K.R.RAMAMANI MEMORIAL NATIONAL TAXATION MOOT PROBLEM 2018-19

Substantial Question of Law:

The assessee, M/s. Vulcantech Software India Private Limited, has filed an appeal before the Hon'ble High Court under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal ("Tribunal") passed in the case of M/s. Vulcantech Software India Private Limited Vs ACIT for the Assessment Year 2014-15. The assessee raised the following substantial question of law which have been admitted by the Hon'ble High Court and fixed for final hearing:

Whether the amount payable by VulcanTech Software India Pvt. Ltd. to Vulcan Ireland PLC for the current assessment year is 'Royalty' as per S.9(1)(vi) of the Income Tax Act, 1961 and Article 12 of the India & Ireland DTAA?

In relation to the matter at hand, the following Annexures form part of the record:

Annexure A: The impugned order of the Tribunal

Annexure B: Grounds of appeal filed before the Tribunal

Annexure C: Final Assessment Order

Annexure D: Directions of DRP

Annexure E: Objections before DRP

Annexure F: Draft Assessment Order

ANNEXURE A

IN THE INCOME TAX APPELLATE TRIBUNAL "A" BENCH, CHENNAI

BEFORE SHRI F.D.LEGELLO, JUDICIAL MEMBER AND

SHRI ANTHONY VARDON, ACCOUNTANT MEMBER

ITA No. 1027/Mds/2016

Assessment Year : 2014-15

M/s Vulcantech Software India Private Limited. ---------- Appellant

- Vs -

Income Tax Officer, Corporate Circle Range 4 (1), Chennai ---------- Respondent

Appellant by : Shri. Aziz Alam

Respondent by : Shri. Raman Gopalakrishnan

Date of Hearing : 1st October, 2018

Date of Pronouncement : 1st November, 2018

ORDER

PER ANTHONY VARDON, ACCOUNTANT MEMBER

1. This appeal by the assessee is directed against the order of Assessment Order passed by the Income Tax Officer, Company Circle – II(4), Chennai u/s 143(3) r.w.s 144C(13) of the Act, dt 24.10.2017 in pursuance of the directions issued by the Dispute Resolution Panel (DRP in short), vide its order dt 13.06.2017 passed u/s 144C(5) r.w 144C(8) of the Act.

2. The facts of the case, in brief, are as under:

2.1 The assessee filed its Return of Income (ROI) electronically for the Assessment Year (AY) 2014-15. The ROI was processed u/s 143(1) of the Income Tax Act (the Act). The case was selected for scrutiny and notice u/s 143(2) of the Act was issued to the assessee.

2.2 The Assessing Officer in the course of scrutiny made a disallowance u/s 40(a)(i) r.w. S.9(1)(vi) of the Act for Rs.19,42,36,785/- and passed an order dated 28.12.2016.

2.3 The assessee filed its objections before the Dispute Resolution Panel (DRP) on 24.1.2017. The DRP heard the assessee and passed an order on 13.6.2017 confirming the disallowances made by the AO and thereby rejecting the objections raised by the assessee. In consequence thereof, the AO passed the final Assessment Order on 24.10.2017 u/s 143(3) r.w.s 144C(13) of the Act.

3. Aggrieved by the above said order of Assessment Order dt 24.10.2017, the Assessee is on appeal before us raising various grounds. Before us, the assessee has reiterated its submissions made before the lower authorities

4. We note that the AO has passed a very detailed, speaking order as to why the disallowances should be upheld. We neither find need to repeat the same points nor interfere with the AO's findings, which have been confirmed by the DRP. Hence, we are unable to accept the contention of the assessee and dismiss the grounds raised by the assessee. **The assessee's appeal is thus dismissed.**

Order pronounced in the open court on 1st day of December, 2018

Sd/- Sd/-

Accountant Member Judicial Member

ANNEXURE- B

Vulcantech Software India Pvt Ltd

Assessment Year 2014-15 (PAN : AACBD4392M)

APPEAL BEFORE THE INCOME-TAX APPELLATE TRIBUNAL AGAINST THE ORDER PASSED u/S. 143(3) r.w. S.144C(13)

GROUNDS OF APPEAL

The DRP/AO:

Ground 1: Erred in Holding that the Vulcan AdWords program is complex computer software, the right to use has been granted to the Appellant without appreciating the fact that Vulcan Adwords program is a standard advertisement product through which the advertiser is able to publish its advertisement on the Vulcan website.

Ground 2: Erred in Holding that Vulcan Ireland PLC has granted the Appellant the right to use of the Vulcan Adwords program, which is a complex computer program without parting with the copyright, thus granting license to use the software without appreciating the fact that the Appellant is only involved in marketing and distribution of advertisement space to the Indian advertisers and that it is Vulcan Ireland PLC which uses the back end process/ program for processing and displaying the advertisement.

Ground 3: Erred in holding that the amount payable towards purchase of advertisement space to be in the nature of 'Royalty' under the Act, even after acknowledging that the Appellant is distributing advertisement space to the advertisers in India.

Ground 4: Erred in confirming that .the distribution rights granted are itself IP rights covered by "similar property"

Ground 5: Erred in holding the amount payable by the Appellant to Vulcan Ireland PLC as Royalty by attributing the same towards right to use of Trademark even after concluding that the assessee company was permitted to use the trademarks of “Vulcan” for the purpose of marketing and distribution of Vulcan Adwords program.

Ground 6: Without appreciating the facts of the case, erred in holding that the amount payable by the Appellant to Vulcan Ireland PLC towards purchase of advertisement space to be in the nature of 'Royalty' under Section 9(1)(vi) of the Act.

Ground 7: Erred in upholding the order of the AO that the amount payable by the Appellant to Vulcan Ireland PLC is towards right to use of trademark and copyrighted computer program and process, hence is in the nature of 'Royalty' as per the Article 12 of the India-Ireland DTAA..

Ground 8: Erred in holding that the training provided in relation to the advertisement program, its functionality, tools available etc. to the distribution team of the appellant who markets and distributes the same to advertisers in India tantamount to rendering of services to the Appellant even after concluding that such training is restricted to use of the Vulcan Adwords program and not how to develop the Vulcan Adwords program.

Ground 9: Erred in not following the principle laid down by coordinate Benches of the Hon'ble Tribunals in the case of Yahoo India, Pinstorm Technology and Right Florists on exactly similar factual matrix.

For VulcanTech Software India Pvt. Ltd

Sd/-

Managing Director

ANNEXURE C

Income Tax Department

No. 121, M.G.Road, Nungambakkam, Chennai – 34

1	Name of the Assessee	M/s.Vulcantech Software India Private Limited
2	Address	New No 75, Dr.R.K.Salai, Mylapore, Chennai, Tamil Nadu
3	PAN/G.I.R. No.	AACBD4392M
4	Circle	Company Circle – II(4), Chennai
5	Status (Domestic/Public/Private, If Applicable)	Company
6	Assessment Year	2014-15
7	Whether Resident/Resident But Not Ordinarily Resident/Non-Resident	Resident
8	Method of Accounting	Mercantile
9	Previous Year	2013-14
10	Nature of Business	Reseller
11	Date of Order	24.10.2017
12	Section under which Assessment Order is passed	143(3) r.w.s 144C(13)

ASSESSMENT ORDER

The assessee is an Indian Private Limited Company belonging to the Vulcan™ multi-national group of companies and is engaged in distribution, reselling and marketing of the "Vulcan Adwords" program. The Return was processed under sub-section (1) of section 143 of the Income Tax Act, 1961.

The case was selected for scrutiny and notice u/s 143(2) of the Act was issued to the assessee. Subsequently, the case was assigned by the Commissioner of Income Tax, Chennai-I to the Income Tax Officer, Company Range II (4), for completion of assessment u/s 143(3) of the Act. The ITO, Company Range-II(4), Chennai issued a Draft Assessment Order u/s 143(3) r.w.s 144C dt 28.12.2016, incorporating one disallowance u/s 40(a)(i) of the Act to tune of Rs.19,42,36,785/-.

