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TAX FLASH NEWS

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Payment for advertising and publicity, with or without the use of marks, identification or logo of non-resident entity is not taxable as royalty or FTS under the Income-tax Act

Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Reebok India Company[1] (the taxpayer) held that the payment for advertising and publicity during ICC [2] events, with or without the use of marks, identification or logo of ICC, are not taxable as royalty under Section 9(1)(vi) of the Income-tax Act, 1961 (the Act) since ICC has not imparted any information concerning technical, industrial, commercial or scientific knowledge, etc. to the taxpayer. The consideration paid will be considered as royalty only 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 the payment for the use of marks, identification or logo is on two counts, that is, for advertisement and promotion, which is dealt with by 'rights fee' clause under the agreement and for manufacture and sale of products, which is dealt with by 'royalty' clause. It is only the latter, which is in the nature of 'royalty income' in the hands of ICC. However, in the present case, the payment is made for 'rights fee', which is exclusively for the use of marks of ICC for the purposes of promotion and advertisement and not for manufacture and sale of licensed products. Therefore, the payment made by the taxpayer to ICC towards 'rights fee' is not in the nature of `royalty' or Fees for Technical Services (FTS) covered under Section 9(1)(vi) or 9(1(vii) of the Act 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.

The Tribunal held that the payment for 'right fee' cannot be treated as FTS under Section 9(1)(vii) of the Act since the non-resident entity is not rendering any managerial, technical or consultancy services, but charging 'rights fee' for assigning certain rights as per the agreement.

Facts of the case

- During the year under consideration, the taxpayer entered into an agreement with non-resident[3] for granting of promotional, advertising and other commercial rights. The non-resident company has agreed to grant such rights on a worldwide basis in connection with ICC events.
- The agreement consists of a bundle of rights wherein ICC listed the manner in which the taxpayer could advertise/market its products during ICC events for a consolidated consideration. In terms of the said agreement, the taxpayer made payment for the acquisition of promotional, advertising and marketing rights to ICC without deducting tax at source.
- The Assessing Officer (AO) held that the payment for such rights is in the nature of royalty or FTS requiring deduction of tax at source. As per the terms of the agreement, the taxpayer was allowed right to use designations, marks and ICC logo, etc., which would fall under the definition of `royalty' under Section 9(1)(vi) of the Act. Such payment was also in the nature of FTS, as the services provided by ICC were in the nature of `managerial services'. In the absence of the

[1] Reebok India Company v. DCIT (ITA No. 954/Del/2016) – Taxsutra.com Note – This decision deals with various other issues. However, this flash news only deals with royalty and FTS related issue.

[2] International Cricket Council

[3] The non-resident is IDI and it is a commercial arm of ICC. ICC is a resident of British Virgin Islands and hence a non-resident under the Act.

taxpayer having deducted tax at source from the payment made to ICC, AO proposed disallowance under Section 40(a)(i) of the Act in the draft order.

- The Dispute Resolution Panel (DRP) held that the benefits availed by the taxpayer from ICC did not fall within the ambit of royalty or FTS and accordingly no disallowance was called for.

Tribunal's decision

- On reference to the terms of the agreement, it indicates that the taxpayer acquired broadly two types of rights, viz., `promotional and advertising' and `marketing' rights. Thus, the taxpayer pays for the sale of licensed products is `royalty' and what it pays for the grant of rights is `rights fee'.

- On reference to Section 9(1)(vii) of the Act, the payment for 'right fee' cannot be treated as FTS since as per the definition of FTS, it is a consideration for the rendering of any managerial, technical or consultancy services. On reference to the relevant clauses of the agreement, it indicates that ICC has charged INR45.6 million not for rendering any managerial, technical or consultancy services, but as 'rights fee' for assigning certain rights as per the agreement. Accordingly, it has been held that the payment made by the taxpayer to ICC cannot be considered as FTS.

- On reference to the relevant terms of the agreement, it indicates that ICC has not imparted any information concerning technical, industrial, commercial or scientific knowledge, etc., to the taxpayer. Therefore, the applicability of clause (iv) of Section 9(1)(vi) of the Act is ruled out. Further, conjoint reading of Clause (iii)[4] and (vi)[5] of Explanation 2 to Section 9(1)(vi), it is vivid 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.

- Rights fee is a package of rights conferred on the taxpayer. In all, there are 21 rights which have been awarded to the taxpayer. Having gone through the nature of these rights, we can classify them in two categories - the first category comprises of rights of advertisement including the right to use marks in connection with promotion and advertisement during ICC events and the second category comprises of rights in connection with the manufacture and sale of licensed products.

- Clause 2 of the agreement is unique from others as it is a combination of both such rights in as much as it allows the taxpayer to use the marks in connection with the manufacture, distribution, advertising, promotion and sale of products to indicate a sponsorship relations with ICC events and to use marks on licensed products.

- So far as part of the right which relates to the use of marks in connection with the `manufacture and sale' of products, it falls within the second category of rights and the other part of the right which relates to the use of marks in connection with the 'advertising and promotion' falls in the above first category.

