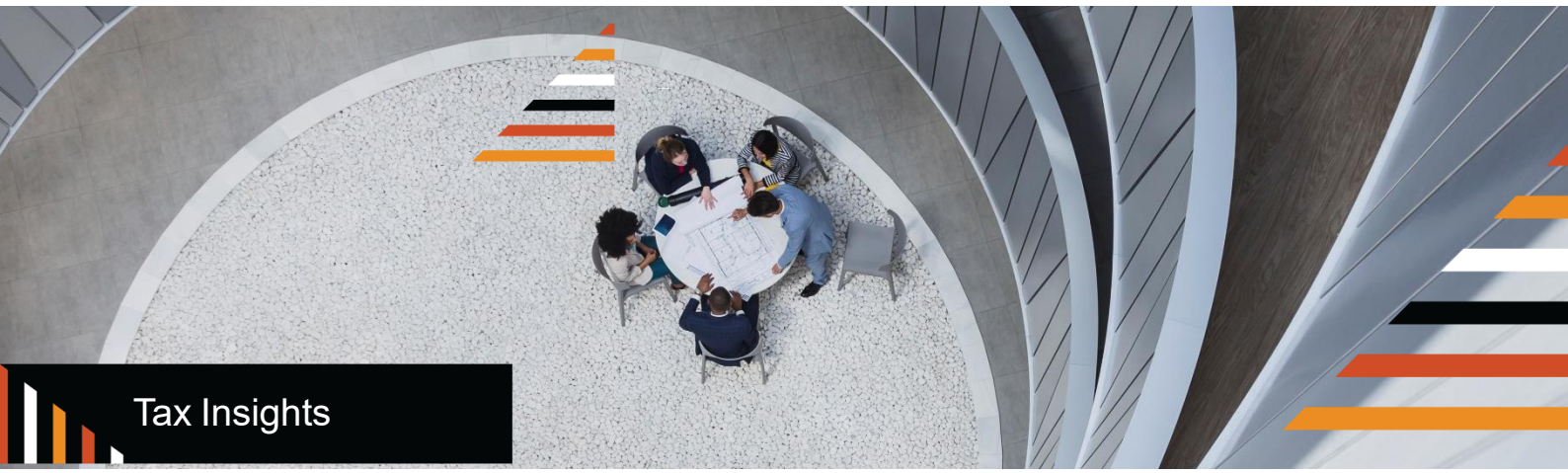

6 April 2023

LoB test in depth examined to hold that payment towards advertising and sponsorship rights does not qualify as 'royalty' under India-Malaysia DTAA – Mumbai bench of the Tribunal

In brief

The Mumbai bench of the Income-tax Appellate Tribunal (Tribunal)[1] rejected the invocation of the Limitation of Benefits (LoB) clause by the Indian Revenue authorities against a Malaysian company under the India-Malaysia Double Taxation Avoidance Agreement (DTAA). The Tribunal held that the Malaysian company cannot be considered as a conduit company being set up to avail the DTAA benefits, when it (i) is well-equipped with a team and is being effectively run by the management based out of Malaysia; (ii) is engaged in revenue-generating business activity not only in respect of clients in India but other jurisdictions as well; and (iii) has been in existence much prior to other group companies to which such Malaysian company is alleged to have been interposed. The Tribunal deleted the demand raised in the hands of the Indian payer for non-deduction of tax at source by holding that payment towards advertising or sponsorship rights made to the Malaysian company cannot be characterised as royalty under the India-Malaysia DTAA.

In detail

Facts

- The taxpayer, an Indian company and a wholly owned subsidiary of Company A based out of Cayman Islands, is *inter alia* engaged in the business of seeking and endorsing sponsorship deals for athletes and carrying on the business of rights sponsorship for sports and entertainment-related accessories.
- The business is carried on by the taxpayer group company as follows:
  - Company A (having 11 subsidiaries around the world, including in India) enters into contracts with cricket board(s) for the purchase of the sponsorship rights of the national cricket team of the respective board.
  - The said rights are sub-licensed by Company A to its another wholly owned subsidiary based out of Malaysia (Company B).
  - Company B further distributes the rights under sub-licensing agreements to other group companies

[1] ITA Nos. 5717/ Mum/ 2016 and 6129/ Mum/ 2016

based on the nature, type of sports and events and their popularity in the respective country, which are then further granted by such other group companies to third parties.

- During the year under consideration (assessment year 2014–15), the taxpayer obtained the advertising and sponsorship rights of the Sri Lanka Cricket Team for the International Cricket Council (ICC) World T20, 2012 (in Sri Lanka) and World T20, 2014 (in Bangladesh), under the sub-licensing agreement from Company B. The advertising and sponsorship rights comprised of the following:
  - Logo rights – right to display the logo of third parties at certain specified places such as the sporting attire of cricket team members.
  - Advertising privileges – right to claim itself as the 'official advertiser' and 'official partner'.
  - Promotional activities rights – right to organise promotional events for the products of third parties etc.
  - Rights of complementary tickets – access to a fixed number of tickets to the tournaments.