The assessee preferred an appeal before the Dispute Resolution Panel (DRP) on 24.01.2017. The DRP passed an order u/s 144C(5) r.w S.144C(8) on 13.06.2017 upholding the order of the AO Hence, as per the directions of the DRP vide its Order dt 13.06.2017 the order of the ITO is confirmed.

Income Tax Officer

Company Range – II(4), Chennai

Copy to:

Assessee

ANNEXURE - D

Income Tax Department
Dispute Resolution Panel (DRP)
No. 121, M.G.Road, Nungambakkam, Chennai – 34

Proceedings to issue directions under sub-section 5 of section 144C read with sub-section 8 of Section 144C the Income Tax Act 1961		
1	F. No. DRP/CHE/98/2014-15	Date of Directions: 13.06.2017
2	Name of the Assessee & Address of Assessee	M/s.Vulcantech Software India Pvt. Ltd. New No 75, Dr.R.K .Salai, Mylapore, Chennai -4
3	PAN	AACBD4392M
4	Assessment Year	2014-15
5	Date of Filing of Objections by the Assessee before the DRP	24.01.2017
6	Date of Direction	13.06.2017
7	Section & Sub-section under which the directions are given	144C(5) r.w 144C(8)

The assessee company had e-filed its Return of Income for the Assessment Year 2014-15 and the AO passed a Draft Assessment order on 28.12.2016 disallowing an amount paid by assessee to Vulcan Ireland PLC under S.40(a)(i) r.w. S.9(1)(vi) for non-withholding of taxes to the tune of Rs.19,42,36,785/-. The assessee filed its objections before the Draft Resolution Panel (DRP) on 24.01.2017 and subsequently, a notice was issued under section 144C(11) and served upon the assessee for providing an opportunity of being heard. The DRP heard the assessee.

Panel : This Panel does not find anything new which has not been considered by the detailed speaking order of the AO. The AO has already considered threadbare all important aspects and then only taken the decision to disallow under S.40(a)(i) r.w. S.9(1)(vi).

This Panel therefore finds that all the objections raised by the assessee and confirms the order of the AO in toto.

Sd/-	Sd/-	Sd/-
Member, DRP, Bengaluru	Member, DRP, Bengaluru	Member, DRP, Bengaluru

Copy Forwarded to:

1. **ITO**
2. **Assessee**
3. **The Guard File**
4. **DIT International Taxation**

ANNEXURE - E

Vulcantech Software India Private Limited

Assessment Year 2014-15

Summary of Objections before the DRP

It is submitted that the AO:

Ground 1: Erred in Holding that the Vulcan AdWords program is complex computer software, the right to use has been granted to the Appellant without appreciating the fact that Adwords program is a standard advertisement product through which the advertiser is able to publish its advertisement on the Vulcan website.

Ground 2: Erred in Holding that Vulcan Ireland PLC has granted the Appellant the right to use of the Vulcan Adwords program, which is a complex computer program without parting with the copyright, thus granting license to use the software without appreciating the fact that the Appellant is only involved in marketing and distribution of advertisement space to the Indian advertisers and that it is Vulcan Ireland PLC which uses the back end process/ program for processing and displaying the advertisement.

Ground 3: Erred in holding that the amount payable towards purchase of advertisement space to be in the nature of 'Royalty' under the Act, even after acknowledging that the Appellant is distributing advertisement space to the advertisers in India.

Ground 4: Erred in confirming that the distribution rights granted are itself IP rights covered by "similar property"

Ground 5: Erred in holding the amount payable by the Appellant to Vulcan Ireland PLC as Royalty by attributing the same towards right to use of Trademark even after concluding that the assessee company was permitted to use the trademarks of “Vulcan” for the purpose of marketing and distribution of Vulcan Adwords program.

Ground 6: Without appreciating the facts of the case, erred in holding that the amount payable by the Appellant to Vulcan Ireland PLC towards purchase of advertisement space to be in the nature of 'Royalty' under Section 9(1)(vi) of the Act.

Ground 7: Erred in upholding the order of the AO that the amount payable by the Appellant to Vulcan Ireland PLC is towards right to use of trademark and copyrighted computer program and process, hence is in the nature of 'Royalty' as per the Article 12 of the India-Ireland DTAA..

Ground 8: Erred in holding that the training provided in relation to the advertisement program, its functionality, tools available etc. to the distribution team of the appellant who markets and distributes the same to advertisers in India tantamount to rendering of services to the Appellant even after concluding that such training is restricted to use of the Vulcan Adwords program and not how to develop the Vulcan Adwords program.

Ground 9: Erred in not following the principle laid down by coordinate Benches of the Hon'ble Tribunals in the case of Yahoo India, Pinstorm Technology and Right Florists on exactly similar factual matrix.

For VulcanTech Software India Pvt. Ltd

Sd/-

Managing Director

ANNEXURE - F

Income Tax Department

1	Name of the assessee	M/s.Vulcantech Software India Private Limited
2	Address	New No. 75, Dr.RK Salai, Mylapore, Chennai – 600004, Tamil Nadu, India
3	PAN/G.I.R. No.	AACBD4392M
4	Circle	Corporate Circle – 4(1), Chennai
5	Status (Domestic/Public/ Private,If Applicable)	Company
6	Assessment Year	2014-15
7	Whether Resident/Resident But Not Ordinarily Resident/Non-Resident	Resident
8	Method of Accounting	Mercantile
9	Previous Year	2013-14
10	Nature of Business	Reseller
11	Date of Order	28.12.2016
12	Section under which Assessment Order is passed	143(3) r.w.s 144C(1)

DRAFT ASSESSMENT ORDER

The assessee is an Indian private limited company belonging to the "Vulcan"(™) multi-national group of companies and is engaged in distribution, reselling and marketing of the "Vulcan Adwords" program. The assessee's Return for AY 2014-15 was processed under sub-section (1) of section 143 of the Income Tax Act, 1961.

The case was selected for scrutiny and notice u/s 143(2) of the Act was issued to the assessee. Subsequently, the case was assigned by the Commissioner of Income Tax, Chennai-I to the Income Tax Officer, Corporate Circle Range 4 (1), for completion of assessment u/s 143(3) of the Act.

In response to the notices issued, Sri. Ramachandran, CFO and Sri. Venkatraman, Dy. Sr. Manager (Fin) appeared from time to time on various dates. He filed the Power of Attorney to appear before the Income-Tax Authorities. Details relevant to the Return of Income were called for from the assessee and were filed. The case was discussed with the assessee's representative and the scrutiny assessment is completed as under.

Factual Background as submitted by the Assessee:

1. Vulcan Tech Software India Private Limited ("Vulcan India"), the assessee, was a Company registered under the provisions of the Companies Act,1956 and a wholly owned subsidiary of Vulcan Ireland PLC, Ireland ("Vulcan Ireland"). Vulcan India is the non-exclusive authorized distributor of Vulcan Adwords programs to the advertisers in India appointed by Vulcan Ireland. "Vulcan"(™) is a popular Internet search engine and offers related advertising services and is the flagship of the Vulcan group; there are a number of other internet and e-commerce services provided by the Vulcan group which are not related to or provided by Vulcan India. Essentially there is an index of websites and other online content which is made available through the Vulcan search engine to anyone with an Internet connection.
2. The assessee ie Vulcan India is mainly engaged as a non-exclusive distributor of the online advertising space under Vulcan Adwords Program to various advertisers in India.
3. Vulcan India entered into an agreement with Vulcan Ireland for resale of online advertising space under the advertisers program to advertisers in India. For the purpose of sales and

marketing the space, work flow of activities of the assessee and advertiser were as under:

a. Enter into resale agreement with Vulcan Ireland and resale of advertising space under the Vulcan Adwords program under the Indian advertisers.

b. Perform marketing related activities in order to promote the sales of advertising space to Indian Advertisers. After training to its own sale force about the features / tools available as part of Vulcan Adwords program, enable them to effectively market the same to advertisers.

c. Enter into a contract with Indian advertisers in relation to sale of space under the Vulcan Adwords program.

d. Provide assistance / training to Indian advertisers if needed in order to familiarize that with the features / tools available as part of our Vulcan Adwords product.

e. Resale invoice to the above advertisers.

f. Collect payments from the aforesaid advertisers

g. Remit payment to Vulcan Ireland for purchase of advertising space from it under the resale agreement.

