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Tax alert: Payment for advertising package/rights not royalty

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The Mumbai Bench of the Income-tax Appellate Tribunal (ITAT), based on facts of the case, has rendered its decision that payment made by an Indian company to its Malaysian group company for advertising package/ rights is not taxable as 'royalty' as per the provisions of the India-Malaysia tax treaty. Further, the ITAT has also held that Article 28 of India-Malaysia tax treaty (relating to limitation of benefits) could not be invoked.

In a nutshell

When Malaysian company was found to be existing much prior to Cayman Island company and the taxpayer, and its revenue and set-up, were not disputed by the Revenue, it would be wrong to allege that the Malaysian company was a mere conduit and paper company existing merely to avail the benefits of India-Malaysia tax treaty. Hence, Article 28 of India-Malaysia tax treaty (relating to limitation of benefits) could not be invoked.

The advertising package/rights licensed by the taxpayer in respect of both the cricket teams, was only for publicity of the sponsor either by displaying the corporate/brand logo or trademark of the sponsor or displaying sponsor's name as 'official sponsor', or attending the sponsor's promotional activities.

There was no transfer of a copyright or the right to use the copyright.

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Background:

- The taxpayer[1] is an Indian company engaged in the business of seeking and endorsing sponsorship deals for athletes and carrying on the business of rights sponsorships for any sports and entertainment related accessories, including jerseys, and arranging sports and entertainment related tours in India and abroad.
- The taxpayer is a wholly-owned subsidiary of an entity based in Cayman Islands (C Co). C Co being the holding company has 11 subsidiaries around the world [including the taxpayer and a company based in Malaysia (M Co)]. M Co is the company through which C Co distributes the advertising and other rights acquired by them.
- M Co acquired advertising package/rights from C Co (C Co had acquired these rights from 'A' and 'B' cricket team). M Co entered into separate agreements with the taxpayer for sub-licensing the advertising package/rights of Country 'A' and Country 'B' cricket team, respectively. In respect of both the above agreements, the advertising package/rights referred to are:
  a. Logo rights;
  b. Advertising privileges;
  c. Promotion activities rights; and
  d. Rights to complimentary tickets.
- In terms of these agreements, the taxpayer made remittance to M Co and did not deduct any tax at source (TDS) under section 195(1) of the Income-tax Act, 1961 (ITA) [relating to deduction of tax at source on income chargeable to tax in case of non-resident taxpayer] on the basis that the income was arising from the events held outside India and had accrued outside India and not in India.
- The Assessing Officer (AO-TDS) passed an order under section 201(1) and 201(1A) of the ITA [relating to consequences for failure to deduct TDS] holding that:
  — The taxpayer made payment to M Co for the use or right to use of the advertisement rights, which were in the nature of the intellectual property (IP) and therefore the consideration paid by the taxpayer fell under the category of 'royalty' under clause (iii) to explanation 2 of section 9(1)(vi) of the ITA [relating to taxability of 'Royalty' income of non-resident taxpayer].
  — The advertising package/rights were sub-leased by C Co to the taxpayer through M Co only to avail the benefit of the India-Malaysia tax treaty since there was no tax treaty between India and Cayman Islands.
  — The consideration for use of rights was paid by the taxpayer to M Co, which had no role in the active or actual exploitation of rights and thus M Co was just a conduit 100% subsidiary company.
  — Since the affairs were managed in such a manner only to take benefit of the India-Malaysia tax treaty, hence Article 28 of the India-Malaysia tax treaty [Limitation of benefits], was applicable to the present case.
  — Accordingly, the taxpayer was required to deduct tax at source on the payments made to M Co.
- Aggrieved, the taxpayer filed an appeal and in the course of appeal proceedings, the matter reached before the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant provisions in brief:

ARTICLE 12(3) of the India-Malaysia tax treaty [relating to Royalties]:

"3. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films or films or tapes used for television or radio broadcasting, any patent, trade mark, design or model, plan, secret formula or

[1] ITO (TDS), 4(1)(2), Mumbai vs. Total Sports & Entertainment India Pvt Ltd [2023] ITA No. 5717/Mum/2016 (Mum-Trib.)

process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information (know-how) concerning industrial, commercial or scientific experience."

