Deloitte.

Tax Alert | Delivering clarity

23 April 2020

Scope of business connection in India for event organized overseas

The Mumbai Bench of the Tribunal considering the changing business models has held that appearance of a celebrity (US tax resident) in an event outside India, resulted in an India business connection, as the event was intended for promoting the business of the taxpayer in India. Accordingly, the payment in respect of celebrity appearance accrued and arose in India and was subject to withholding tax in India.

Facts of the case:

- Volkswagen Finance (P.) Ltd. (the taxpayer)[1] is an Indian company.
- The taxpayer and Audi India (a division of Volkswagen Group Sales India Ltd) jointly planned an event in Dubai for launch of Audi A-8L facelift model. While the event was held in Dubai, the purpose of the event was the launch of a new model of Audi car, Audi A-8L facelift model for the Indian market.
- The taxpayer had flown in about 150 people mostly prospective buyers and some journalists to the launch ceremony.
- Kim Productions Inc., a company incorporated in the USA, agreed to facilitate the appearance of Nicholas Cage (celebrity) for three consecutive hours. In exchange, the taxpayer paid consideration of US$ 440,000 and other incidental costs.
- The taxpayer and Audi India, as a part of the arrangement, received full rights of the launch event capturing the celebrity's presence across all platforms for below-the-line publicity on internet, in press releases, news reports, social media, in Audi Magazine, etc. for a period of 6 months from the date of launch event, and for an unlimited period of time only for internal usage within the Volkswagen Group.
- The taxpayer claimed that since the event took place in Dubai, UAE and the celebrity made his appearance at the event in Dubai, appearance fee was not taxable in India (as the fee did not accrue or arise in India, or deem to accrue or arise in India). Accordingly, the taxpayer did not withhold tax from the payment in relation to the celebrity appearance fee.
- The Assessing Officer (AO) held that the payment was taxable in India as royalty under Section 9(1)(vi) of the Income-tax Act, 1961 (Act) as well as under Article 12 of the India-USA tax treaty. Accordingly, the taxpayer was required to withhold tax.
- On appeal, the Commissioner of Income-tax Appeals [CIT(A)], confirmed the action of the AO and also held that the whole purpose of organizing an India-centric event at Dubai was to avoid "attraction of clause regarding income accruing or arising in India".
- Aggrieved by the order passed by the CIT(A), the taxpayer filed an appeal with the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT).

[1]Volkswagen Finance (P.) Ltd. vs Income Tax Officer (International Taxation) 115 taxmann.com 386 (Mumbai ITAT) (2020)

Decision of the ITAT:

- The ITAT held that the case involved was whether the income accrued or arose in India or was deemed to accrue or arise in India under Section 5 read with Section 9(1)(i) of the Act.
- The ITAT observed that a plain reading of the provisions of Section 5(2)(b) of the Act shows that the event resulting in accrual of income must take place in India. However, given the broader scheme of the Act, an income which, directly or indirectly, accrues or arises to a non-resident, through or from any business connection in India, is also chargeable to tax in India.
- While holding that the term 'business connection' under the Act is inclusive and not an exhaustive definition, the ITAT referred to the landmark judicial precedent of the Supreme Court in the case of R. D. Aggarwal[2] for its interpretation. In the said case, it was held that "a relation, to be a 'business connection', must be real and intimate, and through or from which income must accrue or arise, whether directly or indirectly, to the non-resident".
- Accordingly, the ITAT held that business connection is not only a tangible thing like people or businesses, but, a relationship too, as long as such a relationship, real or intimate, results, directly or indirectly, in an income accruing or arising to the non-resident.
- Further, the ITAT took note of the following key facts:
  - The Audi A-8L facelift launch event was India-centric;
  - The event was for the purpose of promoting business in India which generates enquiry of potential customers in India who in turn would like to purchase Audi cars in India and finance the same from the taxpayer. It was for this reason that the taxpayer was a part of this event;
  - While the event physically took place in Dubai, UAE, the benefits of the event (by way of below-the-line publicity on internet, press releases, news reports, social media of Audi 8L facelift in India) accrued to the taxpayer and Audi India;
  - Below-the-line activities would have, as their targets, Indian customers who would be in addition to the 150 persons flown to Dubai for being present at the launch event;
  - The entire expenses of the launch event were treated as expenses and the taxpayer claimed a deduction of the same.
- In light of the facts of the case, the ITAT held that all the benefits accrued to the taxpayer in India, and it was on account of these benefits that the international celebrity was paid for his participation in the Dubai Audi A-8L facelift event. The ITAT held that the business connection in India is intangible (as it is a relationship rather than an object) but it is significant business connection which has resulted in income accruing and arising to the non-resident. The income thus, based on facts, accrued and arose by reason of business connection in India.
- Further, the ITAT observed that business models are changing but post internet and post the social media revolution, business models have changed so drastically that the very fundamental rules of conducting business have changed. It held that, considering the peculiar facts of the case under consideration, past judicial precedents dealing with the concept of business connection were in the context of primitive trade, commerce and services and were not relevant in the context under consideration. As per the ITAT, the issue under consideration was a new issue and was required to be dealt with on first principles. Hence, it did not deal with such past judicial precedents relating to business connection.