4. Before proceeding forward, it is clarified that the generic term "Vulcan" or "the Vulcan" (as opposed to the specific "Vulcan India" or "Vulcan Ireland") wherever used relates to Vulcan multi-national entities as a whole other than the assessee Vulcan India and thus the term encompasses assessee's parent Vulcan Ireland and all other *foreign* associate/sister concerns/entities of the group represented as a whole and representing the flagship Vulcan search engine and all other e-commerce and internet services offered by said Vulcan group . This generalization allows us to understand the demarcation of services provided by Vulcan group as opposed to Vulcan India without having to get into specifics of what foreign company in the group does which activity - a black box and not relevant to the case at hand as far as we are concerned.
5. Coming back to the facts, it was thus the case of the assessee that no rights in the intellectual property of the Vulcan group (including Vulcan Ireland) were transferred to the assessee from Vulcan Ireland. **Assessee submitted it was mere reseller of advertising space made available under the Vulcan Adwords distribution program by Vulcan Ireland**. Further as per appellant, the assessee is a distributor of advertising space and it do not have any access or control over the infrastructure or the process that are involved in running the Vulcan

Adwords program, as program runs on software, algorithms, data centers which are owned by Vulcan (ie assessee's group entities outside India which assessee has no relation with). It was also the case of the assessee that the Vulcan Adwords platform is running on servers located outside India that belonged to or hired by Vulcan group. Assessee in India has no control over the servers of Vulcan group including those of Vulcan Ireland.

6. It was the case of the assessee that neither the assessee nor its advertisers get any right or right to use or exploitation over the underlying I.P. or software which is entirely owned by Vulcan group and/or its subsidiaries.
7. It was submitted by the assessee that the advertisers gets their advertisement uploaded into Vulcan Adwords program, and thereafter they directly log on the Vulcan Adwords program website owned by Vulcan (ie Vulcan foreign group entities as discussed in para 4) and follows the various steps to create the Vulcan Adwords account for themselves (ie each advertiser directly creates accounts for themselves on the Vulcan Adwords website/platform). It is also the assessee's case that the advertisers select the key words, content and presentation related to its ads and places a bid on the online system for the price it is willing to pay every time its user clicks on its advertisement. One of the steps is the selection of the payment in INR and once the terms and conditions displayed are accepted **an assigning contract is entered between the advertiser and Vulcan India (assessee) for sale of ad space**. It was further submitted that once the advertiser creates the account(s) and uploads the advertisements, the same automatically gets stored on Vulcan Adwords platform owned by Vulcan on the servers outside India and the ads are displayed in the manner determined by the programs running on automated platforms. The assessee periodically raises the bill on the aforementioned Indian advertisers for the advertising spend incurred by the advertisers on clicks through the users (i.e., 'clickthroughs').
8. **In a nutshell, it was the contention of the assessee that it is merely a reseller of advertisement space. The assessee only performs market related activities to promote the sales of advertisement space. No right or intellectual properties were transferred by Vulcan group to the assessee or to the advertiser. The assessee has no control or access to the software, algorithms or data centres. The servers on which the Vulcan Adwords program runs are located outside India over which the assesse is not having control. The assessee or the advertisers do not have any right of any use or exploitation or the underlying I.P. and software. The advertisers select key works and place a bid on the online auction. The assessee periodically raises invoice on advertisers for advertising spend incurred by the advertisers.**

9. On verification of the financials for the year, it was noticed that assessee had credited a sum of Rs.19,42,36,785/- (Rupees Nineteen Crores Forty Two Lakhs Thirty Six Thousand Seven Hundred and Eighty Five) to the account of Vulcan Ireland PLC without deduction of tax at source.
10. I have noted the facts submitted by the assessee and its arguments and analyzed the facts of the instant case in detail.
11. I note that, as it currently stands, the definition of **Royalty along with the Explanation 2 to S.9(1)(vi) of the Act reads as follows:**

"S.9(1).(vi) income by way of royalty payable by—

(a) the Government ; or

(b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :

…

Explanation 2.—For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

(i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(v) the transfer of all or any rights (including the granting of a licence) in respect of any

copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films ; or

(vi) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v).

Explanation 3.—For the purposes of this clause, "computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India.

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret;"

Furthermore, the India-Ireland DTAA Article on Royalties reads as follows:

"ARTICLE 12 ROYALTIES AND FEES FOR TECHNICAL SERVICES

1. Royalties or fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties or fees for technical services may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but if the recipient is the beneficial owner of the royalties or fees for technical services, the tax so charged shall not exceed 10 percent of the gross amount of the royalties or fees for technical services.

3. (a) The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific

work including cinematograph film or films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process or for the use of or the right to use industrial, commercial or scientific equipment, other than an aircraft, or for information concerning industrial, commercial or scientific experience;

(b) The term "fees for technical services" means payment of any kind in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personnel but does not include payments for services mentioned in Articles 14 and 15 of this Convention.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.

5. Royalties or fees for technical services shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority or a resident of that State. Where, however, the person paying the royalties or fees for technical services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties or fees for technical services was incurred, and such royalties or fees for technical services are borne by such permanent establishment or fixed base, then such royalties or fees for technical services shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for technical services, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention."

12. **I have come to the conclusion that the amount payable by the Assessee to Vulcan Ireland PLC for the subject Assessment years is nothing but 'Royalty' as per Explanations to Section 9(l)(vi) of the Act (as well as per the India-Ireland DTAA).** For the same, I summarize as under my substantiation followed by a more detailed substantiation thereafter:

    1. The 'distribution rights' are 'Intellectual Property rights' covered by 'similar property' and the distribution fee payable is in relation to transfer of distribution rights.
    2. Vulcan Ireland has granted the Assessee the right of access to confidential 1information and intellectual property rights.
    3. Vulcan India has been allowed **the use or the right to use** of a variety of specified IP rights and other IP rights covered by "similar property".
    4. Grant of distribution right also involves **transfer of right in copyright**
    5. By exercising its right as **the owner of copyright in the software**, Vulcan Ireland is authorizing Vulcan India to sell or offer for sale, i.e., marketing and distribution of Vulcan Adwords Software to various advertisers in India.
    6. The consideration paid by Vulcan India is for **granting license/authorization to use the copyright** in the Vulcan AdWords program and not for purchase of such software.
    7. Vulcan India has been given **right to use Vulcan Trademarks** and other Brand Features in order to market and distribute of Vulcan Adwords program.
    8. Grant of distribution right also involves **transfer of know-how**
    9. Vulcan Ireland is obliged to train the distributor so that Appellant can market and distribute Vulcan AdWords program.
    10. As per the generic Distribution Agreement, Vulcan Ireland being the copyright holder of the Vulcan AdWords program, is in a position to **share confidential information** whenever required with Appellant.
    11. Grant of distribution right also involves **transfer of process**
    12. Without access to the back-end, Vulcan India cannot perform its marketing and distribution activities. Vulcan India has access to the processes running on the data centers, based on the distribution rights granted to it by Vulcan Ireland
    13. Appellant is granted the use or the **right to use the process** in the Vulcan Adwords platform for the purpose of marketing and distribution.