ARTICLE 28 of the India-Malaysia tax treaty [relating to Limitation of Benefits]:

"1. The provisions of this Agreement shall in no case prevent a Contracting State from the application of the provisions of its domestic law and measures concerning tax avoidance or evasion, whether or not described as such.

2. A resident of a Contracting State shall not be entitled to the benefits of this Agreement if its affairs were arranged in such a manner as if it was the main purpose or one of the main purposes to take the benefits of this Agreement.

3. The case of legal entities not having bonafide business activities shall be covered by the provisions of this Article"

Decision of the ITAT:

The ITAT noted / observed as follows:

Arrangement:

- C Co had entered into a contract with 'A' cricket team for sponsorship rights of its national cricket team comprising such players as announced by team from time to time including coach(es), and others in respect of two tournaments. Under the aforesaid agreement, C Co was granted rights, such as logo rights, advertising rights, promotional activities rights, and rights to complimentary tickets, collectively referred to as 'sponsorship rights'. Further, it was also agreed that sponsorship rights could be sub-licensed by C Co to its clients. Under the agreement, the IP right of C Co and 'A' cricket team would remain their own and this agreement would not affect their ownership in any way unless mutually agreed upon.
- Further, 'A' cricket team was the owner of the patent, copyright, trade secrets, trademark, and any other IP rights which subsist in sporting apparel.
- Vide another agreement, C Co sub-licensed these rights to M Co. These rights were further sub-licensed to the taxpayer vide agreement entered into between M Co and the taxpayer.
- Finally, vide a separate agreement, the taxpayer granted these rights to a company registered in India under the provisions of the Companies Act and having a corporate office in India.
- Similar arrangement was made with 'B' cricket team, which the taxpayer ultimately vide separate agreement granted advertising rights to another Indian company.

Commercial expediency / business rationale for setting up M Co and applicability of Article 28 of the India-Malaysia tax treaty

- The Malaysian office was the head office where all the senior management team members were located.
- The rights obtained by C Co as the parent company or other companies in the group were generally sub-licensed to/routed through M Co (as the head office entity), as the Malaysian office was well equipped, with sufficient teams of staff, and was run effectively under the direction of Chief Financial Officer, Chief Operating Officer, and Chief Executive Officer.
- Thereafter, M Co entered into a sub-license agreement with different other subsidiaries of the group worldwide, taking into consideration the nature/type of sports/event popular or of interest in the country concerned.
- While the rights acquired by C Co were sub-licensed to M Co, however not all sub-license agreements entered into by M Co were necessarily only with the client in India.

- As per the turnover of M Co, the revenues were much higher than the revenue earned by M Co out of the remittance made by the taxpayer, which proved that the taxpayer, as well as others in the Group, had bona fide business activities and the transaction giving rise to remittance was in the normal course of the business.
- M Co was incorporated on 22 November 1999, while C Co was incorporated subsequently on 10 July 2000. The taxpayer in the present case was incorporated on 07 July 2004.
- It could not be said that C Co, M Co , and the taxpayer were incorporated only for the purpose of entering into a contract with the cricket team. In view of the set-up of M Co and scale of revenue earned by the M Co, it could not be said that M Co had no role to play in the entire set-up.
- When M Co was found to be existing much prior to C Co and the taxpayer, and its revenue and set-up were not disputed by the Revenue, it would be wrong to allege that M Co was a mere conduit and paper company existing merely to avail the benefit of India-Malaysia tax treaty.
- Hence, the invocation of Article 28 of India-Malaysia tax treaty in the present case was to be quashed.

