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TAX FLASH NEWS

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Payment for sponsorship rights of cricket tournament is not taxable as royalty under the India-Malaysian tax treaty. Invocation of LOB provisions denied

Executive Summary

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Total Sports & Entertainment India P. Ltd.[1] (TSEIPL) dealt with the issue of applicability of Limitation of Benefit (LOB) provisions under the India-Malaysia tax treaty (the tax treaty) and taxability of the payment to the Malaysian entity for sponsorship rights[2] of the cricket tournament.

The Tribunal rejected the invocation of LOB provisions of the tax treaty as well as the conduit company related arguments on the basis of various factors like-

- The head office was in Malaysia where all the senior management team members were located and thus transactions were routed through Malaysia.
- Total revenues of the Malaysian company were much higher than the revenue earned by it from the Indian company.
- The Malaysian company was incorporated much earlier than its existing holding company and the Indian company.

The Tribunal observed that the Malaysian company had bona fide business activities and the transaction of sponsorship rights was in the normal course of the business. The Malaysian company was not a conduit, or a paper company existed merely to avail the benefit of the tax treaty. Thus, the invocation of LOB provisions was not correct.

With respect to the taxability of cricket sponsorship rights as royalty, the Tribunal observed that there was no transfer of copyright or the right to use the copyright. Such rights were only for publicity of the sponsor either by displaying the corporate/brand logo or trademark of the sponsor or displaying the sponsor's name as an 'official sponsor' or attending the sponsor's promotional activities. Thus, payment for such sponsorship rights was not taxable as a royalty under the tax treaty.

Facts of the case

- TSEIPL, an Indian company, is engaged in the business of seeking and endorsing sponsorship deals for athletes and carrying on the business of sponsorship rights for any sports and entertainment-related accessories, including jerseys and arranging sports and entertainment-related tours in India and abroad.
- TSEIPL is a wholly owned subsidiary of Cayman Island company (TSA Cayman). TSA Cayman has 11 subsidiaries around the world including TSEIPL and TSA Malaysia.
- TSA Cayman entered into a contract with Sri Lanka and the West Indies Cricket Board for sponsorship rights of certain cricket tournaments. Under the agreement, TSA Cayman was granted rights, such as logo rights, advertising rights, promotional activities rights and rights to complimentary tickets, which are collectively referred to as ‘sponsorship rights’. Vide another agreement, TSA Cayman sub-licensed these rights to TSA Malaysia who subsequently sub-licensed it to the taxpayer.
- In terms of this agreement, the taxpayer remitted to TSA Malaysia for sponsorship rights without tax deduction at source.

[1] ITO v. Total Sports & Entertainment India P. Ltd. (ITA No.5717/Mum/2016) – Taxsutra.com
[2] Logo rights, advertising rights, promotional activities rights and rights to complimentary tickets

- The TDS officer held that the consideration paid by TSEIPL was taxable as a royalty under Section 9(1)(vi). Further, the sponsorship rights were sub-leased by TSA Cayman to TSEIPL through TSA Malaysia only to avail the tax treaty benefit since there was no treaty with Cayman Islands. The TDS officer applied LOB provisions and denied the benefit of the India-Malaysia tax treaty to TSEIPL.

- The TDS officer argued that there was no commercial expediency in introducing TSA Malaysia between TSA Cayman and TSEIPL, when the sponsorship rights were required to be transferred to TSEIPL. Thus, TSA Malaysia was only a conduit to claim the benefit of the tax treaty.

Tribunal decision

Tax treaty benefit

- The Malaysian office was the head office where all the senior management team members were located. The rights obtained by TSA Cayman as the parent company or other companies in the group were generally sub-licensed to/routed through TSA Malaysia as the head office entity. The Malaysian office was well equipped, with sufficient teams of staff and was run effectively under the direction of Chief Financial Officer and Chief Executive Officer.

- Rights acquired by TSA Cayman were sublicensed to TSA Malaysia, however, all sublicense agreements entered into by TSA Malaysia were not necessarily only with the client in India.

- Total revenues of TSA Malaysia were much higher than the revenue earned by it out of the remittance made by TSEIPL, which proved that TSEIPL, as well as others in TSA group, had bona fide business activities and the transaction giving rise to remittance was in the normal course of the business.

- TSA Malaysia was incorporated in 1999. While TSA Cayman was incorporated subsequently in 2000 and TSEIPL was incorporated in 2004. Thus, when TSA Malaysia existed much prior to TSA Cayman and TSEIPL and its revenue and setup were not disputed by the TDS officer, it would be wrong to allege that TSA Malaysia was a mere conduit and paper company existing merely to avail the benefit of the treaty. Thus, the invocation of LOB provisions were not correct.

Royalty

- From the perusal of details of each right in the sponsorship rights, it was observed that such rights were only for publicity of the sponsor either by displaying the corporate/brand logo or trademark of the sponsor or displaying the sponsor's name as ‘official sponsor’ or attending the sponsor’s promotional activities.

- The Delhi High Court in the case of Sahara India Financial Corporation Ltd[3] decided the issue dealing with a similar type of rights under the India-Canada tax treaty in favour of the taxpayer. The High Court observed that the payment for the right of title sponsorship and the benefits connected therewith was not for the transfer of copyright or the right to use the copyright. Thus, such payment was not taxable as a royalty under the India-Canada tax treaty.

- Since the present case also dealt with rights of similar nature and the definition of ‘Royalty’ in the India-Malaysia tax treaty is worded similarly to the India-Canada tax treaty, the payment for sponsorship rights was not in the nature of royalty under the tax treaty.

Our comment

It has been observed that tax officers have been invoking LOB provisions in multi-layered companies holding that the ultimate holding company is a beneficial owner of the income. The tax officers have been disregarding the intermediate holding companies by treating them as conduit companies, formed to merely take advantage of a beneficial tax treaty and avoid paying taxes. In this decision, the Tribunal held that the Malaysian company was not a conduit, or a paper company existed merely to avail the benefit of the tax treaty. The Tribunal gave importance to various factors like revenue of the foreign party, functioning of senior management, time of existence of the company, etc. and rejected the invocation of LOB provisions. Based on the facts of each case, it is important to examine whether a particular intermediate holding company is a conduit / paper company or a company with real substance. Further with respect to the taxability of sponsorship rights, the Tribunal held that there was no transfer of copyright and thus the payment was not in the nature of royalty.

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[3] DIT v. Sahara India Financial Corporation Ltd, [2010] 321 ITR 459 (Del)

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