14. Grant of distribution right also involves **use of Industrial, commercial and scientific equipment**
15. Vulcan Adwords program, in one way, **is also commercial cum scientific equipment** and without having access to servers running the Vulcan AdWords platform, Vulcan India cannot perform its functions as per the Distribution Agreement.

13. I place reliance on the following decisions which hold that payments license to use IPR is Royalty and chargeable to tax in India and are directly applicable to the instant case:

1. ***CIT vs. Synopsis International Old Ltd. (2013) Taxman 212 ITR 454 (Kar. HC)***
2. CIT vs. Samsung Electronics Ltd. (245 CTR 481 Kar. HC),
3. CIT vs. CGI Information Systems and Management Consultants (2014) 226 Taxman 319 Kar HC.,
4. Skillsoft Ireland Ltd., In re (AAR No 985 of 2010 dated 20th July, 2015)
5. Vodafone South Ltd vs DDIT 2015 (44) ITR (Trib) 330 (Bangalore)
6. ABB FZ-LLC vs DCIT (2017) 83 Taxman.com 86 (Bangalore -ITAT),

14. I also place reliance on the Madras High Court in the case of ***Consim India Pvt Ltd Vs Google India Pvt Ltd & others (OA Nos.977 and 978 of 2009, Application Nos.6001, 6380, 6381 and 6382 of 2009 and Application No.247 of 2010 in C.S.No.832 of 2009 dated 30/9/2010***) wherein the Madras HC has discussed how search engines work and it is clear from the rationale of the decision that sale of advertisement space to the advertisers by Vulcan India in the search engine of Vulcan is an Intellectual Property (IP) which would amount to infringement.

15. I also rely on case of ***Cargo Community Network Ltd., In re (159 Taxman 243)*** wherein it was held that portal and server together constitute integrated commercial and scientific equipment and for obtaining Internet access to airlines the use of portal without server is unthinkable.

16. Furthermore, I have investigated in detail the functioning of the Vulcan Adwords program (similar to the more popular Google Adwords program for the Google search engine which has a number of online tutorials and documents describing the entire workflow in the public domain and which I have used in coming to my findings in this Order)

a) On the basis of the above, my understanding of how the Vulcan Adwords functions is

as under: The Vulcan Adwords gives an opportunity to the advertiser to reach its target audience with the advertising messages. The text based ads are displayed on Vulcan search engine results however the Vulcan Adwords can also be used to message out in other forms including image, audio and videos. Another way of advertisement is displaying the advertisement as people browse and engaged with the content online.

b) The online advertising is different from the traditional advertising like advertisement in magazine, newspaper and Television as the online advertising is measurable on cost per click basis (CPC) and also gives the advantage to the advertiser to target the particular class into age, sex, language, religion, region etc,.

c) The online advertising (Adwords) is a patent tool used by the advertiser in conjecture with the various sophisticated tools and IPR's of Vulcan. Vulcan gives the platform, techniques, databases, the I.P. address and such IPR as well as suggest potential user/clients of the advertiser.

d) The search advertising with the help of search engine, allows the advertiser to target the people as they search for keywords. This technique is being used in the search engine, which enables the ad to come up in the search results page (right hand side of the search results page (or) on top of the search results as "sponsored links"). Advertisement would be shown to the target consumer with the help of various tools, which include showing of advertisement with keywords, phrase, and broad words with generic or same meaning

e) The Vulcan search engine or search based campaign gives high conversion rate and better return of investment that newspaper, TV, radio or magazines

17. As one can experience whenever he/she is searching on a search engine *hotels in Chennai* then various relevant advertisements would display in the search results. In this process of display of advertisements, search is focused on keywords that people entered into the search engine i.e., search queries. Thus for displaying relevant and related advertisements, algorithms are used in Vulcan Adwords program to target content based on behavioral targeting of servers along with website surfers. Another mode of advertisement by the Vulcan Adwords program is a social advertising program where the advertisements pop up at Facebook, Twitter and other social media with the help of keywords or user profile. In the case of the social advertisement, the advertisement campaign is targeted based on the geography, category of people, area of interest etc.

18. The Vulcan Adwords program has various benefits like(a) show relevant ads to the people (b) target the select audience. (c) It causes minimum advertising expenses and (d) it is only payable when people are engaged. It gives access to the advertiser, the tools of the Vulcan Adwords program which can be accessed through the gateway of Vulcan India / appellant. Through the use of patented technology, Vulcan Adwords platform allows the advertiser to choose the preferred time and season of the year when the ads are to be shown. In fact, after the advertiser accept the terms of the program, the assessee gives the advertiser accesses to the various tools of Vulcan Adwords program.
19. The time zone and display time of advertisement is identified and allocated by Assessee to the advertiser with the help of the assistance of the Vulcan Adwords program. The Vulcan Adwords program is more focused and targeted in advertisement campaigns which result in more attention, engagement, delivery and conversion. which is only possible on the Vulcan network with the access of tools of search engine and Vulcan analytics.
20. Assessee / Vulcan India has the access to the I.P. address of the desktop or laptop or I.P. address of the tablet, photographs , time spent on a web site, eating habits, wearing preferences etc. With the help of the I.P. address, Vulcan search engine has access to various information and data pertaining to the user of the website in the form of name, sex, city, state, country, phone number, religion etc,. Besides the above basic information, Vulcan also has the access of the search, and in some cases browsing, history of the users as well as the behavior of the persons searching Vulcan search engine.
21. Based on various inputs mentioned above and contents of more than two million websites the assessee / Vulcan India is able to provide the effective focused ad campaign to the advertisers. The Vulcan Adwords programs and tools therein allows the advertiser to pick up the key words, phrases which are similar in nature and germane, which are in a digitalized tabulated form / grouped together. The advertiser has access to this Vulcan Analytics program (patented and specialized software) through the appellant. Whenever one particular keyword is searched, the targeted consumers will be shown the ad and by clicking on the ad, the consumers will land on a web page (“landing page”). The selection and the display of the keywords, play a pivotal role in the advertising campaign and for this purpose, Assessee / Vulcan India has done the optimizations and provided the relevant techniques to the advertisers.
22. Vulcan (with the assessee as service provider under the agreement) uses its expertise and the information within its domain and control, to suggest the key words based on the

recent marketing material and need of the advertiser. The assessee also suggests periodical review of the website home page, product and services which can be bundled together. The keyword planner is part of the assessee / Vulcan technology tools. It also suggests the traffic forecast of the list of keywords, multiple keyword placed to get new keyword ideas. Thus, the keywords planner which will display a list of additional keyword suggestion. Based on initial key words, the advertiser enters, the tools shows various keyword suggestions automatically grouped into different ad groups. This is only possible because the assessee permits the use of information, data and key planner to the advertisers which is patent and protected software of Vulcan group. The keyword planner also suggests the suitability of the key words which are useful in the particular month of the year. The advertiser is able to plan their campaign for optimization or for the purpose of getting more impression and conversion based on keyword planner. Based on this impression and forecast, the advertiser is able to bid on the key words.

23. The display of the advertisement based on keywords, is dependent upon the auction price paid by the advertiser. The keyword bid at highest rate by the advertiser would be shown at the top of the search results and therefore, is likely to fetch more visibility and attention. With the help of the tools of Vulcan, the advertiser as well as the appellant have access to the impact of change of keywords on the likely impressions of the advertisement i.e. how the change in keywords would affect the tracking of the impression or the visitor to website of the advertiser.
24. With the help of keyword matching, various approaches are being adopted by the Vulcan Adwords program i.e. broad match, phrase match and exact match. The exact match for example allows the advertiser to focus on the optimization phrase on the individual key words and yields the best result possible. Whereas the phrase match is a much more elaborate process than the broad match and the broad match provides the greatest possibility of coverage of the advertisement.
25. The assessee Vulcan India facilitates the advertisers to start the campaign of advertising initially with the help broad match thereafter with phrase match and thereafter with exact match. Now with the help of the keyword management, the Vulcan Adwords program takes care of the misspelling, singular plural, abbreviation, acronyms (short word) stemming. For example, if the advertisement shows *formal shoes*, then the key words are “formal” plus “shoes”. if it is broad match keywords then the advertisement will show formal shoe, sport shoe, black dress shoe, party shoes etc. However if the advertiser had only opted for exact word match, then search results would only show formal shoes.

