Race circuit used for organising motor racing event in India held to be a fixed place PE of the non-resident

May 07, 2017

In brief

In a recent judgement[1], the Supreme Court (SC) held that a non-resident taxpayer had a fixed place permanent establishment (PE) in India in the form of a motor racing circuit. Accordingly, payments made by the owner of the circuit to the taxpayer for acquiring the right to host, stage and promote a motor racing event in India were in the nature of business income of the taxpayer and liable to be taxed in India.

In detail

Facts of the case

- The taxpayer[1], a UK tax resident company, was the Commercial Rights Holder (CRH) in respect of the motor racing World Championship (Championship). As a result of it being the CRH, the taxpayer was the exclusive nominating body at whose instance, organisers/ promoters were added to the official motor racing calendar.
- Summary of agreements entered into between various parties was as follows:
  - An agreement was entered between the Federation responsible for regulating the Championship and another group company, whereby the Federation had parted with the commercial rights with respect to the Championship in favour of that company.
  - A separate agreement was entered into by that company with the taxpayer on the same day, transferring the commercial rights in favour of the taxpayer for a period of 100 years.
  - A Race Promotion Contract (first RPC – entered in 2007) was entered into between the taxpayer and the Indian Company, by which the Indian Company was only given the right to **promote** the motor racing event in India (event/ Championship).
  - Thereafter, an Organisation Agreement (OA) was entered into between the Federation and the Indian Company, wherein the Indian Company was given the responsibility to **organise** the event.
  - Thereafter, the first RPC was superseded by way of another RPC (second RPC – entered in 2011) that granted the Indian Company rights to host, stage and promote the Event. Another agreement was entered into between the taxpayer and the Indian Company, as per which the Indian Company was permitted to use certain marks and intellectual property belonging to the taxpayer.

[1] TS-161-SC-2017

- On the day of entering into the second RPC, agreements were signed between the Indian Company and three affiliates of the taxpayer, as per which two of the affiliates were separately granted the circuit rights, mainly media and title sponsorship and the paddock rights. Another affiliate was engaged to generate TV feed.
- A Service agreement (SA) was also entered into by the taxpayer with another one of its affiliates on the race day, for provision of various services such as liaison and supervision of other parties at the Event, travel, transport and data support services.

- After entering into the aforesaid agreements, the taxpayer and the Indian Company approached the Authority for Advance Rulings (AAR), for a ruling on the following questions:
  1. Whether the consideration receivable by the taxpayer from the Indian Company in terms of the RPC was in the nature of royalty as per Article 13 of the Double Taxation Avoidance Agreement (tax treaty) between India and UK?
  2. Whether the taxpayer had a PE in India in terms of Article 5 of the tax treaty?
  3. Whether any part of the consideration received/ receivable by the taxpayer from the Indian Company was subject to withholding tax in terms of section 195 of the Income-tax Act, 1961 (Act)?
- The AAR answered the first question by stating that that the consideration paid/ payable by the Indian Company to the taxpayer would amount to royalty under the tax treaty. The second question was answered in favour of the taxpayer, holding that it did not have a PE in India. With respect to the third question, it was held that since the amount received/ receivable by the taxpayer was income in the nature of royalty, the Indian Company was liable to withhold taxes on the same.
- The taxpayer and the Indian Company challenged the AAR ruling on the aspect of royalty by way of a writ petition before the Delhi HC. The Revenue too filed a writ petition before the Delhi HC, challenging the ruling of the AAR on the aspect of PE.
- The Delhi HC[2] reversed the findings of the AAR on both the issues and held that though the amount paid/ payable by the Indian Company would not be treated as royalty, it would be taxable in India as business income as the taxpayer has a Fixed place PE in India in the form of motor racing circuit. The Indian Company would be liable to withhold taxes from the payments to be made to the taxpayer under section 195 of the Act.
- The judgement of the Delhi HC was then challenged by the taxpayer, the Indian Company and the Revenue before the SC.

Issues before the SC

- Whether the taxpayer had a fixed place PE in India.
- Whether the Indian Company was liable to withhold taxes from the amounts paid/ payable to the taxpayer.
- Without prejudice to above, whether only a portion of the taxpayer's income that was attributable to the said PE could be treated as its income in India.
- Whether the Delhi HC was within its jurisdiction to go into the findings of the AAR on the issue of fixed place PE.