[2] CIT v. R D Aggarwal & Co. (1965) 56 ITR 20 (SC)

- Further, the ITAT dealt with the provisions of Section 115BBA of the Act pertaining to taxation of a non-resident entertainer (not being a citizen of India), which includes any income received or receivable from his performance in India. The ITAT held that the same deals with mode and rate of taxation in hands of non-resident entertainer and hence, if an income is not covered under the said provisions, then the same was taxable at normal tax rates.
- The ITAT also dealt with the contention of the taxpayer that since the event was held outside India, the income was not taxable as per Article 18 (dealing with income of entertainers) and under Article 23(1) (dealing with taxation of Other Income) of the India-USA tax treaty, as the event was held outside India. The ITAT held that Article 23(3) of the India-USA tax treaty allows India (being the country in which income arises), to tax such income if the domestic tax law of India so provides. Thus, the ITAT held that treaty protection was not available to the taxpayer under Article 23(1) of the India-USA tax treaty.
- Considering all of the above, the ITAT concluded that the income embedded in payment to the international celebrity, for participation in Dubai A-8L launch event, was taxable in India and accordingly, the taxpayer had the liability to withhold taxes in India.
- Separately, the ITAT also dealt with the contention of the taxpayer that the case of the AO was confined to taxability as royalties under the Act and that it was not open for the ITAT to go beyond the case made out by the AO and tax the income as business income. The ITAT relying on the judicial precedent in the case of Jeypore Timber & Venture Mills[3] observed that it was duty bound to adjudicate the issue raised and it should not result in any enhancement of assessment or it should not be decided without affording due opportunity to the taxpayer.
- It held that in the case under consideration, the taxpayer himself had raised the issue of taxability under Section 5 read with Section 9(1)(i) of the Act and it had adjudicated upon the same. Further, it did not result in an enhancement as the taxpayer was not saddled with a new withholding tax liability. The ITAT relied on the judicial precedent of the jurisdictional Mumbai Special Bench of the Income-tax Appellate Tribunal in the case of Tata Communications Limited[4] in this regard.

Observations:

- Business connection in India has been a litigative issue. The ruling has been rendered considering changing business models for the purpose of interpretation of the term business connection in India (even where activities are not carried out physically in India). Clients may want to assess impact of the same, *inter alia*, while determining tax liability for activities undertaken outside India but having nexus with India.
- Taxpayers also need to consider the attribution to business connection once it is held that a business connection is in India.

[3] Jeypore Timber & Veneer Mills (P.) Ltd. vs CIT (1982) 137 ITR 415 (Gau HC)

[4] Tata Communications Ltd. vs JCIT (2009) 121 ITD SB 384 (Mum ITAT)

Deloitte.