26. Appellant helps the advertiser with the help of tools of Vulcan Adwords program to include or delete various variation of the key words in the realm of advertisement campaign and similarly the advertiser may with the help of Vulcan tool, avoid the unnecessary traffic on its website.
27. The Vulcan Adwords program also has Vulcan Analytics which is connected with the Vulcan Adwords program and is a patented tool to target the key words and the negative keywords. This is the USP of the Vulcan Adwords program, which is maintaining thousands of different keywords used by the people to search the website and based on this user behavior, the Vulcan Analytics suggests the appropriate key words to be used by the advertiser for encouraging the traffic on the website. Similarly the Vulcan analytics also uses the same data to filter out the negative keyword on the basis of which an unattended or unwarranted persons have landed on the website of the advertiser. Assessee is using all these tools in conjunction with advertisers at the time of granting the back-end services to the advertisers.
28. Assessee suggests various strategies like advertisement campaign to create awareness about the product and services. There are different advertisement campaigns for engagement, conversion and retention. In all the advertisement campaigns i.e. for awareness, engagement, conversion and retention, different strategies tools and suggestions are suggested by assessee and those strategies are focused depending upon requirement of the advertiser. For example, if a new product is to be launched, then the advertiser would like to go for awareness program to display the features of its new and upcoming products. However, if it is for engagement, then a different strategy and different advertisement content is provided, if it's for conversion, then different strategies are provided and if it is for retention of the old customer, then refer a friend suggest a friend etc., will be suggested.
29. For all these strategies, Vulcan has a targeted geography-wise, region-wise, gender-wise, class-wise database/set of tools. With the use of these tools there will be an increase in the CTR (Click Through Rate). For that purposes, the expertise and the data base of Vulcan is essential. With the help of these strategies, the targets can be fixed by the advertiser with the help of Vulcan Adwords and the target can be fixed where it is to be displayed (tablet, desktop, mobile, ipad etc.,) search network country, state, city, postal code and schedule of the day, hour and the day of display. Assessee with the help of Vulcan Analytics gives the accurate impression of persons visiting the advertisement and also provides how many are converted. There are various other features of the Vulcan Adwords program which

shows that the program has embedded tools to display the advertisement of the advertiser to the targeted consumers.

30. On the basis of above, in my considered view the agreement between the assessee and Vulcan Ireland was not in the nature of providing the space for advertisement and display the advertisement to the consumers. As per my understanding if the agreement was merely for sale and marketing for providing the space for advertisement, then in that eventuality, it should be treated as an agreement akin to an agreement for advertisement in newspaper / television.

31. If one looks into the advertisement module of Vulcan Adwords program stated herein above, then one will come to an irresistible conclusion that it is not merely an agreement to provide the advertisement space but an agreement for facilitating the display and publishing of an advertisement to the targeted customer. If one looks into the submission made by the learned AR, it is clear that the advertiser, selects some key words and on the basis of key words, the advertisement is displayed on the website or along with the search result as and when the customer selects the key words relatable to the advertisement. The module as suggested does not merely work by providing the space in the Vulcan search engine, but it works only with the help of various patented tools and software. As we have analyzed detailed functioning of Vulcan Adwords program, it is clear that with the help of the search tool/software / database, Vulcan is able to identify the targeted consumer/person as per the requirement of the advertiser. If only service rendered by the assessee was for providing the space then there is no occasion of either directing/channelizing the targeted consumers to the advertisement of the advertiser. In my view truncated search results are displayed keeping in mind the commercial needs of the advertisers.

32. The Assessee / Vulcan India has the access to various data with respect to the age, gender, region, language, taste habits, food habits, cloth preference, the behavior on the website of the users and it uses this information for the purposes of selecting the ad campaign and for maximizing the impression and conversion of the customers to the ads of the advertisers. Thus the activities of the assessee are not merely restricting to display of advertisement but is extended to various other facets as mentioned herein above. In other words, by using the patented algorithm, appellant decides which advertisement is to be shown to which consumer visiting millions of website / search engine. Therefore, in my view, it is not the advertisement or selling of the space rather it is focused targeted marketing for the product/ services of the advertiser by the Assessee/Vulcan with the help

of technology for reaching the targeted persons based on the various parameters information etc,. Had it been merely providing the space then the other features as deliberated and discussed hereinabove would not be required. Therefore, in my view, the agreement entered between the assessee and Vulcan Ireland is not merely for providing the advertisement space but was in the nature of providing the services for displaying and promoting of the advertisement to the targeted consumers.

33. As recorded herein above Vulcan is working on various platforms and the said platforms uses various customer data for targeted ads campaign. The files of these customer data are shared for running the campaign by the assessee with the advertisers. The popular ad campaigns of Vulcan is “like- alike ad”, “customer audience ads”, etc where details of like-set of users are provided by the assessee for running the targeted campaign. Similarly target marketing campaigns are done with the help of customer audience (where the client of advertiser is having its own data and wishes to advertise to them). Like, if an ice cream vendor wanted to launch a new ice cream product, they may approach assessee/Vulcan to share data with similar user profile or liking for ice-cream. The assessee is in possession of such data and shares this data with the advertiser – ice-cream produce manufacturer. Based on this, the ice-cream manufacturer formulates their marketing campaign with the help of assessee and other channel partners.

34. In my view, IP of Vulcan vests in the search engine technology, associated software and other features, and hence use of these tools for performing various activities mentioned herein above, including accepting advertisements, providing before or after sale services, clearly fall within the ambit of "Royalty". Therefore, contention of the assessee is not correct when the assessee is alleging that the user of the search engine is the end user and not the assessee or the advertisers and therefore it will not fall within the ambit of “Royalty”.

35. Further from my reading of the distribution agreement it is clear that : assessee will provide after sales services to advertisers in accordance with the broad instructions, training and standards of Vulcan; further assessee is provided by Vulcan Ireland to utilize space through the Vulcan Adwords program for distribution to advertisers ; Assessee shall be solely responsible for providing all customer services to advertisers, according to procedures, and in compliance with standards, provided by Vulcan; and all advertisers shall be instructed by assessee to contact it for support, and not to communicate directly with Vulcan. Vulcan Ireland owns all right, title and interest in and to all information data including the user data, collected by Vulcan related to advertisers in connection with the

provisions of Vulcan Adwords program. Further it is the duty of the assessee to maintain all user data in accordance with local laws and regulations.

36. Assessee has been providing after sales support to the advertisers. It is not the case of assessee that it is not providing after or before sale services to the advertisers. As per the distribution agreement, the distributor is under an obligation to maintain the user data and therefore has access to such data. The said user data is being used by the appellant for discharging its obligation towards the advertisers and the claim of the assessee is wrong that it does not have the access to the user data.

