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Income from grant of distribution rights is not royalty

The Delhi Bench of the Income-tax Appellate Tribunal held that distribution revenue towards grant of distribution rights is not taxable as royalty under Article 12 of the India-USA tax treaty

Background:

- The taxpayer is a tax resident of USA, deriving advertisement and distribution income by granting exclusive rights to an Indian Company (I Co), to sell advertisement on the products and to distribute, amongst others, the following products:
  - Satellite delivered television services;
  - Any other television, interactive and / or telecommunications service for which the taxpayer holds or acquires advertising and distribution rights for the relevant territory in the future.
- I Co acted as an exclusive distributor of the products to cable operators and other permitted systems on 'principal-to-principal basis 'as per the distribution agreement. The distribution agreement allowed the I Co to distribute the products to various cable operators and ultimately to consumers in India. The distribution revenue collected by I CO was shared with the taxpayer. The ownership of the copyright in the content always remained with the taxpayer and was not transferred to I Co or the sub-distributor.
- The taxpayer declared 10% of the advertisement and subscription revenue received from Indian sources as net profit chargeable to tax in India in its return of income for Financial Years (FY) 2008-09, 2009-10, 2011-12 and 2012-13, corresponding to Assessment Years (AY) 2009-10, 2010-11, 2012-13 and 2013-14.
- The Assessing Officer (AO) treated the distribution revenue to be royalty under section 9(1)(vi) of the Income-tax Act, 1961 (ITA) and Article 12 of the India-USA tax treaty. The AO on examination of agreements and documents, inter alia, in the draft order held that payment received by the taxpayer for grant of right or license to distribute the channel in India is tantamount to transfer of rights including the granting of license in respect of any copyright, etc. and thus, amounted to royalty. The same was on the following basis:
  - The taxpayer granted various rights relating to its products including the right to sub-license.
  - The taxpayer by allowing I Co to sub-distribute the encrypted televisions signals for commercial exploitation granted the 'right to communicate the work to public' as defined under section 2(ff) of the Copyright Act, 1957 (CA).

  As per section 2(ff) of the CA- "communication to the public" means making any work or performance available for being seen or heard or otherwise enjoyed by the public directly or by any

means of display or diffusion other than by issuing physical copies of it, whether simultaneously or at places and times chosen individually, regardless of whether any member of the public actually sees, hears or otherwise enjoys the work or performance so made available

- In appeal proceedings, the matter reached the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT noted that the only issue, which required its consideration, was whether distribution revenue was royalty in terms of Article 12 of the India-USA tax treaty.
- The ITAT noted the following:
  - As per the agreement between the taxpayer and the I Co, the taxpayer had the sole right to determine the content of the products and also the right to change such content from time to time and all the copyrights and other priority rights in the products and in any promotional material vested in the taxpayer alone. The copyright in the product always remained with the taxpayer and was never transferred.

    The ability to initiate legal action against the infringer of the copyright by I Co was merely a commercial term incorporated in the agreement to safeguard the interest of the taxpayer situated in the USA.
  - The taxpayer merely provided right to distribute the product. The I Co did not have any kind of right to edit, interpret, add to the products distributed by it.
  - The term 'copyright' had been defined in section 14 of the Copyright Act, 1957 (CA) and 'broadcast reproduction right' had been defined in section 37 of the CA and both were two distinctive and separate rights.

    The Bombay HC in an earlier case[1] had observed that there was a difference in 'copyright' and 'broadcasting reproduction right'. Section 37 of the CA separately defined the 'broadcast reproduction right and therefore it was different from the payment of any copyright in literary, artistic or scientific work.
- In view of the above, the ITAT held that the taxpayer had only granted commercial rights in the nature of 'broadcast reproduction right' to the I Co, which had been separately defined under section 37 of the CA and therefore, it could not be held that revenue derived by the taxpayer for distribution of products was taxable as 'royalty', albeit it was a business income of the taxpayer.

Accordingly, the ITAT deleted the additions made by the AO and held that distribution income was not taxable as royalty.

[1] CIT v. MSM Satellite (Singapore) Pte. Ltd. [2019] 106 taxmann.com 353 (Bombay HC)

Comment:

- Taxability of distribution income as royalty has been a subject matter of litigation. This ruling reaffirms the principle that payment received on grant of distribution rights is not taxable as royalty under the provisions of the India-USA tax treaty.

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