Whether the payments made to M Co were 'Royalty'?

- In order to be covered under the definition of term 'Royalty' under the provisions of Article 12(3) of the India-Malaysia tax treaty, the payment needs to be the consideration for the following:-
  (a) use of or right to use any copyright of literary, artistic or scientific work including cinematograph films or films of tapes used for television or radio broadcasting;
  (b) any patent, trademark, design or model, plan, secret formula or process;
  (c) for the use of or the right to use industrial, commercial or scientific equipment, or for information (no-how) concerning industrial, commercial scientific experience.
- From the perusal of each right in the advertising package/rights licensed by the taxpayer in respect of both the cricket teams, the same was only for publicity of the sponsor either by displaying the corporate/brand logo or trademark of the sponsor or displaying sponsor's name as 'official sponsor' or attending the sponsor's promotional activities.
- The Delhi High Court in an earlier ruling[2], had held that similar rights (being sponsorship benefits in connection with certain tournament) would not constitute 'Royalty' under the India-Canada tax treaty on the following basis:

  "It is apparent that unless and until the payment is in connection with the right to use or is by way of consideration for the right to use any of the three categories, the payment cannot be termed as a "'royalty"'…

  …It is apparent that the categories (a) and (b) obviously do not arise…

  …it would have to be either as consideration for the copyright or for the right to use a copyright in any of the four categories of works mentioned therein, namely, (i) literary; (ii) artistic; (iii) scientific work; and (iv) cinematographic films and films or tapes for radio or television broadcasting…

  …What was failed to be noted was that there was no transfer of a copyright or the right to use the copyright and, therefore, any payment made by the taxpayer would not fall within article 13(3)(c) of the said India-Canada tax treaty. The reference in article 13(3)(c) is to "any copyright" and it is not a reference to "any right".
- Since in the case under consideration the rights of similar nature were involved and the definition of the term 'Royalty' in India-Malaysia tax treaty is worded similarly to the provisions of India-Canada tax treaty, therefore the payment in respect of aforesaid rights would not fall in the category of 'royalty' under Article 12(3) of the India-Malaysia tax treaty.

[2] DIT vs Sahara India Financial Corporation Ltd [2010] 321 ITR 459 (Delhi-HC)

In view of the above, the ITAT allowed the taxpayer's appeal and held that the payment to M Co by the taxpayer for advertising package/rights in respect of both the cricket teams was not in the nature of 'royalty'.

Comments:

Typically, a tournament / event has various rights (such as advertising / promotional rights) associated with it and the same may be exploited for various purposes. Granting of advertising/promotional rights to agencies/companies, especially in case of sports tournaments or events related to sports, is common. The ITAT, based on facts of the case has held that payment for advertising package/ rights is not in the nature of 'royalty' under the Article 12 of the India-Malaysia tax treaty.

While holding the same, the ITAT has held / upheld the following:

- When Malaysian company was found to be existing much prior to the Cayman Islands company and the taxpayer, and its revenue and set-up were not disputed by the Revenue, it would be wrong to allege that the Malaysian company was a mere conduit and paper company existing merely to avail the benefits of India-Malaysia tax treaty. Hence, Article 28 of India-Malaysia tax treaty (relating to limitation of benefits) could not be invoked.
- The advertising package/rights licensed by the taxpayer in respect of both the cricket teams, the same was only for publicity of the sponsor either by displaying the corporate/brand logo or trademark of the sponsor or displaying sponsor's name as 'official sponsor' or attending the sponsor's promotional activities.
- There was no transfer of a copyright or the right to use the copyright.

Separately, it may be pertinent to note that the ITAT has observed that since the payment was only alleged to be royalty by the Revenue, there was no need to examine taxability under any other provisions of the India-Malaysia tax treaty, in the case under consideration.

Taxpayers with similar facts may evaluate the impact of this ruling to the specific facts of their cases.

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