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Formula one championship circuit constitutes a fixed place of business/PE in India under the India-U.K. tax treaty

Background

Recently, the Delhi High Court in the case of Formula One World Championship Limited[1] (the taxpayer) held that as long as the presence of the taxpayer is in a physically-defined geographical area, permanence in such fixed place could be relative in the context of the nature of the business. The taxpayer carried on business in India for the duration of the race, two weeks before it and a week after the race. Consequently, the Formula one championship circuit (the circuit) constitutes a fixed place of business under Article 5(1) of the India-U.K. tax treaty (the tax treaty).

Payments made to the taxpayer under a specific agreement are not royalty either under the Income-tax Act, 1961 or under the tax treaty, as they are not for the use of trademarks or intellectual property (IP) rights, but rather for the granting of the privilege of staging, hosting and promoting the event at the promoter's racing circuit. The taxpayer carried out business in India through a Permanent Establishment (PE) (the circuit); therefore, the payments made to the taxpayer are business income.

Facts of the case

- The taxpayer, a U.K. tax resident company; the Federation internationale de l' automobile (FIA), an international motor sports events regulating association; and Formula one asset management limited (FOAM) entered into certain agreements. Based on these agreements, FOAM licensed all commercial rights in the FIA formula one world championship (Championship) to the taxpayer for the 100-year term effective from 1 January 2011.

- The taxpayer entered into a Race Promotion Contract (RPC) dated 13 September 2011, by which it granted to Jaypee Sports (Jaypee) the right to host, stage and promote the Formula One Grand Prix of India event for a consideration of USD 40 million. An artworks license agreement (ALA) contemplated in RPC was also entered into between the taxpayer and Jaypee, permitting the use of certain marks and intellectual property (IP) belonging to the taxpayer for a consideration of USD 1. The RPC of 2011 was preceded by another RPC of 25 October 2007; signed by the taxpayer and Jaypee.

- All the participating teams known as 'constructors' enter into a contract, known as the 'concorde agreement' with the taxpayer and the FIA. The concorde agreement assured the participating teams that the FIA would have the exclusive right in the F1 championship and would be entitled to grant to the Commercial Rights Holder the exclusive right to exploit the commercial rights in the F1 championship. In this agreement, they bind themselves to an unequivocal negative covenant with the taxpayer that they would not participate in any other similar motor racing event. This is, in effect, a closed circuit event since no team other than those bound by contract with the taxpayer is permitted participation.

- Every F1 racing event is hosted, promoted and staged by a promoter with whom the taxpayer as the right holder, enters into a contract and whose event is nominated by the CRH (i.e. Contract Right Holder, which is in effect, the taxpayer), to the FIA for inclusion in the official F1 racing calendar. The FOWC had the right to draw the FIA F1 Championship for any season to be approved by FIA.

[1] Formula One World Championship Limited v. CIT [W.P.(C) 10307/2016, C.M. APPL.40563/2016 & 40564/2016], CIT v. Formula One World Championship Limited [W.P.(C) 9509/2016, C.M. APPL.38021/2016, 41063/2016, 41235/2016 & 41236/2016], Jaiprakash Associates Ltd. v. CIT [W.P.(C) 10145/2016, C.M. APPL.40169/2016] – Taxsutra.com

- The taxpayer and Jaypee both approached the Authority for Advance Ruling (AAR). The AAR held that the taxpayer had no fixed place of business in India, it is not doing any business activity in India and has not authorised any entity to conclude contracts on their behalf, and therefore has no PE in India in terms of Article 5 of the tax treaty. Further, it was held that the amounts paid were royalties.

- The taxpayer, Jaypee and the tax department then filed a writ petition before the High Court under Article 226 of the Constitution.

The High Court's decision

Fixed Place PE

- The OECD Model Tax Convention[2] contains a useful commentary on what could be said to constitute fixed place of business. Klaus Vogel in the commentary Double Taxation Conventions[3] stated that the main features of Article 5(1) are: (a) existence of an enterprise; (b) its carrying on a business; (c) existence of a place of business, the nature of such place being fixed and (d) through which (i.e. through the place) the business should be carried on.

- The place of business must be a 'fixed one', the existence of the link between the place of business and the specific geographical bond would be sufficient. In the case of E-Funds4, though the court discussed what could constitute a fixed place of business and concluded that a physical presence in a geographical area is essential, the decision was more related to an interpretation of who is a dependent agent. The High Court has relied upon the commentary in Taxmann's Permanent Establishment in International Taxation[5].

