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TAX FLASH NEWS

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Foreign celebrity appearing in a product launch event organised abroad for promoting business in India, constitutes business connection in India

Recently, the Mumbai Bench of Income-tax Appellate Tribunal (the Tribunal) in the case of Volkswagen Finance Pvt Ltd.[1] (the taxpayer) dealt with an issue of taxability of payment made to a foreign celebrity for an appearance made in a product launch event held at Dubai for promoting business in India. The Tribunal held that while the event, in which appearance was made by the celebrity, was held outside India, all the benefits accrued to the taxpayer in India. On account of these benefits to the taxpayer in India, the foreign celebrity was paid for his participation in the Dubai car launch event. Thus, income accrued and arised in India due to business connection in India. Accordingly, income embedded in the payment to the foreign celebrity, for participation in Dubai launch event, was taxable in India. The taxpayer was liable to withhold taxes from the payment made to the foreign celebrity for appearance at the Dubai launch event.

Facts of the case

In 2014, the taxpayer (an Indian company), jointly with its related entity[2] planned an event in Dubai for the launch of a premium car for the Indian market. A US based company which organises event, agreed to facilitate the appearance of a foreign celebrity for three hours at this event. During the Assessment Year 2015-16, the taxpayer made a payment of 'appearance fee' plus other incidental costs such as travel, accommodation, etc. to the celebrity with respect to such event. However, the taxpayer did not deduct tax from the said remittance.

As a part of such arrangement, the taxpayer and the related entity had full rights to use all the event footage, material, films, stills, interviews, etc., capturing the foreign celebrity's presence, across all platforms for 'below the line publicity'[3] on the internet, in press releases, news reports and social media.

The taxpayer contended that deduction of tax was not required from appearance fee as the celebrity or his agent were not carrying out any activities in India. The appearance fees did not accrue or arise in India or deemed to accrue or arise in India.

The Assessing Officer (AO) observed that the payment made to the celebrity was taxable as royalty in India under the Income-tax Act, 1961 (the Act) and under the India-US tax treaty (tax treaty). The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO and also held that such fees may qualify as business income accruing or arising in India.

Tribunal's decision

Business connection

In case of a non-resident, under Section 5(2) of the Act there are only two situations whereby the income can be taxed in India. First, when the income is received or is deemed to be received in India in such year by or on behalf of such person[4] and second, when an income accrues or arises or is deemed to accrue or arise to him in India during such year[5].

[1] Volkswagen Finance Pvt Ltd. v. ITO [ITA No. 2195/Mum/2017, AY- 2015-16] - Taxsutra.com

[2] Audi India

[3] The expression 'below the line publicity' has been described as targeting 'a specific group of potential consumers', 'highly targeted, with advertisements being created keeping in mind the demographic and psychographic characteristics of a particular customer segment', and 'an advertising strategy where products are promoted in media other than mainstream radio, television, billboards, print, and film formats'

[4] Section 5(2)(a)

[5] Section 5(2)(b)

To trigger taxation under the first limb of Section 5(2)(b), the event resulting in accrual of income must take place in India which was not the situation in the present case. What results in an income accruing or arising to the foreign celebrity was participation in the car launch event, and this event has taken place outside India. The income to the celebrity cannot be said to have accrued or arisen in India. However, given the broader scheme of the Act, even such first limb needs to be read with, inter alia, Section 9(1)(i) of the Act which extends the scope of income accruing or arising in India by applying the deeming fiction[6].

The definition of 'business connection', as set out in Explanation 2 to Section 9(1)(i) introduced by the Finance Act 2003, is also an inclusive, and not exhaustive definition. The Supreme Court in the case of R D Aggarwal & Co[7] observed that 'a relation, to be a business connection, must be real and intimate, and through or from which income must accrue or arise, directly or indirectly, to the non-resident'. Therefore, a business connection is not only a tangible thing (like people, businesses etc.), but also a relationship.

The car launch event was India-centric and the entire expenditure for the launch of event were treated as expenditure of Indian entities. The event had physically taken place in Dubai but, the benefits of this event were to accrue to the taxpayer and other Indian entity (premium car company). The company had also invited 150 persons, mostly prospective buyers and some journalists, to Dubai. The cost of event was very high, and this expenditure could not have been justified for influencing car purchasing decisions of these less than 150 persons. The Tribunal observed that the MoU with celebrity's agent indicates that the predominant benefit of this event was 'below the line publicity' on internet, in press releases, news reports, social media for the launch of car in India.

While the event, in which appearance was made by the celebrity, was held outside India, all the benefits accrued to the taxpayer in India, and it was on account of these benefits to the taxpayer that the foreign celebrity was paid for his participation in the Dubai car launch event. The income thus accrues and arises, by the reason of business connection in India.

The audio-visual clips were available for the use exclusively for Indian entity and the taxpayer. The use of this event, as a tool of marketing, was only in India.

Further, all the expenses were borne by the taxpayer, and its associate and it was claimed as a deduction under Section 37(1) of the Act. It implies that the expenses have been incurred wholly and exclusively for the purposes of businesses of the taxpayer and the business of the taxpayer was only in India. There was no doubt that it was because of this relationship between the event in Dubai and business of the taxpayer in India, the income has accrued and arisen to the celebrity making appearance in Dubai launch event.

