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"INTANGIBLE BUSINESS CONNECTION" | INTERNATIONAL CELEBRITY'S INCOME FROM APPEARANCE IN AN OFFSHORE PRODUCT LAUNCH TAXABLE IN INDIA

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The Income tax Appellate Tribunal, Mumbai in its recent judgment in the case of Volkswagen Finance Pvt Ltd (Taxpayer), ITA No. 2915/2017, ruled that payment made to a non-resident celebrity for an appearance made by him at a product launch event in Dubai was taxable in India as the same was made in connection with Taxpayer's India business, resulting into an intangible business connection.

Background

As per section 9(1)(i) of the Income Tax Act, 1961 (IT Act), which contains source rule for income arising to non-residents, income accruing or arising to a non-resident directly or indirectly through or from inter-alia any 'business connection' in India shall be deemed to accrue or arise in India and therefore, taxable in India.

The Taxpayer, an Indian company along with its affiliate Audi India had jointly planned an event in Dubai for launch of Audi's new car model targeted at the potential customers in India. Such promotional events generate enquires from potential customers who in turn may avail financing facilities offered by the Taxpayer for purchase of Audi vehicles

The event was held in Dubai (where cars were already available) as against shipping the models from Germany to India which could have taken around 4-5 months. The Taxpayer had flown about 150 people, mostly prospective buyers and some journalists, to Dubai to attend the launch event.

An international celebrity (Nicholas Cage), a non-resident in India under the IT Act, was invited for this product launch event in Dubai. The Taxpayer and Audi India had full rights to use the event footage and other material capturing celebrity's presence for 'below the line publicity' on internet, in press releases, news reports, social media, Audi Magazine etc. For the appearance at the event in Dubai, Taxpayer made a payment of USD 440,000 to Nicholas Cage (NR Celebrity) without any deduction of tax at source on the basis that the NR Celebrity was not carrying out any activities in India and hence, the income did not accrue to him in India.

The tax authorities however held that the payment made by the Taxpayer to the NR Celebrity was taxable as "royalty" under section 9(1)(vi) of the IT Act as well as under India-USA Double Taxation Avoidance Agreement (Tax Treaty). The tax authorities were of the view that the whole purpose of organizing an India centric event in Dubai was to avoid income accrual in India which would have been subject to tax in India.

Arguments Advanced

The Taxpayer relying on a series of judgments argued that for the instant income to be taxable in India, it is essential for the NR Celebrity to carry out economic activity in India or render services in India. In the present case, the NR Celebrity neither had any

presence in India nor rendered any services in India. The Taxpayer also referred to section 115BBA of the IT Act which provides for taxability of income derived by a non-resident entertainer from his 'performance in India' to support its proposition that income from performance outside India is not covered within the Indian tax net.

Additionally, the Taxpayer claimed that in view of Article 23(1) of the Tax Treaty, as the income accruing to the NR Celebrity is not expressly dealt with in any of the other articles, such income should be taxed only in the US and not in India.

Ruling

The Tribunal in this unprecedented ruling held that though the NR Celebrity did not carry out any activity in India, as the event held in Dubai was entirely in relation to India business of the Taxpayer, it resulted into an intangible business connection and hence, income accruing to the NR Celebrity was taxable in India. Some of the noteworthy observations made by Tribunal are as under:

- While on a strict legal reading of section 5 of the IT Act, income accruing to the NR Celebrity outside India cannot be taxed in India, the same has to be read with section 9(1)(i) of the IT Act as per which income that has accrued through or from a business connection in India shall be subject to tax in India.
- Referring to the decision of the Supreme Court in the case of CIT Vs R D Aggarwal & Co [1965] (56 ITR 20), the Tribunal mentioned 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 into an income for the non-resident.
- The product launch event was for 'below the line publicity' in India targeted at a specific group of potential customers in India, advertisements being created keeping in mind the demographic and psychographic characteristics of particular customer segment in India. As all the benefits from the event accrued to the Taxpayer in India, payment made to the NR Celebrity for participation in the event shall be construed as income accruing and arising in India by reason of the business connection in India.
- There is dichotomy in the stand of the Taxpayer as on the one hand it claims that expenses incurred for Dubai event are for the purpose of business in India and at the same time it claims that Dubai launch event does not have any business connection in India. Given that the expenses for holding the event are incurred admittedly for the business in India, it is a natural corollary that income arising to a non-resident from participation in the event has to be viewed as arising through or from a business connection in India.
- Various judicial precedents relied on by the Taxpayer to support the proposition that carrying on of economic activity or rendering services in India is a pre-requisite for the instant income to be taxable in India, are not relevant as none of them deal with 'below the line publicity', a fundamentally new issue which has not been a subject matter of dispute in any of these judgments.
- Section 115BBA referred to by the Taxpayer cannot restrict the scope of section 5(2)(b) and hence, not relevant to the facts on hand. Further, Taxpayer's claim of income being taxable only in USA under Article 23(1) of the Tax Treaty is rejected, as Article 23(3), a non-obstante clause provides that income arising in India may be taxed in India.

Comment

The Tribunal looked at the issue in a completely new light and dealt with it on first principles as there is no judicial precedent dealing with a similar issue. While the ruling seeks to expand the scope of 'business connection', it seems to be deviating from the well settled position that under section 5(2)(b) read with section 9(1)(i) of the IT Act, income in case of a non-resident taxpayer is deemed to accrue or arise in India provided that the recipient of income has a business connection in India. The legislature has consciously made an exception to this principle for income in the nature of interest, royalty and fees for technical services where income payable by an Indian resident to a

non-resident is said to accrue or arise in India (unless the same is in relation to business carried on by the payer outside India or earning of income outside India). In case of business income, the established nexus rule for bringing such income to tax in India is that the person earning income should have a business connection in India and payer's India nexus or status should be immaterial.

It is important to note that while the Tribunal affirmed the order of the tax authorities by upholding the withholding tax obligation of the Taxpayer on the basis of there being a business connection, it did not deal with the nature of income. The tax authorities had treated the income as 'royalty'. This could also lead to an inconsistent conclusion as taxability of royalty income does not depend on the business connection nexus rule – this rule applies in the context of business income, and tax rates and basis with respect to both is different.

Another interesting point to note is that in the ruling of R. D Aggarwal (supra) referred to by the Tribunal, the income assessed to tax in India was reversed on the basis that non-resident did not have a business connection in India. This supports the position that business connection has to be established from income earner's perspective. In the instant facts, income earned by the NR Celebrity from the Taxpayer was independent of target audience of the event and NR undisputedly did not have any business connection in India.

Deeming income earned by a non-resident outside India as taxable in India, in the absence of such non-resident having any presence in India or undertaking any sort of activity in India is stretching the concept of business connection too far and is likely to give rise to a flurry of tax disputes.

This ruling could have far reaching implications in similar cases where non-residents earn business income from carrying on activities outside India as part of events which are focused or targeted at Indian audience.

It should also be noted that as per the recently passed Finance Act , 2020, the income derived by non-residents from advertisement targeted at customers in India or income from sale of data collected from persons in India or sale of goods using data collected from a person in India is made subject to tax in India. The question is while these provisions are being implemented with a prospective effect, will the facts of the case even fall within the purview of the wider deeming rules (as amended) and if not, whether the Tribunal's decision goes far beyond the scope of existing provisions of tax law which could set a precedent leading to more uncertainty for determining source of income in the more evolved business models.

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