37. Now coming to the next argument that space of advertisement is being sold by the assessee to the advertiser, Vulcan Adwords program is working on various parameters, variables, dynamics and uses various permutations and combinations to show the advertisement to targeted consumers. The advertisements on Vulcan Adwords program are changing on day to day, week to week or month to month basis. The online bids are required to be placed by the various competitors on dynamic basis. If we assume that the space is sold by the assessee to the advertiser, then there is no question of bidding or out-bidding for running or displaying of the advertisements. The inter-se bidding among the advertisers for displaying the advertisement in real-time basis, clearly shows that the space is not sold by the assessee, rather the placement of the advertisement to a particular targeted consumer at a particular time is bided among the advertisers and for that, services were rendered by the appellant with the help of patented Vulcan Adwords program . If one advertiser bid for the particular keyword like *sport shoes* higher than the other competitor, then the advertisement of that sport shoes would be displayed first in comparison to other competitors. However if in the next week there is sale for the product of the second bidder pertaining to sport shoes, the second bidder may bid higher in comparison with the first bidder, In that eventuality, the advertisement of the second bidder would be displayed first on the search result, in comparison to the first advertiser. Thus there was no sale of ad space on the web for displaying of advertisement on a particular place / site. Even otherwise, if we consider that the appellant is selling advertisement space then, at which location/ web place the said ad- space was sold by the appellant to the advertiser? It is the case of the assessee that the ads are stored in the servers situated outside India. In my view, the appellant has not sold the storage space on the server outside India nor it has sold the identified / demarcated ad on the web site / search engine. Further if the ad-space is sold, then the Vulcan Adwords program would be incapable of functioning as the advertisement would be shown to various locations,

persons and targeted consumers. **In my view, there is no sale of space, as concluded hereinabove rather it is a continuous targeted advertisement campaign to the targeted and focused consumer in a particular language to a particular region with the help of digital data and other information with respect to the person browsing the search engine or visiting the website.** Further, the argument of selling the space is not available to the assessee and **we are of the opinion that it is not merely selling the space but it is rendering the services by making available the technology permitted by Vulcan to the assessee and permitting the same to be used by advertiser for purpose of targeted focused advertisement campaign by using the gateway of Vulcan India / assessee**. Thus the activities clearly fall within the ambit of 'Royalty' as mentioned in Income Tax Act and under DTAA.

38. The Assessee cannot be compensated by the Vulcan Ireland for rendering the services to itself or for rendering the services which the assessee is required to render under the distribution agreement. The use of intellectual property is embedded in the Vulcan Adwords program which is necessary to be used by the appellant for rendering the services prior or post sales of the advisement space under the distribution agreement. Therefore in my view amount was being paid by the Assessee to Vulcan Ireland for the use of patent invention, model, design, secret formula, process, etc .

39. It was further contended by the assessee that there is no transfer of the trademark or copyright of Vulcan to the assessee and therefore it will not fall within the purview of the royalty. It was submitted by the assessee that there is no specific transfer of any patent trademark to the appellant and the use of Vulcan trademark and other brand features referred in the distribution agreement are merely incidental to enable the appellant to distribute the ad space in India.

    It was submitted by Assessee that mere use of name of brand for procuring ad contracts would not amount to use of trademark and, hence, even assuming that a part of the price paid by the assessee to Vulcan Ireland can be characterized as a payment for the alleged use for trade mark such income would not be liable to tax as royalty under the provisions of the Act. For this purposes the assessee relied upon its financials and submitted that no part of the said sum was the payment for use of trademark, as the Appellant was only having a right to use the trademark for distribution purpose. Assessee submitted that no right to commercially exploit its trademark was given by the Vulcan Ireland and therefore, having regard to the following decisions of the Hon'ble Delhi High Court, the

payment cannot be characterized as a payment by way of royalty. In any event, no payment as such is made for the use of the trademark.

Sheraton International Inc v DDIT [2009) 313 ITR 267 (Delhi HC)

> *"In view of the aforesaid findings of the Tribunal that the main service rendered by the assessee to its clients-hotels was advertisement, publicity and sales promotion keeping in mind their mutual interest and, in that context, the use of trademark, trade name or the stylized 'S' or other enumerated services referred to in the agreement with the assessee were incidental to the said main service, it rightly concluded, in our view, that the payments received were neither in the nature of royalty under section 9(1)(vi) read with Explanation 2 or in the nature of fee for technical services under section 9(1) (vii) read with Explanation 2 or taxable under article 12 of the DTAA. The payments received were thus, rightly held by the Tribunal, to be in the nature of business income. And since the assessee admittedly does not have a permanent establishment under the article 7 of the DTAA 'business income' received by the assessee cannot be brought to tax in India. The findings of the Tribunal on this account cannot be faulted. The Tribunal pointedly observed that there was no evidence brought on record by the revenue to enable them to hold that the agreement was a colourable device, in particular, that the payments received were for use of trade mark, brand name and stylized mark 'SY'"*

Formula One World Championship Ltd. v CIT [20161 76 taxmann.com 6 (Delhi HC):

> *"There is no doubt that the main object of the RPC and the relevant provisions of the ALA was not the permission to use the trademarks, but granting and designating Jaypee as the promoter of the event and laying out the rights of the parties, particularly FO WC as regards the event, the spaces to be made available to it exclusively, the sole and exclusive rights over all event related activities, the right to exploit them commercially, etc. The use of the mark on the tickets sold by Jaypee was only incidental. The AAR's findings that the use of the mark and intellectual property rights benefitted Jaypee, which paid for them, is entirely erroneous. Jaypee permitted use, as it were, was for a limited duration and of an extremely restricted manner; this is contained in the definition of emitted use' in the ALA.As event promoter and host Jaypee had to publicize the F1 Grand Prix Championship. Therefore, it was bound to use the F1 marks, logos and devices; however, it was not authorized to use the marks*

on any merchandise or service offered by it. This condition, in the opinion of the court, places the matter beyond the pale of controversy; the use of the trademarks were purely incidental. The conclusion of the AAR is therefore, incorrect. The answer to the question is that the amounts paid to FOWC by Jaypee were not 'royalty' within the meaning of article 13 of the DTAA, as they were business income and could not be brought to tax under the head of 'royalty.'

40. I believe that contention of the assessee is not correct, as the use of trade mark is NOT incidental and hence amounts to royalty. The assessee has acquired a right under the distribution agreement to sell the advertisement space in the search engine which is an IPR including the trademark. The assessee is using the distribution agreement coupled with IPR as tool of the trade and hence the payment towards use of trademark is also in the nature of royalty and liable to tax under the Act as well as under DTAA.
41. Further, **in my opinion the reliance on the judgments of the Delhi High Court in the case of *Sheraton International 313 ITR 267* and *Formula One World Championship Delhi High Court (2016) 76 taxman.com* are not relevant for the issue under consideration.** In all the judgments relied on by the assessee and referred to above, the main service provided was not the advertisement and providing of any license to use the IPR was not involved. Whereas in the present case the use of IPR is involved. In the facts and circumstances of the above cases the Hon'ble Courts have held that use of trademark were incidental to the main purpose of the agreement. The main purpose of the agreement is referred to as carrying out advertisement, publicity and sales promotion. The main purpose/ business do not involve providing license to use any IPR and IPR was not used as a tool of the trade.
42. We have heard the rival contentions of the parties and perused the record. As per the agreement, the assessee was permitted to use trade name trademarks, service marks, domains or other distinctive brand features of Vulcan solely for the use under the distribution agreement. Further, the agreement provides the IPR, such as brand features, were granted by Vulcan to the appellant on a non-exclusive and non-sublicensable basis for the purposes of marketing and distribution of Vulcan Adwords program, subject to the condition mentioned therein.
43. If we look into the activities of the assessee, for the purpose of marketing and distribution of Vulcan Adwords program, then, it is not possible for the appellant to undertake these

activities, without the use of the Vulcan, trademark and other brand features. Further, for marketing and distribution of Vulcan Adwords program, the use of the Vulcan trademark is essential and pivotal for doing the business of advertisement on the search engine and the websites. In the absence of the Vulcan trademark, it is difficult to comprehend that the Assessee would attract lot of advertisers for its advertisement space on search engine and web site. Assessee was getting lot of engagement and clientage only on account of Vulcan trademark. It may not be possible to have this kind of business inflow of advertisements without using the trademark of Vulcan. The distribution agreement had not made any provision for making the payment for the Vulcan brand features and had only made provision for making the lump sum payment under the agreement. Therefore in my view, the payments made by the assessee under the agreement was not only for making and promoting the Vulcan Adwords program but was also for the use of Vulcan brand features. Needless to add that the said Vulcan brand features were used by the appellant as marketing tool for promoting and advertising the advertisement space, which is main activity of Assessee and is not incidental activities .The use of trademark for advertising marketing and booking in the case of ***Hotel Sheraton (Supra)*** as well as in the case of ***Formula 1*** were incidental activities of the assessee therein as the main activities in the cases were providing Hotel Rooms and organizing Car Racing respectively whereas in the present case the main activity of the assessee is to do marketing of advertisement space for Vulcan Adwords Program. Therefore, these two judgments are not applicable to the facts of the present case. Hence for this reason also the payment made by the assessee to Vulcan Ireland also falls within the four corners of royalty as defined under the provisions of ACT as well as under the DTAA.

