no business in India. The advertisement is also targeted to audience outside India. Thus, there is no India nexus.
- ▶ In such case, where advertisers are NR and target audience is also outside India and resident in India is merely making payment to Google on behalf of such NR advertisers, Ad EL provisions are not triggered and, hence, payments made to Google by the Taxpayer should not be disallowed.

Comments

The present Tribunal ruling is a welcome decision and appears as an early judicial review of Ad EL provisions which are effective since 1 June 2016.

In this case, the Jaipur Tribunal has taken the favorable view on Ad EL basis two major reasons:

- The Taxpayer was merely conduit/agent between NR advertisers and Google; the ultimate beneficiary of Google advertisement services was NR advertisers and not the Taxpayer.
- The online advertisement was not targeted to an Indian audience i.e., the targets of advertisements were neither in respect of business carried out by the Taxpayer-resident nor in respect of NR advertisers' business in India.

Importantly, the Tribunal appears to have relied on the substance of the matter to ascertain that the Taxpayer was acting as an intermediary/agent/conduit between NR advertisers and entity providing online advertisement service (i.e., Google). The decision highlights the importance of documentation and factual representation in analyzing the applicability of tax provisions.

Taxpayers affected by Ad EL provisions may wish to evaluate if the principles laid down in this ruling can be applied in their fact patterns, determined basis the contractual terms and conduct of the parties.

Our offices

Ahmedabad

22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon
Temple, Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

Bengaluru

12th & 13th floor
"UB City", Canberra Block
No. 24, Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground Floor, 'A' wing
Divyasree Chambers
11, O'Shaughnessy Road
Langford Gardens
Bengaluru - 560 025
Tel: + 91 80 6727 5000

Chandigarh

Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai

Tidel Park, 6th & 7th Floor
A Block, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR

Golf View Corporate Tower B
Sector 42, Sector Road
Gurugram - 122 002
Tel: + 91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad

THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jamshedpur

1st Floor, Shantiniketan Building,
Holding No. 1
SB Shop Area, Bistupur
Jamshedpur - 831 001
Tel: + 91 657 663 1000

Kochi

9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata

22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

Pune

C-401, 4th floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

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