

Supreme Court upholds Formula One's PE in India

In a significant ruling, the Supreme Court (SC) has held that Formula One World Championship Limited (FOWC), a non-resident, had a Permanent Establishment (PE) in India, in respect of the Grand Prix Motor Racing event conducted at the Buddh International Circuit in India, notwithstanding the relatively short duration of racing event. FOWC has been held liable to pay tax in India on the business income attributable to such PE in India.

The relevant facts, key contentions of the taxpayers and the Revenue and ruling of the SC, are summarized below:

A. Facts

Federation Internationale de l'Automobile (FIA), a not-for-profit association in France, is the principal body for establishing rules and regulations for all major international four-wheeler motorsport events. FIA regulates the FIA Formula One World Championship (Championship) which comprises of annual 'Grand Prix' series of motor races. In Formula One (F1) Grand Prix events, F1 racing cars (manufactured by the participating teams in strict conformity with relevant technical norms) compete against each other.

FIA has exclusive rights in the Championship. It granted the rights for commercial exploitation to FOWC. FOWC is incorporated under the laws of the United Kingdom (UK), and is a tax resident of the UK. FOWC, in its capacity of commercial rights holder, is entitled to enter into a contract with a promoter for hosting, promoting and staging the F1 racing event, and nominates such promoter to the FIA for inclusion in the official F1 racing calendar.

In the case at hand, FOWC, Formula One Asset Management Limited (FOAM), Beta Prema 2 Limited (BP 2), All sports Management SA (Allsports), Formula One Management Ltd. (FOM), entered into a series of agreements with Jaypee Sports International Limited (Jaypee), an Indian company which owned the Buddh International Circuit. Whilst FOWC appointed Jaypee as the promoter for the Indian F1 Grand Prix event (Event), Jaypee entered into separate back to back agreements whereby BP 2, Allsports and FOM were conferred various rights pertaining to the Event.

Diagrammatic representation of aforesaid contractual arrangements –

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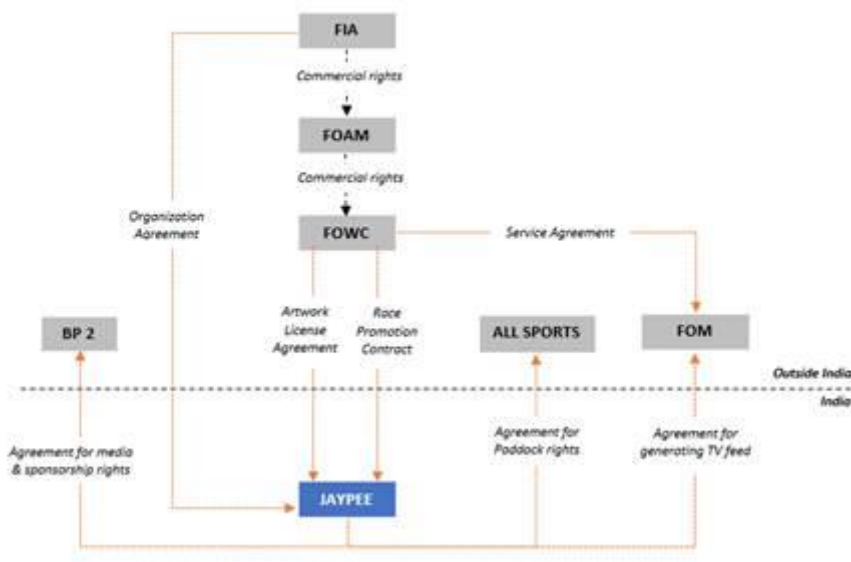


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FOWC and Jaypee approached the Authority for Advance Rulings (AAR) seeking determination of the tax implications of the consideration paid by Jaypee to FOWC under the Race Promotion Contract (RPC) executed in 2011. The AAR held that consideration paid by Jaypee to FOWC is in taxable as 'royalty', under provisions of the Income-tax Act, 1961 (Act) and the India-UK tax treaty. Further, the AAR held that FOWC did not have a PE in India, either by way of a fixed place of business, or by way of a Dependent Agent.

Aggrieved by AAR's ruling, FOWC, Jaypee and the Revenue filed writ petitions before the Delhi High Court (HC)¹. The HC reversed the order of the AAR. It held that FOWC constituted a fixed place PE in India on account of the circuit and the consideration received by FOWC (from Jaypee) was taxable as 'business income' and not as 'royalty'.

Pursuant to the HC's ruling, FOWC, Jaypee and the Revenue again filed appeals before the SC.

B. Key issue for adjudication by SC

- Whether FOWC constituted a PE in India under provisions of Article 5 of the India-UK tax treaty. Critical conditions for FOWC to be held to have constituted a PE in India were:
 - FOWC had a 'fixed place' in India at its disposal; and
 - FOWC conducted business activity through such 'fixed place'.

C. Summary of contentions

Taxpayers' contentions:

- Following contentions were made to argue that neither of the above conditions were met in present case –

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- Tier 2 firm in International Tax Review, World Transfer Pricing 2015 Guide
- Ranked No.1 & No.8 (by deal count) Most Active Transaction Advisor for M&A and PE deals by Venture Intelligence

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- Reference was made to agreement executed between FIA and Jaypee to contend that whilst FIA had control over conduct of the Championship, it was Jaypee who was responsible for conducting the race in Delhi at the circuit. Reference was also made to Organization Agreement wherein Jaypee was described as the ‘organizer’.
- It was contended that Jaypee had constructed the circuit at its expense, with own engineers, architects and that Jaypee had used the circuit for multiple other events, all year round.
- Jaypee was liable for all acts and obligations, from construction of the circuit till conclusion of the Event, with no role of FOWC therein. The business of FOWC was to exploit the commercial rights in the Event, and not to hold the Event.
- RPC 2011 demonstrates that FOWC merely gave permission to Jaypee to host the Event, as only FOWC has the exclusive right to exploit the commercial rights in the Championship. A condition precedent to the agreement required Jaypee to enter into a valid and binding agreement with FIA.
- Even if it is accepted that the FOWC had control over the circuit, the F1 Event was a temporary model for three days (in a year) only and possession of a site for three days cannot be termed as a PE.
- Additionally, it was contended that the consideration received by FOWC from Jaypee was taxable in the UK, considering provisions of section 9(1)(i) of the Act and the fact that rights to hold the event were granted in the UK.

Revenue’s contentions:

- It was contended that a business activity was carried out from the circuit (and paddock, etc, were part of the circuit).
- The Revenue contended that contractual arrangements relevant to the Event manifest that FOWC and its affiliates had complete control over the Event, whereas Jaypee’s role was to only host the Event, with total access at the time of construction and at the time of Event being vested with FOWC.
- It was contended that rights granted by FOWC to Jaypee were transferred in turn to FOWC’s affiliates by way of separate back to back contracts signed almost simultaneously with RPC 2011. Also, FOWC engaged FOM, an affiliate, to provide specified services, which indicates physical management of the business activity.
- Further, it was contended that RPC 2011 was worded only to give an impression that Jaypee was vested with real control of the affairs of the Event, whereas the factual circumstances were different.

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D. Ruling of SC

- The SC observed that 'Buddh International Circuit' is a 'fixed place' and 'Grand Prix' (ie, the Event) is an 'economic /business activity'.
- To ascertain FOWC's real role in the Event, the SC holistically analyzed all agreements between FOWC (and other affiliates) and Jaypee. Following this approach, the SC culled out following material factors from the contractual arrangements –
 - FIA assigned commercial rights in favour of FOAM vide agreement dated April 24, 2001, and FOAM assigned such rights to FOWC for a period of 100 years.
 - The Concorde agreement defines 'F-1 business' to mean exploitation of various rights, including media rights, hospitality rights, title sponsorship rights, etc.
 - In 2007, Jaypee was granted rights to 'promote' the Event. In 2011, however, another agreement was executed whereby FOWC granted rights to Jaypee for hosting, staging and promoting the event for a consideration of USD 40 mn. On the same day, Jaypee executed agreements with three affiliates of FOWC, by which it transferred circuit rights to BP 2, paddock rights to Allsports, and engaged FOM to generate TV feed.
 - BP 2 actually granted the media rights to a third party (Bharti Airtel) a month before such rights were granted by Jaypee to BP 2.
 - On date of the race, FOWC engaged its affiliate FOM for providing liaising, supervisory and support services
- The SC observed that the entire Event was taken over and controlled (including, physical control) by FOWC and its affiliates. The SC observed that FOWC exercised complete control over the track in India and earned income from the same, which is also borne out of the terms of RPC 2011. The SC observed that in such a case the construction of track by Jaypee is of no consequence in deciding who was in control of the Event (ie the business activity).
- The SC further observed that existence of PE has to be examined considering that even though the race was conducted only three days in the year, FOWC has full access to the circuit for the entire duration of the Event (including two weeks prior and a week succeeding the Event). In this regard, the SC quoted following observations of the HC –
 - At all material times FOWC had exclusive access to the circuit and places where teams were located, whereas Jaypee's capacity, whilst designated as promoter of the Event, was extremely restricted.

- The nature of activity, ie, racing and exploitation of rights vested with FOWC in the capacity of commercial rights holder, implied a moving and shifting presence. With such activity, whilst there may not be substantiality in an absolute sense with regard to the time period, both the exclusive nature of access and the period for which it is accessed, creates a 'fixed' presence as contemplated in Article 5(1) of the India-UK tax treaty.

The SC affirmed HC's findings on constitution of the PE and reiterated the following PE related jurisprudence from foreign courts that was relied on by the HC

–

- *Universal Furniture Ind. AB v. Government of Norway*² – In this case the Norwegian Court held that home of the Norwegian salesman hired by a Swedish company for sale of furniture (assembled in Sweden) in Norway could be regarded as 'fixed place of business' of the Swedish company.
- *Joseph Fowler v. Her Majesty the Queen*³ – In this case the Court held that camper trailer used by the taxpayer for visiting and selling goods in fairs for a number of years, constituted a fixed place of business, even though the taxpayer's presence in fairs was upto 2 /3 weeks only. The Court held that the having regard to peculiarities of the business, the place was one of business despite the short duration.

It is pertinent that the HC had also placed reliance on the OECD⁴ and Klaus Vogel's⁵ commentary on the general principle that as long as presence is in a physically fixed place, permanence in such fixed place could be relative having regard to nature of business.

- Further, the SC held that FOWC being commercial rights' holder for the Event, is in the business of exploiting such rights (including intellectual property rights), which in the present case were exploited through actual conduct of the Event; FOWC had access and control over the track and actively participated in the Event. The SC reiterated HC's findings in this regard.
- In view of the SC's findings, the SC held that the Buddh International Circuit is a fixed place where commercial /economic activity of conducting F-1 Championship was carried on as a virtual projection of FOWC in India. The SC stated that the three characteristics of a PE⁶ viz, *stability*, *productivity* and *dependence*, were present in the instant case. Accordingly, the SC held that FOWC is liable to pay tax in India on the income earned from the Event, as it had conducted business in India through a fixed place PE.

The SC observed that the relevant portion of FOWC's business income which is attributable to the PE, therefore, be subject to deduction of tax at source under provisions of section 195 of the Act, which was a statutory obligation for the payer, ie Jaypee. The SC observed that quantum of business income attributable to FOWC's PE in India would have to be separately determined during its assessment proceedings.

Consistent with the international commentary on general principles underlying determination of fixed place PE, the SC has held that if the place of business is fixed, 'permanence' of such place is to be evaluated having regard to the nature of business. The fact that duration of business activities carried out through such fixed place may not be substantial in absolute sense, is not really material; so long as taxpayer has exclusive and repetitive access, and such access is permanent relative to the nature of business, place of business can be deemed as fixed place PE.

Control of the business for determining PE – The SC has ruled on the principle of 'control' of a business carried out in India. By viewing all the agreements entered into by FOWC and its affiliates with regard to the Event, it concluded that the dominant control over conduct of the Event was not with the Indian company, which owned the circuit, but was with FOWC. It, therefore, endorsed the principle of looking at the substance emanating from all the agreements.

The judicial outcome emerging from Formula One ruling also assumes more significance, as it nearly coincides with the introduction of General Anti Avoidance Rule under the domestic tax law from the current financial year. The ruling also sets out certain principles for testing commercial substance, or lack thereof, in any arrangement.

Duration of business for determining PE – The ruling is likely to refuel debate on PE determination for taxpayers engaging in activities which entail relatively shorter duration of presence in India, but tend to have reasonable degree of frequency attached thereto. Earlier, the AAR in case of Golf In Dubai LLC⁹ had held that elements of regularity, continuity and repetitiveness were missing in the Golf tournaments conducted in India and thus, the non-resident did not constitute a PE in India on account of an isolated or solitary activity. The AAR, in the Formula One case, distinguished the Golf In Dubai ruling. SC's finding (same as Delhi HC's) that in essence FOWC was carrying on 'business activity' from the circuit is likely to entail significant taxation related concerns for events hosted with similar *modus operandi*.

¹ Formula One World Championship Ltd.v. Commissioner of Income-tax, International Taxation Delhi [2017] 291 CTR 24 (Delhi)

² (Stavanger Court, Case No. 99-00421, dated 19-12-1999 referred to in Principles of International Taxation by Anghard Miller and Lyn Oates, 2012)

³ 1990 (2) CTC 2351

⁴ Para 6 of the OECD Commentary 2010, states that a place of business may, however, constitute a permanent establishment even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for that short period of time.

⁵ Klaus Vogel in the commentary Double Taxation Conventions (Kluwer Law International, 2005) has stated that the main features of Article 5(1) are: (a) existence of an enterprise; (b) its carrying on a business; (c) existence of a place of business, the nature of such place being fixed and (d) through which (i.e. through the place) the business should be carried on. Further, the existence of link between the place of business and the specific geographical bond would be sufficient for meeting the 'fixed' criterion.

⁶ Indicated by Philip Baker in 'A Manual on the OECD Model Tax Convention on Income and on Capital'

⁷ Union of India vs Azadi Bachao Andolan and Another [2003] 263 ITR 706 (SC)

⁸ Vodafone International Holdings B.V. vs Union of India [2012] 341 ITR 1 (SC)

⁹ Golf In Dubai LLC, In re [2008] 306 ITR 374 (AAR)



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