- For the duration of the event as well as two weeks prior to it and a week succeeding it, the taxpayer had full access through its personnel the areas reserved for it. The team contracted to it, both racing as well as spectator teams could also dictate who were authorized to enter the areas reserved for it.

- In terms of the RPC agreement, Jaypee was designated as the promoter or the event host, but its capacity to act was extremely restricted. At all material times, the taxpayer had access - exclusively, to the circuit, and all the spaces where the teams were located.

- Though the taxpayer's access or right to access was not permanent, at the same time, the model of commercial transactions it chose is such that its exclusive circuit access - to the team and its personnel or those contracted by it, was for up-to six weeks at a time during the F1 Championship season.

- The teams competed in the race in a given place and after its conclusion moved on to another locale where a similar race is conducted. This nature of activity was a moving presence. With this kind of activity, both the exclusive nature of the access and the period for which it is accessed, makes the presence of a kind contemplated under Article 5(1), i.e. it is fixed. Thus, the presence is neither ephemeral or fleeting, or sporadic. The fact that RPC-2011's tenure is of five years meant that there was a repetition.

- Having regard to the OECD and Klaus Vogel's commentary on the general principles applicable, that as long as the presence is in a physically defined geographical area, permanence in such fixed place could be relative having regard to the nature of the business, the circuit itself constituted a fixed place of business.

Business and commercial activity in India

- A perusal of the Concorde and RPC-2011 Agreement indicates that the CRH, which is the taxpayer only, has the right to include a venue in any FIA annual calendar, and FIA is bound to accord permission for such inclusion. Only the taxpayer has exclusive rights towards making sound, television and other recordings and exploitation of its media rights.

- The taxpayer was entitled to charge fees for the recording, telecasting, broadcasting and creation of internet and media rights, etc. Also, the taxpayer charged, a fee annually from Jaypee in relation to the race event or FIA F1 Championship event conducted on the circuit in India. The entire event, i.e. F1 FIA Championship in the circuit was organized and controlled by the taxpayer.

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[2] OECD Model Tax Convention on Income and on Capital (Condensed Version- July 2010)
[3] Kluver Law International, 2005
[4] Director of Income Tax v. E-Funds Corporation [2014] 364 ITR 256 (Del)
[5] by Dr. Amar Mehta, May 2012

- If Jaypee is the event promoter, which owns the title to the circuit in the sense that it owns the land, the taxpayer is the commercial rights owner of the event, by virtue of the Concorde Agreement. FIA parted with all its commercial rights to the taxpayer. The bulk of the revenue earned is through media, television and other related rights, and the basis of those rights is the event.

- The taxpayer decides the venue and the participating teams are bound to it, to compete in the race in the terms agreed with the taxpayer. All these, unequivocally, show that the taxpayer carried on business in India for the duration of the race and for two weeks before the race and a week thereafter. Every right, which it possessed was monetized, and the amount which Jaypee was paid was only a part of that commercial exploitation by the taxpayer.

- Consequently, the taxpayer carried on business in India within the meaning of Article 5(1) of the tax treaty.

Business through its agents

- Article 5(5) has certain preconditions, if an entity has to be treated as a dependent agent. The agent must have the authority to conclude contracts, which bind the represented enterprise, and it must habitually exercise such authority.

- The three agreements independently entered into by the three subsidiaries of the taxpayer do not indicate that the contracts they entered into and the businesses they were engaged in, was for and on behalf of the taxpayer.

Payment by Jaypee to the taxpayer - royalties

- Under the trademark law, particularly in India, the trademark use even for advertisement purposes is to be preceded by the prior consent of the proprietor and any unauthorized use could lead to an infringement of the trademark[6].

- To secure registration for the marks in India from the Trademark Registry, the taxpayer and Jaypee entered into the ALA. The function of the ALA was (a) to provide for a strictly limited usage of the marks i.e. only for advertisement and promotion of the Indian Grand Prix Event; (b) to provide for restrictions on usage of such marks, i.e. not for any commercial purposes such as use on merchandise, etc.

- The OECD commentary[7] states that payments solely made in consideration for obtaining the exclusive distribution rights of a product or service in a given territory are not royalties since the resident distributor does not pay for the right to use the trade name/mark under which the products are sold. The resident distributor merely obtains the exclusive right to sell in his/her state of residence the product that he/she is agreeing to buy from the manufacturer and such payments will be characterized as business income.