Contentions of the taxpayer and the Indian Company

- To constitute a fixed place PE of the taxpayer in India, two conditions had to be satisfied i.e. there should have been a "fixed place" in India that should have been "at the disposal" of the taxpayer, and further, the taxpayer should have carried out its business activity from such a fixed place. It was argued that both these ingredients were missing in the instant case.
- With respect to the condition that there should have been fixed place at the disposal of the taxpayer in India, the following key contentions were raised:
  - The circuit on which the races were to be conducted was owned by and under the control of the Indian Company. The Indian company was using it all year round for organising many other events.
  - Drawing attention to the OA, it was argued that the Indian Company was given the right to organise the event starting from constructing/ laying down the track for conducting the races till the conclusion of the event/ Championship with no role of the taxpayer therein.
  - The role of the taxpayer was primarily that of advising, assisting and

[2] [2017] 390 ITR 199

consulting with the Indian Company in relation to the event in such manner as considered necessary and/ or appropriate by the taxpayer for the staging and promotion of the event to the mutual benefit of the parties.

- The main business of the taxpayer was not to organise races but to exploit its ownership of the commercial and intellectual property rights with respect to the Championship. The taxpayer was not responsible for holding of the event, for which an OA was entered into by the Indian Company with a third party (i.e. the Federation) to organise the event. Further, as far as the sale of advertisement rights to an affiliate of the taxpayer was concerned, it was pointed out that the affiliate was an independent company.
- Further, the entire event was for three days, and even if it was accepted that the taxpayer had control over the place for those three days, possession of the site for three days could not have been termed as PE. The threshold for holding that a non-resident had a PE in India had to be very high.
- Alternatively, since the RPC was signed in the UK, the consideration paid by the Indian Company under that agreement had also accrued to the taxpayer in the UK and was taxable in the UK
- The Delhi HC did not have jurisdiction, in exercise of its powers under Article 226 of the Constitution, to go into the findings of the AAR on the issue of fixed place PE.
- Since the Indian company had followed the binding ruling of the AAR, it should not have been fastened with the liability to pay interest under section 201 of the Act. Only the portion of the amount paid by the Indian Company to the taxpayer that was attributable to the said PE could have been treated as the taxpayer's income in India.

Revenue's contentions

- The Indian Company was only responsible for hosting the event whereas total access to the circuit at the time of construction as well as at the time of event was with the taxpayer.
- A comparison of the first and second RPC clearly demonstrated that the second agreement was meant to avoid payment of taxes in India. In the first agreement, only the right to "promote" the event was granted, whereas in the second agreement, the right to "host, stage and promote" the event was granted. The right to host and stage the event was conferred upon the Indian Company to give it a semblance of control of the affairs, whereas in reality, the taxpayer had the rights of hosting and staging the competition.
- Furthermore, the so-called rights granted to the Indian Company were transferred back to the taxpayer's affiliates in the form of media, title sponsorship and paddock rights. The business was carried from circuit, paddock, etc., and accordingly, it could not have been said that no business activity had been carried out from that place.
- The fact that the taxpayer had entered into a contract with another group company to grant rights for providing various services also showed that control and physical management of the business was with the taxpayer.
- With respect to the powers of the Delhi HC to revisit the AAR ruling on the issue concerned, based on a judgment of the SC[3], the Delhi HC was well within its jurisdiction while deciding the issues contained in the writ petitions filed by the taxpayer and Indian Company itself.

SC Court's decision

- A combined reading of Article 5(1), 5(2) and 5(3) of the tax treaty clearly reveals that only certain forms of establishments are excluded [as mentioned in Article 5(3)],and which would not be considered as PEs. In order to bring any other establishment that was not specifically mentioned, the following twin conditions laid down in Article 5(1) was to be satisfied:-

  1. Existence of a fixed place of business; and
  2. Through that place, the business of an enterprise was wholly or partly carried out.