There is an inherent dichotomy in the approach of the taxpayer. On one hand, the taxpayer claims that the expenditure in the Dubai launch event are deductible expenditure incurred for the purposes of business in India, which is the only geographical location where the taxpayer does business, and on the other hand, the taxpayer claims that the Dubai launch event does not have a business connection in India.

Taxpayer's reliance on the decision of business connection

The taxpayer relied on various decisions to contend that, for taxation in India, the non-resident must carry out the economic activity in India or render the related services in India. These decisions were distinguished based on the following:

- The term 'business connection' is not defined in the Act and the categories of business connection are incapable of exhaustive enumeration.
- Business models are constantly changing, but post the internet and social media revolution, they have changed drastically, with the fundamental rules of the game changing. The internet and social media have changed the way businesses communicate and, hence, the law is to be seen in tandem with the ground realities of the business world, rather than in the strict confines of what has been decided in judicial precedents which were in the context of a different business world altogether.
- Presently, virtual and intangible business are far more critical, important and commonplace than the conventional brick and mortar business connection. To disregard such business connection only because courts, while delivering judgments several decades ago, could not visualize the same and hedge their observations about such possibilities, will be a travesty of justice.
- None of the earlier decisions had an occasion to examine an intangible business connection. The very concept of 'below the line publicity' is something quite fundamentally new and, undisputedly, none of the decision cited dealt with such contemporary instruments influencing customer behavior.
- Hence, the Tribunal did not rely on any of these decisions and observed that 'it would be inappropriate to use the words and expressions employed in these rulings, in isolation, as complete exposition of law and as to a blind man's walking stick'.

Taxability under Section 115BBA of the Act

The taxpayer contended that the provision of Section 115BBA provides for taxability of an entertainer, who is not a citizen of India and is a non-resident relating to his income received or receivable from his performance in India. Section 115BBA refers to the 'performance in India' implying thereby that performance outside India is outside the ambit of taxation in India.

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[6] Section 9(1)(i) - all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India

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

The Tribunal observed that Section 115BBA deals with the mode and rate of taxation in the hands of non-resident sportsmen, non-resident sports associations and institutions, and non-resident entertainers. These modalities of taxation cannot be treated restrictions on chargeability to tax under Section 5(2)(b) of the Act. In case any income is not eligible for the specified treatment under Section 115BBA , on account of not fulfillment of certain criteria set out therein, such income will be taxable in the normal course in the hands of the non-resident entertainer in India. Accordingly, the Tribunal rejected this ground.

Taxability under 'Other Income Article' of the tax treaty

The taxpayer contended that since the income on account of participation in a product launch event outside India was not covered by any specific provisions of the tax treaty including Article 18 dealing with income of the entertainers. In such a situation, , it can only be taxed in the residence state under Article 23(1) of the tax treaty. The Tribunal rejected the contention of the taxpayer for the simple reason that Article 23(3), which is a non-obstante clause vis-à-vis Article 23(1), provides that items of income of a resident of one State not dealt with in the foregoing articles and arising in the other State may also be taxed in that other State. What essentially follows is that Article 23(3) allows the country in which the income arises, to tax such income if its law so provides. The scheme of the treaty is thus unambiguous inasmuch as the treaty protection from source taxation is not available to an income which is not covered by the specific articles of the treaty in question.

Conclusion

Income embedded in the payment to the foreign celebrity, for participation in the Dubai launch event, was taxable in India. The taxpayer was liable to withhold taxes from the payment made for appearance of the foreign celebrity at the Dubai launch event. Accordingly, the CIT(A) was justified in upholding impugned demands raised under Section 201 read with Section 195 of the Act.

Our comments

The issue with respect to business connection in the case of conventional business models v/s. digital model has been a subject matter of debate before the Courts. While evaluating the concept of business connection in the case of conventional business models, the Courts have looked at a non-resident's physical business activities in India, irrespective of whether such activity is performed by the non-resident itself or by some other person.

The impact of digital developments vis-à-vis business connection has been examined by some of the Courts[8]. The Kolkata Tribunal in the case of Right Florist[9] observed that the existing provisions of the Act are not wide enough to capture remote/virtual/digital presence of a non-resident in India. This is also supported by the discussions taking place at the OECD-G20 level especially in the BEPS Action Plan 1 Final Report (2015).

In the present case, the Tribunal has dealt with the evolving business models emerging due to the internet and social media revolution. The Tribunal held that the event was in connection with business in India. The Indian entities had the right to use the foreign celebrity's performance across all platforms for 'below the line publicity' on the internet, in press releases, news reports and social media which would be targeted to the Indian audience to generate sales in India.

It is important to note that India has introduced various measures in the Act to tax digital and remote operations. Such measures include expanding the scope of a business connection by introducing Significant Economic Presence (SEP) provisions. The government had introduced equalisation levy (@6 per cent) on online advertisement, digital advertising space or any other such facility or service. Further a new set of equalisation levy (@ 2 per cent) has now been introduced to include the consideration received or receivable by an e-commerce operator from e-commerce supply or services.

On the global front, taxation of the digitalised economy is an ongoing debate under OECD BEPS 2.0 and is expected to reach a global consensus by the end of 2020.

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[8] Verizon Communications Singapore Pte. Ltd [TS- 577-HC- 2013(MAD)], ABB FZ-LLC [TS-256-ITAT-2017(BANG)]
[9] Right Florist [2013] 25 ITR(T) 639 (Kol)

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