- So far as the rights of advertisement and promotion to the taxpayer without the use of designations or marks etc. are concerned, such as, tickets, boards, and signage, demonstration, sale and display of products, Instadia video screens, these are purely in the nature of advertisement and hence payment for them cannot be considered as royalty in the hands of the recipient.

- As regard the rights of advertisement and promotion of the taxpayer with the use of designation or marks, such as, internet promotion, designations, part of marks and event identification, here again, the use of designations or marks is limited to the use during the advertisement and promotion of the taxpayer. These marks are used alongside the taxpayer's trademark or logo etc. for the purposes of advertisement and promotion and not for the sale of its licensed products.

- Relying on the Delhi High Court's decision in the case of Sheraton International Inc[6] it has been held that the consideration for the use of designations and marks of ICC by the taxpayer during its advertisement and promotion activities does not result in `royalty' income in the hands of the recipient. Accordingly, the payment for advertisement and publicity by the taxpayer during the ICC events, with or without the use of marks or identification, etc., does not fall within the realm of `royalty' in the hands of the recipient.

[4] Royalty means consideration for the use of any patent, invention, model, design, secret formula or process or trade mark or similar property

[5] Royalty means consideration for rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v) of Explanation 2 to Section 9(1)(vi) of the Act

[6] DIT v. Sheraton International Inc [2009] 313 ITR 267 (Del)

- The rights with the `manufacture and sale' of licensed products are not for any advertisement and promotion by the taxpayer but for the use of marks of ICC in manufacture and sale of licensed products. There is no bifurcation of consideration relatable to such rights individually. Apart from the payment of `rights fee', this agreement also requires payment of `royalty' by the taxpayer, which is a fee payable by the taxpayer to ICC for each licensed product sold as specified in the agreement.

- In terms of the agreement, the taxpayer shall be liable to pay royalty at the rate of 6 per cent on the wholesale price of cricket bats sold using its marks, 5 per cent on the wholesale price of other cricket equipments sold using its marks and 12.5 per cent on wholesale that there is a separate provision in the agreement for payment of royalty on the manufacture and sale of licensed products using the marks of ICC, which is obviously in the nature of `royalty' duly covered under Clause (iii) of Explanation 2 to Section 9(1)(iii) of the Act.

- Evidently, there is some overlap in the agreement in as much as the consideration for the right to use marks on the 'manufacture and sale of licensed products' has been covered under both under 'royalty' and `rights fee'. What is pertinent to note is that consideration for the use of marks on the manufactured products meant for commercial sale is exclusively covered under the `royalty' clause of the agreement and a minuscule part of the `rights fee' clause also embraces it.

- In the absence of any separate consideration for the part of Clause 2 of the agreement dealing with royalty and further due to non-provision of any mechanism in the agreement for apportioning `rights fee' among 21 rights, it has to be held that no part of `rights fee' is 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.

- Thus, taking a holistic view of the agreement, it is held that payment for the use of designations and marks etc. is on two counts, that is, for advertisement and promotion, which is dealt with by `rights fee' clause and for manufacture and sale of products, which is dealt with by `royalty' clause. It is only the latter, which is in the nature of `royalty income in the hands of ICC.

- In the decision of Sheraton International Inc, the services to be rendered by Sheraton were not only publicity, advertisement but also concerning sales, for which one composite payment was made, which was held to be not in the nature of 'royalty.' In the instant case, the payment of INR45.6 million is made for `rights fee', which is exclusively for the use of marks of ICC for the purposes of promotion and advertisement and not for manufacture and sale of licensed products.

- When a consolidated payment for both the advertisement and non-advertisement services was held to be not `royalty', it cannot be held payment only for the advertisement services, as royalty.

- The Tribunal held that the payment made by the taxpayer to ICC towards `rights fee' is not in the nature of `royalty' or FTS covered under Section 9(1)(vi) or 9(1)(vii) of the Act 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.

Our comments

The issue with respect to taxability of payment for advertising and publicity vis-à-vis use of the logo, etc., has been a matter of debate before the Courts. Various Courts have observed that the category of income would depend upon the 'predominant purpose for which the consideration is paid in a transaction'. Broadly, if the consideration is towards the 'right to commercially exploit the intellectual property in the product', then the same could be characterised as royalty.

The Delhi Tribunal in the case of Hero MotoCorp Ltd[7] held that the payment made in relation to the sponsorship of various sports events organised by ICC is not taxable as royalty since it was purely for advertisement and publicity of the brand name and for the promotion of its product during the cricketing events of ICC, and not the payment of royalty. The agreement in question includes sponsorship rights such as advertising on billboards, advertisement in official brochure, the website of ICC, etc., which is purely incurred for the promotions, advertisement and publicity of the taxpayer's brand name and products. If incidentally, the proprietary trademark or logo of ICC is put alongside the taxpayer's logo, it is only incidental to the main services obtained by the taxpayer.

[7] Hero MotoCorp Ltd v. ACIT [2013] 60 SOT 25 (Del)

The Delhi Tribunal in the present case has held that the payment for advertising and publicity with or without the use of marks or identification, or logo of ICC, is not taxable as royalty/FTS under Section 9(1)(vi)/(vii) of the Act.

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