Grant of distribution rights involves transfer of rights in process

44. Assessee in this regard, has submitted that the Assessee does not have access to any back-end portion as databases, software tools etc. under the Distribution Agreement. Therefore, the assessee has been granted the use of or the right to use the process in the Vulcan AdWords platform, especially for the purpose of marketing and distribution is factually incorrect and is based on surmise and conjecture.

45. Further assessee submitted that the Vulcan Adwords, though a program, cannot be considered as a "process" within the meaning under Explanation 2(i) to section 9(1)(vi) of the Act. Further Vulcan Adwords Program cannot be equated to a secret process since information relating to the program is freely available to the public on Vulcan's website along with explanatory videos regarding the same. Hence, Vulcan AdWords program

cannot be considered a secret process and hence, it does not constitute "process" within the meaning of the term as defined in Clause (i)

46. In this regard it will suffice to say that we had already concluded in the foregoing paragraphs that though Vulcan Adwords program along with associated videos are available in public domain but how this program functions, for targeted marketing campaign, promoting advertisements are only possible with the use of secret formula, confidential customer data only . This secret process of targeting the customers, is not in public domain therefore in my view the **assessee is using the secret process for marketing promoting displaying of the advertisement.**

47. It was submitted by assessee that revenue earned from advertisement is not liable to be taxed as royalty or fees for technical services and is required to be taxed as business profit and in absence of any PE, remittance made by assessee cannot be taxed in India. In this regard it was submitted **OECD had set up a Technical Advisory Group ('TAG')** to examine the issues arising in characterization of ecommerce payments. The TAG has categorized e-commerce transactions into 28 types including Internet Advertising. The TAG has concluded that the payments arising from advertisements would constitute business profits falling under Article 7 rather than Royalties (Article 12). The relevant extract of the TAG report is reproduced:

"Category 17: Advertising

Definitions

Advertisers pay to have their advertisements disseminated to users of a given website. So-called "banner ads" are small graphical images embedded in a web page, which when clicked by the user will load the web page specified by the advertiser. Advertising rates are most commonly specified in terms of a cost per thousand "impressions" (number of times the ad is displayed to a user), though rates might also be on the number of "click-throughs" (number of times the ad is clicked by a user).

Analysis and conclusions

30. All members of the Group agreed that the payments arising from these transactions would constitute business profits under Article 7 rather than royalties, even under alternative definitions of royalties that cover payments 'for use, or the right to use, industrial, commercial or scientific equipment."

50. Further it was submitted that **Central Board of Direct Taxes vide F No 5001 122/ 99**

dated December 16, 1999 has constituted a High Power Committee on 'Electronic Commerce and Taxation'. The committee has held that payments arising from advertisements would constitute profits and gains from business or profession. It was submitted that Technical Advisory Group report and the High powered Committee report are binding in nature. In this regard, assessee submitted that India had a representative as part of the Technical Advisory Group constituted by the OECD which representative did not express any dissent to the view expressed and High Powered Committee was constituted by the CBDT itself and all the members of the Committee have agreed with the view taken, including Members from the CBDT . Further it was submitted that coordinate bench in the matter of ***ITO vs. Right Florists Pvt. Ltd.. (2013) 25 ITR (Trib) 0639 (KolTrib)*** has agreed with the views of the High Powered Committee and stated as under:

> *"13.1n the light of the above discussions, even as per the High Power Committee, a website per Se, which is the only form of Google's presence in India - so far as test of primary meaning i.e. basic rule PE is concerned, cannot be a permanent establishment under the domestic law. We are in considered agreement with the views of the HPC on this issue"*

51. Further it was submitted that coordinate Mumbai bench of the ITAT in the case of ***eBay International AG vs DDIT*** **(140 ITD 20)** has upheld the reliance placed on the aforesaid reports while holding that the income received by the assessee in the said case towards operation of its website is business income. Relevant extracts are reproduced below for reference:

> *"13. The ld. CIT(A) has also referred to High Powered Committee (HPC) on "Electronic Commerce Taxation" constituted by the Central Board of Direct Taxes, which has stated in its report that such amount would be in the nature of payment for business activities. He also referred to The Technical Advisory Group (TAG) formed by OECD, which, vide its report on Tax Treaty Characterized Issues Arising From E-Commerce issued in February, 2001, has also opined that revenue earned by operating online facility are in the nature of business profits falling under Article 7 of the Treaty. These findings recorded by the id. CIT(A) have remained uncontroverted by the id. DR.*
>
> *14. In view of the above discussion, there remains no doubt whatsoever that the fee received by the assessee can't be described as 'Fee for technical services', but is in the*

nature of 'Business profits'. In our considered opinion the Id. CIT(A) was fully justified in holding accordingly. The grounds raised by Revenue in support of this solitary issue in its appeal, are thus not allowed"

52. It was submitted that the reading of the decision in ***Right Florist P. Ltd (supra)***, it is clear that the coordinate bench relied upon the decision of High Power Committee on the premises that the *Advertisers paying to website for advertisements disseminated to users of a given website* and had concluded that the payment would be a business profit and is not taxable in India in the absence of PE.

53. We have in detail examined the working of Vulcan Adwords Program herein above and come to the conclusion that assessee makes use of the user data /customer data (personal information, general information like user profile, age sex, language, type of mobile, time when customer is visiting particular web site/ searching on search engine , how much time is spent on internet and on which web site etc. for the purposes of targeted/ focus marketing campaign for the advertisers) and the patented technology , with algorithm to advertise/ disseminate ads, which was not the case either before the High Powered Committee or in the matter of Right Florist P. Ltd (supra). Present case is not a case of merely displaying or exhibiting of advertisement by the advertiser on the website, case in hand is a case of use of patented technology, secret process, use of trade mark by the appellant, therefore decision of coordinate bench in the case of Right Florist Private Limited is not applicable to the facts and circumstances of the present case. In the present case Vulcan India has been provided access to the IPR, Vulcan Brand features, secret process embedded in Vulcan Adwords Program as tool of the trade for generation of income. Therefore the payment made by the assessee to Vulcan Ireland is royalty and not the business profit and therefore chargeable to tax in India.

54. Assessee further relied upon para 21 of the decision of the coordinate bench in ***Income Tax Officer vs Right Florists Pvt Ltd (ITA No. 1336/Kol2011)***, Para 6 of ***Pinstorm Technologies P. Ltd vs ITO*** **(2013) 154 TTJ 0173 (Mumbai)** and para 8 of ***Yahoo India P. Ltd. vs. DCIT*** **(2011) 140 TTJ 0195** to prove that the issue of online advertisement had been considered in all the decisions and it was held that the payment made by the advertiser to the website owner was business profit and in the absence of any business connection and PE in India and not the Royalty. Therefore, the said payment made to the service provider were not chargeable in India.

