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Web promotion and social media management services not taxable in India

The Ahmedabad Bench of the Income-tax Appellate Tribunal rendered its decision that payment for web promotion and social media management services qualify neither as fees for included services nor as royalties under Article 12 of the India- USA tax treaty. Accordingly, in the absence of a permanent establishment, payment for these services is not taxable in India.

Background:

- Esm Sys Pvt ltd (taxpayer)[1] is engaged in the business of web designing search engine optimisation services, social media management, bulk SMS, e-mail management, website advertising, online video management, mobile application designing.
- During the Financial Year (FY) 2012-13, corresponding to Assessment Year (AY) 2013-14, the taxpayer made payments to ESM SYS LLC (payee) a US company, for obtaining the services of data promotion, social media management, general consulting and web promotion.
- The taxpayer did not withhold tax from the payment made to the payee on the basis that:
  - The services were neither in the nature of technical services nor royalty as per the provisions of the India-USA tax treaty;
  - The services were in the nature of business profit and since the payee did not have a permanent establishment in India, this payment was not taxable in India as per the provisions of the India-USA tax treaty.
- The Assessing Officer (AO) in the audit order held that:
  - The hiring of server and providing of web hosting services were in the nature of technical services as per the provisions of section 9(1)(vii) of the Income-tax Act, 1961 (ITA).
  - The payments were also in the nature of royalty as per the provisions of section 9(1)(vi) of the ITA.

  Accordingly, the taxpayer was required to withhold tax at source and due to failure to withhold tax from the payment made to the payee, the AO disallowed the expenses in the hands of the taxpayer.
- On appeal, the Commissioner of Income-tax (Appeals) [CIT(A)] upheld the AO's order.
- Aggrieved by the CIT(A)'s order, the taxpayer filed an appeal before the Ahmedabad Bench of the Income-tax Appellate Tribunal (ITAT).

[1] ESM Sys Pvt. Ltd. v. ITO [ITA No. 350 / Ahd / 2018 (AY 2013-14)]

Decision of the ITAT:

- The ITAT noted that:
  - The taxpayer had obtained services of web promotion, social media management and the payee had used techniques such as web content development, search engine optimisation to increase the site traffic.
  - The taxpayer explained that the payee had provided services which were in the nature of site promotional activity i.e. bandwidth provisions, data storage and web hosting services using the servers located in the USA. There was no sharing of knowledge or know-how or any technology to the taxpayer during the provision of web hosting services.
  - The entire transaction took place on internet through virtual servers located worldwide outside. The servers were not under the taxpayer's control; and used for hiring space for domain hosting and display of advertisement.
  - The CIT(A) had dismissed the appeal of the taxpayer in a general manner without giving reason for not agreeing with the taxpayer's contention for non-deduction of tax as per Article 12 of the India-USA tax treaty (relating to taxation of royalties and fees for included services).
  - The Mumbai ITAT in an earlier case[2] had held that, payment made to non-resident for uploading and display of banner advertisement on its portal, in absence of any permanent establishment of non-resident in India was not chargeable to tax in India.
  - The Kolkata ITAT in an earlier case[3] had held that, fees for online advertisement was not fees for technical services as per the provisions of the India-USA tax treaty.
- In view of the above, the ITAT held that:
  - Considering that the payee was a tax resident of the USA; the taxability of the payment was governed by provisions of the India-USA tax treaty, being more beneficial than the provisions of the ITA.
  - As per Article 12(4) of the India-USA tax treaty, services being technical in nature qualified as 'fee for included services' only when it had made available technical knowledge or skill to the recipient of services. The ITAT also relied on various judicial precedents[4] in this regard.
  - There was no sharing of knowledge or know-how or any technology by the payee to the taxpayer as per the provisions of Article 12 of the India-USA tax treaty.

[2] Pinstorm Technologies (P.) Ltd. v. ITO [2012] 24 taxman.com 345 (Mumbai ITAT)

[3] ITO v. Right Florists (P.) Ltd. [2013] 32 taxman.com 99 (Kolkata ITAT)

[4] ITO v. B.A. Research India Pvt. Ltd. [TS-6184-ITAT-2015 (Ahmedabad)-O]; ITO v. Cadila Health Care Ltd. [TS-5220-ITAT-2017 (Ahmedabad)-O];

Mckinsey & Co. Inc. (Philippines) v. ACIT [2006] 99 ITD 549 (Mumbai ITAT); Pinstorm Technologies (P.) Ltd. v. ITO [2012] 24 taxman.com 345 (Mumbai ITAT); ITO v. Right Florists (P.) Ltd. [2013] 32 taxman.com 99 (Kolkata ITAT) and Yahoo India (P.) Ltd. v. DCIT [2011] 11 taxman.com 431 (Mumbai ITAT).

Accordingly, the ITAT held that the payment made by the taxpayer was not taxable in India and therefore, the taxpayer was not required to withhold tax in India.

Comments:

- This ruling affirms the principle that web promotion and social media management services are not taxable in India as per the provisions of the India-USA tax treaty.

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