The taxpayer acquired similar rights for the West Indies Cricket Team in respect of the ICC Champions Trophy, 2013 (in England and Wales) and ICC World T20, 2014 (in Bangladesh) under the sub-licensing agreement from Company B.

The taxpayer, in turn, entered into separate agreements with third parties in India and granted the aforesaid rights to such third parties.

- While making remittance towards the rights acquired under sub-licensing agreement from Company B, the taxpayer did not deduct tax at source (TDS) under section 195 of the Income-tax Act, 1961 (the Act) based on the premise that the event(s) were held outside India. Thus, receipts arising therefrom are not taxable in the hands of Company B as the same did not accrue or arise in India.
- The Tax Officer, while rejecting the claim of the taxpayer, held as follows:
  - The payments made by the taxpayer to Company B are for the use or right to use of the advertisement rights, which being in the nature of the intellectual property, qualify as 'royalty' as per Explanation 2(iii) to section 9(1)(vi) of the Act and thus, are liable to TDS under the Act.
  - In light of the LoB clause of the DTAA, the benefits of the DTAA are not available to Company B considering that:
    a) Company B is merely a conduit, incorporated by Company A to avail DTAA benefits.
    b) Company B had no role in the active or actual exploitation of rights.
    c) The agreement for the sub-licensing of rights pertaining to the West Indies Cricket Team was executed among the taxpayer and Company B prior to the execution of the contract between Company A and West Indies Cricket Board, and thus, the same is a colourable device.
- On further appeal before the Commissioner of Income-tax (Appeals) [CIT(A)], the CIT(A) held as follows:
  - The benefit of the DTAA is available to Company B, and invocation of the LoB clause is not warranted.
  - The payment made to Company B was bifurcated into two categories in the ratio of 60:40 *viz.* Category P – payment in respect of rights for the display of logo on the apparel of cricket team members, display of contents on billboards and advertising of the products of the taxpayer's clients, and Category Q – payment made for the use of the name 'Official partner' or 'Official advertiser' in respect of the teams, providing links on the website and use of various items (which include photographs, etc.) of the teams for promoting products related to the taxpayer's clients.
  - Category P payment does not qualify as royalty either under the Act or the DTAA, and Category Q payment is covered within the ambit of 'copyright of literary work' and 'trademark' under the DTAA as well as 'rights in respect of trademark or similar property' under the Act, and thus, is in the nature of royalty.

Issues before the Tribunal

- Whether Company B is eligible to claim DTAA benefits in light of the LoB clause?

- Characterisation of receipts in the hands of Company B - whether 'royalty'?

Tribunal's ruling

- Company B is not a conduit company, and the LoB clause cannot be invoked on account of the following:
  - The Malaysian office (Company B) is the head office where all the senior management team members are located. It is well-equipped, with sufficient staff teams and is run effectively under the direction of the CFO, COO and CEO of the company.
  - All sub-license agreement(s) entered into by Company B are not necessarily only with Indian clients. Thus, the activities of Company B cannot be held to be country or DTAA specific. In fact, the total revenue earned by Company B is much higher than the remittance(s) made by the taxpayer to Company B.
  - Company B was incorporated prior to the incorporation of Company A and the taxpayer. Moreover, all the entities were in existence much prior to entering into the agreement(s) or transaction(s) under consideration.
- The fact that rights were granted to the taxpayer by Company B prior to the granting of same by the West Indies Cricket Board to Company A cannot be taken as the basis to deny DTAA benefit. The West Indies Cricket Board had already confirmed that they intend to contract with Company A. All the parties, including the West Indies Cricket Board and the sponsor, honoured all the agreements, and the Revenue has not brought any evidence contrary to the above on record.
- Payment towards rights under the sub-licensing to Company B is only for the publicity of the sponsor either by displaying the corporate or brand logo or trademark of the sponsor or attending the sponsor's promotional activities etc. (and not 'for the use of, or the right to use, any copyright'). Thus, such payment is not covered within the purview of 'royalty' under the India-Malaysia DTAA. In this regard, the Tribunal relied on the Delhi High Court decision in the case of Sahara India Financial Corporation Limited[2].

The takeaways

Presently, the Indian Government has been increasingly introducing the LoB clause in the DTAAs, and the same is likely to be tested more often by the Indian Revenue authorities going forward while granting DTAA benefits for the payments to non-residents. This is a welcome ruling, where the Tribunal rejected the invocation of the LoB clause having regard to the *bonafide* business activities carried out by the non-resident payee and other relevant considerations.

[2] DIT *v.* Sahara India Financial Corporation Limited [2010] 321 ITR 459 (Delhi)

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