IN THE INCOME TAX APPELLATE TRIBUNAL
'A' BENCH : BANGALORE
BEFORE SHRI. CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER

ITA No. 3066/Bang/2018
Assessment Year : 2015-16

M/s. Moonfrog Labs Pvt. Ltd., 16/3, Level-3, Adarsh Yellavarthy Centre, Cambridge Road, Ulsoor Jogupalya, Bangalore – 560008. PAN: AAICM9563H	**Vs.**	The Assistant Commissioner of Income Tax, Circle – 4(1)(2), Bangalore.
APPELLANT		**RESPONDENT**

Assessee by	:	Shri Padamchand Khincha, CA
Revenue by	:	Shri Sankar Ganesh .K, JCIT (DR)

Date of Hearing	:	21-10-2021
Date of Pronouncement	:	14-12-2021

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present appeal by the assessee has been filed by assessee against the assessment order dated 18.12.2017 passed by the ACIT, Circle – 4 (1)(2), Bangalore relating to Assessment Year 2015-16.

The grounds raised by the assessee are as under:

"***1. General Ground***

1.1. The learned Assistant Commissioner of Income Tax, Circle-4(1)(2), Bangalore (`A0') has erred in passing the assessment order under section 143(3) of the Income Tax Act, 1961 (`the Act') in the manner passed by him and the Commissioner of Income Tax-(Appeals)-4 (`CIT(A)') has erred in confirming the said assessment order. The said order being bad in law is liable to be quashed.

2. Grounds relating to treatment of marketing expenses as royalty under section 9(1)(vi) Notional Tax Effect : (1,16,00,53593.6%). 38,97,780

2.1. The learned AO and CIT(A) erred in treating the marketing expenses amounting to Rs. 1,16,00,535 as royalty under section 9(1)(vi) and disallowing the same under section 40(a)(i) for non-deduction of tax at source under section 195.

2.2. The learned AO has erred in concluding that the impugned payments were in the nature of Fees for technical services / Royalty under the Act and DTAA.

2.3. The learned CIT(A) erred in concluding that the impugned payments were in the nature of `Royalty' as a consideration towards use or right to use any industrial, commercial or scientific equipment or services rendered in connection therewith.

2.4. The learned AO and CIT(A) have erred in upholding that the provisions contained in section 195(2) are to be resorted to mandatorily for chargeability of tax.

2.5. The learned AO and CIT(A) failed to appreciate that tax is deductible under section 195 of the Act only in a scenario where income is chargeable to tax.

2.6. The Honourable CIT(A) has erred in concluding that the deductor cannot be permitted to take shelter under the DTAA as the benefit of DTAA is conferred only on the non-resident recipient.

2.7. The Hon'ble CIT(A) has erred in not appreciating that DTAA is also to be considered for the purposes of deduction of tax at source.

2.8. The impugned conclusions of the CIT(A) in sustaining the addition made by the learned Assessing Officer are contrary to law, bad in law and liable to be quashed.

2.9. On facts and circumstances of the case and law applicable, payments made to non-residents amounting to Rs. 1,16,00,535 was not liable for TDS under section 195 and consequently disallowance confirmed under section 40(a)(1) should be deleted.

The Appellant prays accordingly."

Additional ground

"*1. Assuming without admitting that the credits/payments to non-residents was liable for disallowance under section 40(a)(i), the said disallowance, if any, should be restricted to 30% of the expenditure as per the Non Discrimination Article in the Double Taxation Avoidance Agreements. The appellant prays accordingly.*"

Brief facts of the case are as under:

2. The assessee is an Indian Company engaged in the business of developing, marketing and operating games and gaming infrastructure for mobile phones. For the relevant Assessment Year, the assessee filed the return of income on 29.09.2015, returning a loss of Rs.(2,15,32,462/-) and claiming a refund of Rs. 5,39,168/-.

2.1 Notice u/s. 143(2) and 142(1) was issued. The Ld.AO called for the details of advertising expenses with name and address of the person to whom the payment was made. The assessee submitted the details vide letter filed on 28.11.2017. The Ld.AO noticed that advertisement expenses were paid among others to Facebook, Ireland, Tapjoy, USA and Motive Inc, USA. Before the Ld.AO, the assessee vide letter dated 07.12.2017 submitted the TRCs, no PE declarations and explained that the advertisement expenses paid to Facebook Inc, and other entities are not liable for TDS under section 195. The Ld.AO issued show cause notice to assessee to show cause as to why advertisement expenses paid to Facebook, Tapjoy and Motive Inc should not be disallowed under section 40(a)(i) for non deduction of tax at source under section 195. Assessee submitted that the payment made to Facebook and other entities for digital advertising was not chargeable to tax under the provisions of the Act / DTAA and hence not liable for TDS under section 195.

2.2 The AO after considering the submissions of assessee disallowed Rs. 1,16,00,535/- under section 40(a)(i) for non-deduction of tax at source as royalty and /or FTS in respect of the payments made to Facebook and other entities under section 195. The Ld.AO also disallowed sum of Rs. 9,28,716 under section 14A read with rule 8D(2)(iii) of the Act.

3. Aggrieved by the order of Ld.AO, assessee preferred appeal before Ld.CIT(A).

3.1 The Ld.CIT(A) held that the advertisement expenses paid to Facebook and other entities constitutes use of industrial, commercial or scientific equipment under section 9(1)(vi) of the Act whether active or passive and hence 'Royalty' under the Act. As regards taxability as "Fees for technical services", it was held by the Ld.CIT(A) that since the process is automated and there is no human intervention, the payments do not qualify as Fees for technical services under section 9(1)(vii) of the Act.

3.2 The disallowance under section 14A was deleted by the CIT(A) in the absence of exempt income.

4. Aggrieved by the order of Ld.CIT(A), the assessee preferred appeal before this *Tribunal*.

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).*

Accordingly, grounds raised by assessee stands allowed for statistical purposes.

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

Order pronounced in the open court on 14th December, 2021.

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

Bangalore,
Dated, the 14th 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