IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH : BANGALORE

BEFORE SHRI. CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER

ITA No. 1781/Bang/2019
Assessment Year : 2016-17

M/s. Home Interior Designs E-Commerce Pvt. Ltd., Unit No. 401, 3rd Floor, Prestige Obelisk, Kasturba Road, Bangalore – 560 001. PAN: AADCH4222R	**Vs.**	The Deputy Commissioner of Income Tax, Circle – 3(1)(2), Bangalore.
APPELLANT		**RESPONDENT**

Assessee by	**:**	Shri K.R. Vasudevan, Advocate
Revenue by	**:**	Smt. Priyadarshini Baseganni, JCIT (DR)

Date of Hearing	**:**	26-10-2021
Date of Pronouncement	**:**	23-12-2021

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present appeal has been filed by assessee against order dated 21.06.2019 passed by Ld.CIT(A)-3 for Assessment Year 2016-17 on following grounds of appeal.

"*1. The order of the CIT(A) is erroneous and prejudicial to the interest of the Appellant and against the facts of the case.*

2. Disallowance under Section 40(a)(i) read with Section 195 of the Income-tax Act, 1961 ('the Act') - Rs.1,29,38,417:

a. The learned CIT (A)/learned AO erred in disallowing a sum of INR 1,29,38,417 under section 40(a)(i) of the Act on the ground that taxes have not been withheld on the online advertisement, publicity and sales promotion charges paid to Facebook Ireland Limited ('Facebook');

b. The learned CIT(A) erred in holding that payments made to Facebook are in the nature of royalty by opining that the Company is granted use or right to use of complex software, intellectual property rights, database, customer data which host the website where the Company's advertisements are displayed;

c. The learned AO erred in considering that services availed by the Company are in the nature of use of technology, model, process or equipment or customer data and the same is covered under provisions of Section 9(1)(vi) read with clause (iii) and (iva) of Explanation 2;

d. The learned CIT(A)/ the learned AO ought to have appreciated that the Company merely provides only the advertisement to Facebook and it is the responsibility of Facebook to upload and display of the banner advertisement;

e. The learned CIT(A) erred in not appreciating that even if right to use complex software or technology or model or equipment or customer data were granted, such access is incidental to main activity of advertisement service and hence consideration for such service cannot be characterized as royalty;

f. The learned CIT(A)/the learned AO failed to appreciate that services provided by Facebook are in the nature of marketing, sales promotion and the payments for availing such services cannot be characterized as royalty;

g. The learned CIT(A)/the learned AO ought to have appreciated that the payment of online advertisement and sales promotion charges does not amount to royalty under the provisions of Act or double taxation avoidance agreement.

h. The learned CIT(A)/ the learned AO erred in not following various judicial precedents which have held that tax is not deductible on online advertisement and sales promotion expenses;

i. The learned CIT(A)/the learned AO ought to have appreciated that withholding of tax on the advertisement expenditure in case of residents is specifically covered under section 194C of the Act, which clearly indicates the intent of the law that the advertisement expenditure does not fall under section 1943 which inter alia covers the withholding of tax on royalty and fee for technical services.

j. The learned AO erred in considering that Facebook has permanent establishment in India.

k. The learned CIT(A)/the learned AO ought to have appreciated that the advertisement expenses paid to non-residents are in the nature of business income in their hands and thereby not taxable in absence of a permanent establishment in India.

The appellant submits that each of the above grounds/ sub-grounds are independent and without prejudice to one another.

The appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing, of the appeal, so as to enable the Income-tax Appellate Tribunal to decide the appeal according to law.

The appellant prays accordingly."

2. Brief facts of the case are as under.

The assessee is a domestic company incorporated on 23.06.2014, is engaged in the business of providing online platform (e-commerce) for purchase, selling, supplying and designing of furniture, fixtures home interiors decoration, kitchen platforms and other home interior related orders from the customers. The assessee has filed return of income for the A.Y. 2016-17 on 25.09.2016, declaring a loss of Rs. 97,189,455/-. The case was selected for scrutiny and notices u/s. 143(1) alongwith 143(2) were issued to assessee. In response to statutory notices, assessee filed details / submission. The Ld.AO from the submissions filed by the assessee noticed that assessee did not deduct TDS on advertisement expenses. It was also noticed from the profit and loss account, the assessee debited Advertisement charges to the tune of Rs. 1,29,38,417/- paid to Facebook Ireland Limited but not deducted the required TDS payment.

