

The Jaipur Appellate Tribunal rules on India's Equalisation Levy

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In a recent ruling, the Jaipur bench of the Income Tax Appellate Tribunal (the “**Tribunal**”) has upheld that there will be no Equalisation Levy on Google advertisement payments made by an Indian tax resident if the advertisers and the target audience are located outside India.

Statutory provisions

The Income-tax Act, 1961 (the “**IT Act**”) introduced the Equalisation Levy with effect from June 1, 2016, as a separate, self-contained code, not forming part of the IT Act. The Equalisation Levy is charged at the rate of 6% on the gross consideration received by a non-resident service provider furnishing “specified services” (and who does not have a permanent establishment in India). “Specified services” have, *inter alia*, been defined to mean online advertisements, provision of digital advertising space, or provision of a facility or service for the purpose of online advertising.

Under the IT Act, a specified payer (being a tax resident carrying on business in India or a non-resident having a permanent establishment in India) is under an obligation to deduct the Equalisation Levy from the amount paid by it to the non-resident for “specified services.” The failure to deduct the Equalisation Levy leads to a disallowance of the entire expense in the hands of the Indian payer in computing taxable business profits, and has withholding tax, interest and penal implications.

Background

An Indian individual tax resident (the “**Taxpayer**”) was engaged in providing support services to Google Asia Pacific Pte. Ltd., Singapore (“**Google Singapore**”) in respect of online advertisement, digital marketing and web designing. The Taxpayer received consideration from its foreign clients to place advertisements on Google. A specified part of this consideration was then paid by the Taxpayer to Google Singapore, and the balance was retained by the Taxpayer towards his consultancy charges. At the time of making the payment to Google Singapore, the Taxpayer did not deduct the Equalization Levy from such payment resulting in the Indian tax authorities disallowing the entire expense and adding it back to the Taxpayer's total income.

Tribunal's Decision

To substantiate that the advertisements were not displayed in India, the Taxpayer submitted significant documentary evidence to the Tribunal, namely, (i) the names of the non-resident customers; (ii) facts establishing that the Taxpayer's clients were companies outside India; (iii) copies of foreign inward remittance certificates denoting receipt of foreign exchange service fees and Google Singapore's advertisement charges from the non-resident clients; and (iv) a campaign report obtained from Google Singapore establishing that the target audience of such advertisements was outside India.

Based on the facts and an analysis of the submissions made by the Taxpayer, the Tribunal held that the Taxpayer was merely an agent of Google Singapore. It was the Taxpayer's clients who decided in which geographical location the advertisements were to be run, the targeted audience, and the duration of the advertisements.

The Taxpayer was merely a conduit who helped non-resident advertisers avail services under the Google programme, and only acted as an intermediary who received payments from clients outside India and made payments to Google Singapore on their behalf. The ultimate beneficiary of the services were the non-resident advertisers, who had no business or permanent establishment in India.

Moreover, the advertisements were targeted to audiences outside India, and hence, there was no India nexus. The Indian tax authorities could not contradict the foregoing facts.

The Tribunal ruled that for the taxability of such transactions, there had to be some intimate connection of the business to India or the users needed to be stationed in India. However, in the present case, as both were outside India, the Equalization Levy provisions were not triggered, and payments made to Google Singapore by the Taxpayer could not be disallowed.

Our Comments

This is a welcome ruling as it clarifies that the Equalization Levy is not attracted if online advertisements are placed abroad (i.e., outside India) on behalf of a non-resident by an Indian agent. However, the Tribunal's ruling is specifically on Equalization Levy, and from this standpoint alone, the Taxpayer is not an agent of Google Singapore. But, from a profit attribution perspective, the Indian tax authorities can allege that the Taxpayer is a dependent agent (both legally and economically) of Google Singapore in India, and hence, the attributable profits of Google Singapore should be taxed in India at 44%.

The Tribunal decision also highlights the importance of having all records and proper contracts in place between service providers and their clients. As the tax scrutiny process is now being conducted online in a faceless manner, clear records are a must to justify one's case.