  As far as the first condition was concerned, it was held that the motor racing circuit was undeniably a fixed place from which different races were conducted. Accordingly, the core questions to be looked at were whether the place was at the disposal of the taxpayer and whether this was a fixed place of business of the taxpayer.
- For determining whether the motor racing circuit was at the disposal of the taxpayer and whether it had carried out its business therefrom, the entire arrangement between the taxpayer, its affiliates and the Indian Company had to be kept in mind. The various agreements could not have been looked into by isolating them from each other. This was essential to determine who was having a real and dominant control over the event that will consequently

[3] (2012) 11 SCC 224

answer the question of whether the motor racing circuit was at the disposal of the taxpayer or not.

- The SC took note of the fact that on the same day of entering into the second RPC, the Indian Company had given the circuit rights, mainly media and title sponsorship, and the paddock rights to the taxpayer's affiliates. Further, the Indian Company had engaged another affiliate of the taxpayer to generate TV feed. Furthermore, the taxpayer's affiliate who had been given the media rights by the Indian Company, had entered into the Title Sponsorship Agreement with the Sponsor more than month before getting the rights from the Indian Company. Additionally, the SA for providing various services in relation to the event on the race day was signed by the taxpayer. The entire arrangement clearly demonstrated that the entire event was taken over and controlled by the taxpayer and its affiliates.
- The physical control of the circuit was with the taxpayer and its affiliates from the inception of the Event till its conclusion. Omnipresence of the taxpayer and its stamp over the event was clear and firm. It was an undisputed fact that the race was physically conducted in India and that the income from this race was generated in India. Thus, common sense and plain thinking about the entire situation would lead to the conclusion that the taxpayer had made its earnings in India through the said track over which it had complete control during the period of race.
- The SC took cognizance of the Revenue's argument that the duration of the second RPC was five years that was further extendable to another five years. Even the examination of the said contract leads to the same conclusion.
- Accordingly, the fact that the taxpayer had full access to the motor racing circuit through its personnel, the number of days for which the access was there would not make any difference.
- Coming to the question of whether the taxpayer had carried out business or commercial activity from the circuit, it was noted that all the possible commercial rights, including advertisement, media rights and even the right to sell paddock seats were assumed by the taxpayer and its affiliates. Thus, as a part of its business, the taxpayer as well its affiliates had undertaken commercial activities in India.
- Mere construction of the motor racing circuit by the Indian Company at its own expense was of no consequence. The ownership or organising of other events by the Indian Company was immaterial. It is difficult to accept that the taxpayer had no role in conducting the event and its role came to an end with granting permission to host the event. The argument that the motor racing circuit was not under the control and at the disposal of the taxpayer was rejected.
- As CRH of these events, the taxpayer was in the business of exploiting these rights, including intellectual property rights; however, these became possible only with the actual conduct of these races and active participation of the taxpayer in the said races, with access and control over the circuit.
- The test laid down by Andhra Pradesh HC[4] with respect to the requirement of there being a virtual projection of the foreign enterprise on Indian soil was satisfied in the instant case, along with the presence of the three characteristics for constitution of fixed place PE, namely, stability, productivity and dependence.
- Since payments made by the Indian company to the taxpayer under the RPC were business income of the taxpayer's PE in the form of motor racing circuit, the Indian Company was bound to withhold taxes therefrom under section 195 of the Act.
- However, only that portion of the taxpayer's income that was attributable to the said PE could have been treated as its income in India and from which, taxes were required withheld by the Indian company. The decision in relation to how much of the income was attributable to the said PE and whether penalty was to be imposed upon the Indian Company for its failure to withhold taxes was left for the Tax Officer to quantify.
- With respect to the powers of the Delhi HC to revisit the AAR ruling on the issue of fixed place PE, it was held that the Indian Company and taxpayer themselves had approached the Delhi HC, challenging the AAR's ruling on certain issues. The Delhi HC had examined the legal issues and facts while delivering its judgement, and accordingly, the contentions of the taxpayer and the Indian Company in this regard were unacceptable.

The takeaways

- This decision has the potential to stir a debate on the relevance of duration test to determine whether a foreign

[4] [1983] 144 ITR 146

entity has a fixed place PE in India.

- A holistic view of the entire commercial arrangement would need to be undertaken before concluding on the existence of a PE or otherwise.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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