3. The Ld AO relied on the decision made by the *High Court of Chennai* in the case of *Consim Info Pvt Ltd Vs Google India Pvt Ltd* where in detailed discussion was made on the functioning of the

online advertisement, search engine and the overview of the advertisement on the internet. The Ld.AO concluded that the services provided by M/s Facebook Ireland Limited is similar to the services provided by Google India Pvt Ltd and accordingly disallowed the payments made to M/ s Facebook Ireland Ltd. by assessee.

4. The Ld AO was also of the view that the payments made to M/s Facebook Ireland Limited for advertisement is nothing but the usage of its technology, process, equipment, etc, to enable the advertiser to reach the target audience in the most efficient manner, in order to develop the business of the assessee. The Ld.AO observed that M/s Facebook Ireland Ltd. provides many options to the businesses/advertisers to reach its database of users, unlike the traditional medium of advertisements, what M/s Facebook Ireland Ltd. offers is dynamic, highly target-group specific, real-time monitored advertising.

Accordingly the Ld.AO was of the opinion that, the payments made to M/s Facebook Ireland Ltd. would be in the nature of Royalty and so would get covered under the provision - Section 9 (1)(iii), as these are payments towards the use of patent, invention, model, design, secret formula or processes or trade mark or similar property and also provision of section (iva) as it is the use or right to use any industrial, commercial or scientific equipment .

The Ld.AO stated that since the technology of M/s Facebook Ireland Ltd. is being utilised, the said services are in the nature of technical services or royalty as it is the usage of their equipment or platform based on which services are rendered, and

would not fall under advertisement services and would be liable tax deduction under section 9(1)(iii) of the Income tax act 1961.

The Ld.AO also concluded that M/s Facebook Ireland Ltd has a Service Permanent Establishment (PE) in India and such PE is empowered to enter into or conclude contracts, carry out jobs exclusively for its principal place of working.

The Ld.AO thus held payment made to M/s Facebook Ireland Ltd. to be in the nature of royalty, on which TDS is applicable, and since the assessee has failed to deduct taxes at source an amount of Rs. 3,881,525/- is being disallowed u/s 40(a)(ia) of the Income Tax Act.

Aggrieved by the order of Ld.AO, assessee preferred appeal before Ld.CIT(A). Ld.CIT(A) held as under:

"The assessee has relied upon various decisions, however the same are found to be rendered on different facts. This is noted that the said decisions were also considered by the jurisdictional ITAT Bangalore in the case of Google India (P.) Ltd. v. Joint Director of Income-tax (International Taxation), Range-1, Bengaluru[2018] 93 taxmann.com 183 (Bangalore - Trib.) and the ITAT distinguished the same. Although in the above case of Google India the facts were slightly different as in the said case Google India was acting as the distributor on behalf of Google Ireland and the services availed were then provided to the clients desirous of placing advertisement, however the ratio of this decision as far as the nature of services being provided though Google AdWord program is concerned, the same is squarely applicable to the services provided by Facebook Ireland directly to its clients in India through its Facebook Ad program.

Considering above, the action of the AO in treating the payment made to Facebook Ireland as royalty is upheld."

Aggrieved by the order of Ld.CIT(A), assessee is in appeal before us.

4.1 The Ld.AR submitted that for purposes of marketing its games, the assessee advertise/market its games via Facebook (a prominent social media platform) and other platforms to create visibility and

awareness about its games in various markets around the world. He submitted that, the advertisements provided by the assessee are delivered on the website or other properties operated by Facebook and other entities, and that the assessee has to specify the area or space for the delivery of the advertisements, the amount and type of adverting inventory being purchased (e.g., impressions, clicks, duration or other desired actions or metrics), fees and rates, maximum amount of money to be spent, the start and end dates of the advertisement etc.

4.2 He submitted that Facebook and other entities deliver the digital advertisement in accordance with the scope agreed with the client. He submitted that they are responsible for the design, layout, look, feel and maintenance of any and all aspects of the advertisement including with respect of the display and performance of any Client Ads. Facebook may in its sole discretion redesign, delete or replace any pages, groups or other areas on which Client Ads will be displayed, even if such redesign, deletion or replacement results in the removal of Client Ads, and that the role of the assessee is limited to the extent of providing the content to be advertised.

4.3 The Ld.AR thus submitted that the assessee does not have any control or possession over the way in which these advertisements are digitally advertised by the Facebook and other entities. No access to the technology behind the airing of the advertisement on the website is provided to the assessee. He thus advocated that the payment does not amount to Royalty under the Act.

4.4. On the contrary, the Ld.Sr.DR submitted that the decision rendered by *Hon'ble Supreme Court* in the case of *Engineering Analysis Centre of Excellence P Ltd (supra)* cannot be blindly followed. She submitted that each payment made by the assessee needs to be examined on the basis of the agreement

entered between the assessee and the suppliers of software in order to find out whether there was transfer of copy right or not. Accordingly, the Ld. D.R. submitted that the entire issues may be restored to the file of the A.O. for examining it afresh and assessee may be directed to furnish the agreements/ other information and explanations that may be called for by the A.O.

