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F1's Indian Permanent Establishment: Car crash or racing to the future?

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Sunday, May 21st, 2017

On 24 April 2017 the Indian Supreme Court held that Formula One World Championship Ltd, the holder of the commercial rights to the Formula One Grand Prix, had a permanent establishment in India at the Buddh International Circuit where the event was held in 2011, 2012 and 2013. The Supreme Court concluded that the UK resident company had a permanent establishment in India under article 5(1) of the India-UK double tax treaty (*Formula One World Championship Ltd v Commissioner of Income Tax, International Taxation*).

FOWC granted Jaypee, an Indian company, the right to host, stage and promote the Formula One Grand Prix of India event for a consideration of US$ 40 million on September 13, 2011 pursuant to a Race Promotion Contract. Concurrently, by separate agreement, FOWC licenced certain marks and intellectual property to Jaypee for a consideration of US$ 1 million. Concurrently, Jaypee contracted with three FOWC affiliates: Jaypee granted media and title sponsorship rights, to Beta Prema 2 who had pre-sold those rights to an Indian telecoms company, Bharti Airtel, for US$ 8 million; and Jaypee also engaged FOAM to generate TV Feed and grated paddock rights to Allsports.

On day of the race in October 2011, FOWC engaged FOAM to provide various services including licensing and supervision of other parties at the event, travel and transport and data support services.

Physical permanent establishment

Article 5(1) of the India- UK treaty is identical to the OECD Model which defines "permanent establishment" as "a fixed place of business through which the business of an enterprise is wholly or partly carried on." The Court recognised the essential characteristics described in the OECD Commentary, namely:

- a "place of business", such as premises that are at the disposal of the enterprise .
- this place of business must be "fixed", that is, established at a distinct place with a certain degree of permanence;
- the business of the enterprise must be carried on through the fixed place of business. This means usually that persons who, in one way or another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated.

The Court ruled that the circuit was put at the disposal of FOWC under the Race Promotion Contract which granted FOWC, its affiliates, contractors and licensees and their respective personnel and equipment (if any) access to the circuit for a three week period starting 14 days before the day of the race and ending seven days after the race. It also held that the circuit was a distinct place in order to qualify as fixed. Most observers would regard these conclusions as relatively uncontroversial.

Two highly controversial and unsettled points were also addressed:

- How long should the place of business endure to have a sufficient degree of permanence?
- Is the business carried on through that fixed place?

These questions include some of the more difficult points that have been under examination by the OECD in its 2012 consultation on the Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention which was overtaken by the BEPS project. The time requirement (Issue 6), subcontracting all aspects of a contract (Issue 8) and fragmentation of activities (Issue 18) proved intractable problems of interpretation during the consultation. Fragmentation of activities was an element of BEPS Action 7 which resulted in proposed amendments to the preparatory or auxiliary exceptions in article 5(4) of the OECD Model and article 13 of the BEPS Multilateral Instrument.

Aggregation of group activity

In addressing whether FOWC carried on business at the place, the Court viewed the exploitation of the F1 commercial rights as a group exercise by FOWC and its affiliates thus:

“We would like to start our discussion on a crucial parameter viz. the manner in which commercial rights, which are held by FOWC and its affiliates, have been exploited in the instant case. For this purpose entire arrangement between FOWC and its associates on the one hand and Jaypee on the other hand, is to be kept in mind. Various agreements cannot be looked into by isolating them from each other. Their wholesome reading would bring out the real transaction between the parties.

The aforesaid arrangement clearly demonstrates that the entire event is taken over and controlled by FOWC and its affiliates.”

The jurisprudential basis for this finding is not set out in the decision. Although valuable rights were given to affiliates, the transactions were not circular so that the overall profit did not end up with FOWC. The question of whether any of other affiliates may have had permanent establishments which may have resulted in their profits being taxed in India was not considered. Instead the whole was aggregated in the hands of FOWC, with little explanation other than the fact that the companies were related.

Time requirement

The Supreme Court showed no awareness of the controversy in relation to the time requirement, or of the fact that the time spent at the place was at an extreme end of the scale. It said that the “appellants are trying to trivialize the issue by harping on the fact that duration of the event was three days” when one of the most difficult fact patterns involves a business that returns to the same place for very short time over a period of years. In concluding that “that having regard to the duration of the event, which was for limited days, and for the entire duration FOWC had full

access through its personnel, number of days for which the access was there would not make any difference" the court conflated the requirement for the place to be at the disposal of the enterprise with the time requirement.

The requirements for a permanent establishment are cumulative. Even if the group activities are properly aggregated, it is necessary for sufficient duration of the place to meet the stability requirement. The Court relied entirely on the five year length of the contract, even though the circuit was only accessible for three weeks a year.

Principles of treaty interpretation

Other Supreme Courts, in recent decisions (South Africa: *Krok v CSARS* [2015] ZASCA 107; United Kingdom: *Anson v HMRC* [2015] UKSC 44; Australia: *Bywater Investments Ltd and others v Commissioner of Taxation; Hua Wang Bank Berhad v CoT* [2016] HCA 45), have commenced their analysis of double tax treaties by recognising and applying the codified principles of treaty interpretation in articles 31-33 of the Vienna Convention on the law treaties. The Court in FOWC ignored the taxpayer's submissions on principles of treaty interpretation, relying instead on secondary material such as textbooks (including outdated editions). Uncritical reliance on foreign case law, such as *Fowler v MNR* (1990) 2 C.T.C. 2351 (Tax Court of Canada) (much criticised in Canada) as well as the controversial "painter" example in the OECD Commentary to article 5 mean that the decision is of limited precedential value in other jurisdictions.

A changing world of international tax

Despite the shortcomings of the decision as a matter of legal analysis, it serves as a stark warning about changing attitudes towards the taxation of multinational enterprises. Foreign enterprises that. in some sense, project onto the territory a country are increasingly viewed as taxable there as a matter of public opinion. The Indian Supreme Court concluded its ruling thus: "Aesthetics of law and taxation jurisprudence leave no doubt in our mind that taxable event has taken place in India and non-resident FOWC is liable to pay tax in India on the income it has earned on this soil."

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