- Under the RPC, the taxpayer has the exclusive right to exploit the commercial rights in the championship. The amounts payable by Jaypee to the taxpayer under the RPC are for the privilege of hosting and staging the championship race and not for the IP rights. Further, the ALA does not confer any additional rights, neither was a license nor any form of right to use the trademark given to Jaypee by the taxpayer, which resulted in royalty payment within the meaning of Article 13 of the DTAA.

- The judgment in the case of Ericsson A.B.[8], held that a lump-sum payment which is not based on or connected with the extent of the use of the IP rights would not constitute 'royalties' within the meaning of the tax treaty.

- In the present case, the payments made under the RPC were not based on the total amount of revenue earned by Jaypee, and would not constitute royalties.

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[6] Section 29 of the Trade Marks Act,1999

[7] Para 10.1 of OECD commentary on Article 12 of the Model Convention

[8] DIT v. Ericsson A.B. [2012] 343 ITR 470 (Del)

- The ALA prohibited Jaypee from using any of the licensed marks, or as part of the name of the circuit, any corporate name, etc. Thus, Jaypee had no IP rights independently of the staging and hosting of the event. The parties did not intend, through the RPC and the ALA, to license the trademark, and therefore, it does not amount to royalty under the tax treaty.

- The definition of royalty as set out in the second Explanation to Section 9(1)(vi) of the Act is significantly broader than that set out in Article 13(3) of the tax treaty. The payments made to it under the RPC are not royalty under either the Act or the tax treaty, since they were not for the use of trademarks or IP rights, but for the grant of the privilege of staging, hosting and promoting the event at the promoter's racing circuit.

- In the case of Sheraton International Inc.[9], this Court held that when the main work of the foreign collaborator was to render services in relation to advertisement, publicity and sales promotion, its incidental use of the trademark did not amount to receipt of royalty by it.

- 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 indicates that the use of the trademarks was purely incidental.

- Thus, the amounts paid to the taxpayer by Jaypee were business income and could not be brought to tax under the head of 'royalty' under Article 13 of the tax treaty.

Jaypee - application of Section 195

- The Supreme Court in the case of GE India Technology Centre (P) Ltd.[10] held that the payer is bound to deduct tax at source only if the sum paid is assessable to tax in India. The object of the provision of Section 195 is to clarify what proportion of the payment made by the payer is liable to tax deduction.

- Having regard to the conclusion reached that the taxpayer carried on business in India through a PE at the circuit, it is held that payments made to the taxpayer, under the RPC were business income. Accordingly, the payments are chargeable to tax, according to the rates applicable in India at that time.

Our comments

With globalization, multinational organisations are spreading their business activities across the globe. This may result in constituting a PE in the other country under Article 5 of the relevant tax treaty. However, to constitute a PE it is essential that there is some degree of permanence and continuity. The issue with respect to having a PE vis-à-vis test of permanence has been the subject of many a matter before the courts.

The Delhi High Court in the case of National Petroleum Construction[11] held that the word permanent in the term 'permanent establishment' indicates that there should be some degree of permanency attached to the fixed place of business before the same can be construed as a PE of an enterprise. The word permanent does not imply for all times to come but merely indicates a place, which is not temporary, interim, short-lived or transitory.

The Mumbai Tribunal in the case of Renoir Consulting Ltd.[12] held that the services rendered by the Mauritian company to an Indian company for improving the management performance quotient by enhancing the operating parameters, reducing costs etc. constituted a PE in India under the India-Mauritius tax treaty, since some place was at the disposal of the taxpayer or its employees during the entire period of the stay in India. The Tribunal observed that the word 'permanent' means there must be a certain degree of permanence and a fixed place would include a movable place of business. However, the establishment must have a commercial coherence or purpose, without the same, the enduring quality would be immaterial.

In line with the above decisions, in the present case, the High Court held that the taxpayer had exclusive access to the race circuit for a certain period and its presence is in a physically-defined geographical area, which resulted in fixed PE in India under the Article 5(1) of the tax treaty.

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[9] DDIT v. Sheraton International Inc [2009] 313 ITR 276 (Del)
[10] GE India Technology Centre (P) Ltd v. CIT & Anr. [2010] 327 ITR 456 (SC)

[11] National Petroleum Construction v. DIT [2016] 66 taxmann.com 16 (Del)
[12] Renoir Consulting Ltd. v. DDIT [TS-211-ITAT-2014(Mum)]

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