5. We heard both sides in light of records placed before us.

5.1 We notice that the Ld CIT(A) has followed the decision rendered by *Hon'ble Karnataka High Court* in the case of *Samsung Electronics Co. Ltd (supra)* to decide the issues against the assessee. However the above said decision has since been reversed by *Hon'ble Supreme Court* in the case of *Engineering Analysis Centre of Excellence P Ltd (supra)*. The issue of granting license to use software was examined in the context of its taxability as royalty by *Hon'ble Supreme Court* in the case of *Engineering Analysis Centre of Excellence (supra)*. The *Hon'ble Supreme Court* examined this question considering four types of situations, which has been narrated as under:-

> ***4.*** *The appeals before us may be grouped into four categories:*
>
> *(i) The first category deals with cases in which computer software is purchased directly by an end-user, resident in India, from a foreign, non-resident supplier or manufacturer.*[3]
>
> *(ii) The second category of cases deals with resident Indian companies that act as distributors or resellers, by purchasing computer software from foreign, non-resident suppliers or manufacturers and then reselling the same to resident Indian end-users.*[4]
>
> *(iii) The third category concerns cases wherein the distributor happens to be a foreign, non-resident vendor, who, after purchasing software from a foreign, non-resident seller, resells the same to resident Indian distributors or end-users.*[5]

(iv) The fourth category includes cases wherein computer software is affixed onto hardware and is sold as an integrated unit/equipment by foreign, non-resident suppliers to resident Indian distributors or end-users.

5.2 After analysing the provisions of Income tax Act, provisions of DTAA, the relevant agreements entered by the assessees with non-resident software suppliers, provisions of Copy right Acts, the circulars issued by CBDT, various case laws relied upon by the parties, the Hon'ble Supreme Court concluded as under:-

"*CONCLUSION*

***168**. Given the definition of royalties contained in Article 12 of the DTAAs mentioned in paragraph 41 of this judgment, it is clear that there is no obligation on the persons mentioned in section 195 of the Income-tax Act to deduct tax at source, as the distribution agreements/EULAs in the facts of these cases do not create any interest or right in such distributors/end-users, which would amount to the use of or right to use any copyright. The provisions contained in the Income-tax Act (section 9(1)(vi), along with explanations 2 and 4 thereof), which deal with royalty, not being more beneficial to the assessees, have no application in the facts of these cases.*

***169**. Our answer to the question posed before us, is that the amounts paid by resident Indian end-users/distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale/use of the computer software through EULAs/distribution agreements, is not the payment of royalty for the use of copyright in the computer software, and that the same does not give rise to any income taxable in India, as a result of which the persons referred to in section 195 of the Income-tax Act were not liable to deduct any TDS under section 195 of the Income-tax Act. The answer to this question will apply to all four categories of cases enumerated by us in paragraph 4 of this judgment.*"

5.3 It is pertinent to mention that the *Hon'ble Supreme Court* has analysed the provisions of Copy right Act and their applicability to the payments made for use of software. We also notice that the decision rendered by *Hon'ble Karnataka High Court* in the case of *Samsung Electronics Co Ltd (supra)* has been reversed by

Hon'ble Supreme Court in paragraph 101-102 of its order. Similarly decision of coordinate bench of this *Tribunal* in case of *Google India Pvt. Ltd. vs. JCIT* reported in *(2018) 93 taxmann.com 183* relied by Ld.Sr.DR has been remanded back to ITAT by *Hon'ble Karnataka High Court.* This decision of *Hon'ble Karnataka High Court* is reported in *(2021) 127 taxmann.com 36.*

5.4 However, as rightly pointed out by Ld D.R, we are of the view that the issues contested in all these appeals require fresh examination at the end of Ld CIT(A) applying the ratio of the decision rendered by *Hon'ble Supreme Court* in the case of *Engineering Analysis Centre of Excellence P Ltd (supra).* Accordingly, we set aside the orders passed by Ld CIT(A) in all these appeals and restore all the issues to his file for examining them afresh applying the ratio of the decision rendered by *Hon'ble Supreme Court* in the case of *Engineering Analysis Centre of Excellence P Ltd (supra).*

In the result, the appeal filed by the assessee stands allowed for statistical purposes.

Order pronounced in the open court on 23rd December, 2021.

Sd/-	Sd/-
(CHANDRA POOJARI)	(BEENA PILLAI)
Accountant Member	Judicial Member

Bangalore,
Dated, the 23rd December, 2021.
/MS /

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore
6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore