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Global Business Tax Alert

Sharp Insights

The Delhi Tribunal, in the case of Reebok India Company [ITA Nos. 954 and 1620/Del/2016] held that payment made by the taxpayer as 'Rights fee' was exclusively for use of marks for the purposes of promotion and advertisement and not for manufacture and sale of licensed products. Therefore, the payments were not in nature of 'royalty' or 'fees for technical services' ('FTS').

Issue no: GBTA/32/2017

In this issue:

Background

- Reebok India, the taxpayer, an Indian company, entered into an agreement with International Cricket Council ('ICC'), a resident of British Virgin Islands.
- As per the terms of the agreement, the taxpayer was granted `promotional, advertising, marketing and other commercial rights' on a worldwide basis in connection with ICC events and was designated as the 'Official Partner of ICC' and was allowed the right to use ICC's logo, designations, marks etc.
- The agreement consisted of a bundle of rights wherein ICC listed the manner in which Reebok could advertise/market its products during ICC events for a consolidated consideration.
- The Assessing Officer ('AO') noticed that as per the terms of the agreement, the taxpayer was allowed the right to use designations, marks and ICC logo etc., which in his opinion fell under the definition of 'royalty' as defined under section 9(1)(vi) of the Income Tax Act, 1961 ('the Act').
- The AO further held that such payments were in the nature of FTS, as the services provided by ICC were in the nature of 'managerial services'.
- As the taxpayer had not deducted tax at source under section 195 of the Act in respect of payment made to ICC, the AO proposed disallowance under section 40(a)(i) of the Act in the draft order.
- The taxpayer challenged the proposed disallowance before the Dispute Resolution Panel ('DRP'), which held that the benefits availed by the taxpayer from ICC, did not fall within the ambit of royalty or FTS, and therefore no disallowance was called for.
- Aggrieved by the direction of DRP, the Revenue filed an appeal before the Delhi Tribunal.

Ruling of the Tribunal

- The Tribunal made a reference to various clauses in the agreement and observed that ICC is the official international governing body for cricket and the taxpayer is desirous of becoming an Official Partner of ICC. ICC has granted the taxpayer certain 'promotional, advertising, marketing and other commercial rights' on a worldwide basis in connection with ICC events. The Tribunal thereby broadly classified the rights into two baskets *viz.*, 'promotional and advertising' and 'marketing' rights.
- The Tribunal further observed that the payment for the sale of licensed products is termed as 'royalty' and payment for the grant of rights is termed as 'Rights fee'.
- The present appeal is in respect of payment during the year as 'Rights fee' on account of the ICC cricket World Cup.
- The only question that arose was whether the 'Rights fee' can be categorised as being in nature of royalty or FTS.

Payment in the nature of FTS

- After analysing the agreement, the Tribunal observed that the 'Rights fee' was paid to ICC for assigning certain rights and not for rendering any managerial, technical or consultancy services. The payment for 'Rights fee' therefore cannot be considered as being in the nature of FTS.
- The tax department also accepted that the payment cannot be in the nature of FTS.

Payment in the nature of Royalty

- The Tribunal observed that a 'Rights fee' can be classified in in two categories, first (i) rights of advertisement including the right to use marks in connection with promotion and advertisement during ICC events and second (ii) rights in connection with the manufacture and sale of licensed products.
- The Tribunal held that ICC has not imparted any information concerning technical, industrial, commercial or scientific knowledge, experience or skill and therefore clause (iv) of Explanation 2 to Section 9(1)(vi) cannot be invoked.
- The Tribunal further stated that on a conjoint reading of clause (iii) and (vi) of explanation 2, it is clear that any consideration will assume the character of `royalty' if it is paid for the use of any patent, invention, model, design etc. or any services in connection with these.
- The Tribunal observed that on a meticulous reading of all the clauses of the agreement and the 'rights package', it is crystal clear that 20 out of the 21 rights are exclusively for advertisement and promotion in connection with ICC events with or without the use of designations and marks etc. The said payment for advertisement and publicity during ICC events does not fall within the realm of 'royalty'.
- In relation to the payment of royalty for rights in connection with the manufacture and sale of licensed products, the Tribunal observed that the same would qualify as 'royalty' as per clause (iii) of Explanation 2 to section 9(1)(vi) of the Act.
- The Tribunal observed that there is a separate provision in the agreement for payment of royalty on the manufacturing and sale of licenced products both under the 'royalty' and 'Rights fee'. It is pertinent to note that consideration for the said right in 'Rights fee' agreement was a miniscule part. Due to non-provision of any mechanism in the agreement for apportioning 'Rights fee' amongst 21 rights, it was held that no part of 'Rights fee' was attributable to the use of marks for the manufacturing and sale of licenced products, the consideration for which was exclusively covered under 'royalty' clause of the agreement.
- The Tribunal also made a reference to the decision of the Hon'ble Delhi High Court[1], wherein it was held that the use of trademark, trade name etc. in rendering of advertisement, publicity and sales promotion services is neither in the nature of royalty nor FTS.
- Based on the above, the Tribunal held that the payment for 'Rights fee' is not in the form of royalty.

Payment in the nature of Business income

- The Revenue also contended that India does not have a tax treaty with British Virgin Islands and accordingly, income of ICC would be taxable because of business connection under section 9(1)(i) of the Act.
- The Tribunal rejected Revenue's contention after noting that taxpayer had specifically argued before AO that ICC had no business connection in India.
- The Tribunal, therefore, held that the payment made by the taxpayer to ICC as 'Rights fee' is not in the nature of 'royalty' or 'FTS' and as such the taxpayer was not obliged to deduct tax at source on this payment. Accordingly, the provisions of section 40(a)(i) of the Act are not attracted.

[1] Sheraton International Inc (313 ITR 267)

Conclusion

- The Tribunal held that payment of 'Rights fee' cannot be considered as being in the nature of FTS since the `Rights fee' was paid for assigning certain rights and not for rendering any managerial, technical or consultancy services.
- The Tribunal held that the payment of 'Rights fee' was exclusively for use of marks for purposes of promotion and advertisement and the same is not in the nature of royalty. Whereas, payment for manufacture and sale of licensed products was in the nature of royalty. However, (in the absence of a separate consideration and due) to non-provision of any mechanism in the agreement for apportioning 'Rights fee' amongst 21 rights, no part of `Rights fee' can be attributable to the use of marks for the manufacture and sale of licensed products, consideration for which is exclusively covered under `royalty' clause of the agreement.
- The Tribunal further held that if receipt itself was not taxable in India, there will be no liability on the part of taxpayer to withhold tax and consequently no question of disallowance under section 40(a)(i) of the Act, would arise.

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