55. We have gone through the above said decisions. In para 8 of Yahoo India (supra),

coordinate bench held as under :

> *"8. As already noted by us, the payment made by assessee in the present case to Yahoo Holdings (Hong Kong) Ltd., was for services rendered for uploading and display of the banner advertisement of the Department of Tourism of India on its portal. The banner advertisement hosting services did not involve use or right to use by the assessee any industrial, commercial or scientific equipment and no such use was actually granted by Yahoo Holdings (Hong Kong) Ltd., to assessee company. Uploading and display of banner advertisement on its portal was entirely the responsibility of Yahoo Holdings (Hong Kong) Ltd. and assessee company was only required to provide the banner Ad to Yahoo Holdings (Hong Kong) Ltd., for uploading the same on its portal. Assessee thus had no right to access the portal of Yahoo Holdings (Hong Kong) Ltd. and there is nothing to show any positive act of utilization or employment of the portal of Yahoo Holdings (Hong Kong) Ltd., by the assessee company. Having regard to all these facts of the case and keeping in view the decision of the Authority of Advance Rulings in the case of Isro Satellite Centre (supra) and Dell International Services (India) (P.) Ltd. case (supra), we are of the view that the payment made by assessee to Yahoo Holdings (Hong Kong) Ltd., for the services rendered for uploading and display of the banner advertisement of the Department of Tourism of India on its portal was not in the nature of royalty but the same was in the nature of business profit and in the absence of any PE of Yahoo Holdings (Hong Kong) Ltd., in India, it was not chargeable to tax in India. Assessee thus was not liable to deduct tax at source from the payment made to Yahoo Holdings (Hong Kong) Ltd., for such services and in our opinion, the payment so made cannot be disallowed by invoking the provisions of section 40(a) for non-deduction of tax. In that view of the matter we delete the disallowance made by the Assessing Officer and confirmed by the learned CIT(A) under section 40(a) and allow the appeal of the assessee."*

56. Relying upon para 8 of ***Yahoo India (supra)***, the coordinate in para 6 of the decision in ***Pinstorm (supra)*** held as under :

> *"6. We have heard arguments of both the sides and also perused the relevant material on record. It is observed that a similar issue had come up for consideration before the Tribunal in the case of Yahoo India (P.) Ltd. v. Dy. CIT [2011] 46 SOT 105/11*

taxmann.com 431 (Mum.)(URO), the Tribunal decided the same in favour of the assessee for the following reasons given in paragraph No.8 of its order:

> *"8. As already noted by us, the payment made by assessee in the present case to Yahoo Holdings (Hong Kong) Ltd. was for services rendered for uploading and display of the banner advertisement of the Department of Tourism of India on its portal. The banner advertisement hosting services did not involve use or right to use by the assessee any industrial, commercial or scientific equipment and no such use was actually granted by Yahoo Holdings (Hong Kong) Ltd. to assessee company. Uploading and display of banner advertisement on its portal was entirely the responsibility of Yahoo Holdings (Hong Kong) Ltd. and assessee company was only required to provide the banner Ad to Yahoo Holdings (Hong Kong) Ltd. for uploading the same on its portal. Assessee thus had no right to access the portal of Yahoo Holdings (Hong Kong) Ltd. and there is nothing to show any positive act of utilization or employment of the portal of Yahoo Holdings (Hong Kong) Ltd. by the assessee company. Having regard to all these facts of the case and keeping in view the decision of the Authority of Advance Rulings in the case of Isro Satellite Centre 307 ITR 59 and Dell International Services (India) (P.) Ltd. 305 ITR 37, we are of the view that the payment made by assessee to Yahoo Holdings (Hong Kong) Ltd. for the services rendered for uploading and display of the banner advertisement of the Department of Tourism of India on its portal was not in the nature of royalty but the same was in the nature of business profit and in the absence of any PE of Yahoo Holdings (Hong Kong) Ltd. in India, it was not chargeable to tax in India. Assessee thus was not liable to deduct tax at source from the payment made to Yahoo Holdings (Hong Kong) Ltd. for such services and in our opinion, the payment so made cannot be disallowed by invoking the provisions of section 40(a) for non-deduction of tax. In that view of the matter we delete the disallowance made by the A.O. and confirmed by the learned CIT (A) u/s 40(a) and allow the appeal of the assessee.""*

57. Similarly, in para 21 of the decision in ***Right Florists (supra)***, it was held as under :

> *"21. That takes us to the question whether second limb of Section 5(2)(b), i.e. income*

'deemed to accrue or arise in India', can be invoked in this case. So far as this deeming fiction is concerned, it is set out, as a complete code of this deeming fiction, in Section 9 of the Income Tax Act, 1961, and Section 9(1) specifies the incomes which shall be deemed to accrue or arise in India. In the Pinstorm Technologies (P.) Ltd.'s case (supra) and in Yahoo India (P.) Ltd's case (supra), the coordinate benches have dealt with only one segment of this provision i.e. Section 9(1)(vi), but there is certainly much more to this deeming fiction. Clause (i) of section 9(1) of the Act provides that all income accruing or arising whether directly or indirectly through or from any 'business connection' in India, or through or from any property in India or through or from any asset or source of income in India, etc shall be deemed to accrue or arise in India. However, as far as the impugned receipts are concerned, neither it is the case of the Assessing Officer nor has it been pointed out to us as to how these receipts have arise on account of any business connection in India. There is nothing on record do demonstrate or suggest that the online advertising revenues generated in India were supported by, serviced by or connected with any entity based in India. On these facts, Section 9(1)(i) cannot have any application in the matter. Section 9(1)(ii), (iii), (iv) and (v) deal with the incomes in the nature of salaries, dividend and interest etc, and therefore, these deeming fictions are not applicable on the facts of the case before us. As far as applicability of Section 9(1)(vi) is concerned, coordinate benches, in the cases of Pinstorm Technologies (P.) Ltd. (supra) and Yahoo India (P.) Ltd. (supra), have dealt with the same and, for the detailed reasons set out in these erudite orders - extracts from which have been reproduced earlier in this order, concluded that the provisions of Section 9(1)(vi) cannot be invoked. We are in considered and respectful agreement with the views so expressed by our distinguished colleagues. "

58. After going through all the above cited decisions of the coordinate bench, we are unable to persuade ourselves to agree with the reasoning for treating the payment made by the advertisers as a business profit and not as a royalty. As in my opinion, the detailed working of the Vulcan Adwords program of the assessee and Vulcan Ireland clearly shows that the assessee is having the right to access not only to the patented technology but also to the customer data, information (like telephone number, user behaviors, region, gender , language, colour, photographs, place of visit, mobile device used, time spent etc.,) and which was not the case in the the decisions in Yahoo India, Pinstorm and Right Florist (supra). As clear from the distribution agreement, the assessee is also having right, title and interest over

the intellectual property right of Vulcan. Further, as per the standard advertisement with the advertiser, which specifically empowers the appellant to delete / remove / withdraw the advertisement.

59. In view of the above, the decisions relied upon by the assessee are not applicable to the facts of the case.

60. I also note that the definition of 'royalty' under DTAA and the Indian Income Tax Act are in *pari materia* so the assessee cannot take shelter under the definition of Royalty in the DTAA. In my opinion the Explanation 2 amendments by Finance Act 2012 are just clarificatory in nature in my opinion and **the main definitions of Royalty are the same in the DTAA and the Act**. This view in my opinion is supported by the Hon'ble Madras High Court in ***Verizon Communication Singapore Pte Ltd vs. ITO (TCA Nos.147 to 149 of 2011 and 230 of 2012 dated 7.11.2013).***

61. **I am therefore of the considered opinion, after considering all the facts of the case, the submissions of the Assessee, the coordinate Bench decisions in this regard and the relevant provisions of the Act that the payments made by assessee to Vulcan Ireland is in the nature of Royalty as per Explanation 2 to S.9(1)(vi) and the amount paid by assessee to Vulcan Ireland of Rs.19,42,36,785/- is disallowed u/s 40(a)(i) of the Act r.w. S.9(1)(vi) of the Act for non-deduction of tax at source.**

Sd/-

(G.Krishnamurthy)

Corporate Circle 4(1), Chennai