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Racing circuit constitutes fixed place PE, Indian Supreme Court rules

Shilpa Goel (Tax Lawyer) · Tuesday, May 23rd, 2017

Consider this. Formula One World Championship Limited UK (Formula One) entered into a Race Promotion Contract (RPC) with Jaypee Sports International Limited (Jaypee), an Indian entity, under which Jaypee was granted the right to host, stage, and promote a motor racing event in India. Buddh International Racing Circuit located in the Indian state of Uttar Pradesh was chosen as the venue. Jaypee was to receive a consideration of USD40m under the RPC. All the commercial rights in relation to the racing event were vested with Formula One. Will income attributable to the racing event conducted in India by Formula One give rise to a permanent establishment (PE) of Formula One in India?

The Supreme Court of India answered this question in the affirmative in a decision delivered on April 24 in the case of *Formula One World Championship Ltd vs Commissioner of Income Tax* (downloadable link). The main contention, the arguments raised by Formula One and the Income Tax Department, and the Supreme Court's reasoning employed in arriving at its findings are discussed below. I must point out that although the case is 110 pages long, the main discussion starts at page 87: the first few parts of the judgment simply reiterate the text of Article 5 of the UK-India tax treaty including PE exceptions (which were not in issue), the OECD Commentary on Article 5, and writings of international tax scholars and barely adds anything new to the existing jurisprudence on PE.

The main contention

It could not be denied that the racing circuit which was used to carry on a business activity, that is, the motor racing event, is a fixed place. The main question before the Supreme Court was whether the Buddh International Racing Circuit was at Formula One's disposal (that is, whether it was a fixed place of business of Formula One) and whether Formula One generated some business income through conducting the racing event from that fixed place. Readers may be aware that the Delhi High Court had last year decided this issue in favor of the Income Tax Department in a well-reasoned and detailed judgment (while overturning the reasoning given by the Authority for Advance Ruling). The Supreme Court has merely upheld that decision after placing enormous reliance on the reasoning provided by the Delhi High Court.

So, was the racing circuit at the disposal of Formula One?

The Supreme Court was looking at the definition of PE given in Article 5 of the UK-India tax

treaty as “a fixed place of business through which the business of an enterprise is wholly or partly carried on.” The fact that the racing circuit is a fixed place and that the fixed place was used to carry on a business activity, that is the racing event, was undisputed. The main contention of Formula One was that the racing circuit was not at its disposal. In this regard, Formula One submitted that Jaypee, as the organizer, had complete control over the event and that Jaypee was using the race track for other events that were being organized on a regular basis.

For its part, the Income Tax Department strenuously argued that Formula One had taken total control over the event that took place in India. It pointed out that Jaypee’s only role was to host the event and it was Formula One alone who had complete access to the circuit at the time of construction as well as at the time of event. The Department relied extensively on over ten agreements executed between different stakeholders to demonstrate the flow of commercial rights in relation to these events.

The Supreme Court went on to examine in great detail the manner in which commercial rights, which are held by Formula One, were exploited in the instant case to find out as to who had the real and dominant control over the racing event. The Supreme Court concluded that a wholesome view of the commercial arrangement demonstrated that the entire event was taken over and controlled by Formula One. The Supreme Court reasoned in the following way:

“*There cannot be any race without participating/competing teams, a circuit and a paddock. All these are controlled by [Formula One]. Event has taken place by conduct of race physically in India. Entire income is generated from the conduct of this event in India. Thus, commercial rights are with [Formula One] which are exploited with actual conduct of race in India. Even the physical control of the circuit was with [Formula One] from the inception, i.e. inclusion of event in a circuit till the conclusion of the event. Omnipresence of [Formula One] and its stamp over the event is loud, clear and firm.*”

The Supreme Court agreed with the High Court that the duration of the event (which was for limited days only) was immaterial as Formula One had control over the racing event for the entire duration of the event (as well as two weeks prior to it and a week succeeding it), for whatever small duration that may be. In any event, the Court noted that the duration of the agreement was five years, extendable to another five years, showing some element of continuity. The Court ruled that, having regard to the model of commercial transactions, such an access for a period up to six weeks at a time during the Championship season was sufficient for the purposes of Article 5(1) of the tax treaty.

And did the business activity give rise to some income?

The Supreme Court agreed with the Delhi High Court that Formula One being the sole commercial rights holder “carried on business in India for the duration of the race (and for two weeks before the race and a week thereafter). Every right, which [Formula One] possessed was monetized; the USD40m which Jaypee paid was only a part of that commercial exploitation by Formula One.” In the opinion of the Court, the bulk of the revenue was earned through exploitation of media, television, and other related rights and the terms or the basis of those rights was the racing event. On the question of attribution of income to the PE, the Court emphasized that it would be for the assessing officer to determine how much business income of Formula One is attributable to its PE in India, which would be chargeable to tax in India.

The Supreme Court's observations are worth reiterating:

"Omnipresence of Formula One and its stamp over the event is loud, clear and firm…the undisputed facts were that race was physically conducted in India and from this race income was generated in India. Formula One had made their earnings in India through the said track over which they had complete control during the period of race. [Formula One] is trying to trivialize the issue by harping on the fact that duration of the event was three days and therefore, control would be for that period only. The question of the PE has to be examined keeping in mind that the aforesaid race was to be conducted only for three days in a year and for the entire period of race the control was with Formula One."

PE versus business connection

It is interesting to note that the Supreme Court did not go into examining the definition of business connection stated in section 9 of the Income Tax Act 1961 ("IT Act") to see if the deeming fiction under that section could be invoked to tax Formula One's business income generated in India from the racing event. The Court did start with section 9 of the IT Act but then rather abruptly went to discuss Article 5 of the tax treaty noting that "if a non-resident has a PE in India, then business connection in India stands established."

In an earlier judgment delivered back in 2007 (*Ishikawajma Harima Heavy Industries*), the Supreme Court had noted that "the existence of a PE will not constitute sufficient business connection." I had argued in an earlier blog that while the reverse may be true (that is, the existence of a business connection may or may not constitute a PE), the argument that a foreign enterprise can have a PE in India and yet have no business connection in India is misplaced. There, I also argued that it is always desirable that courts must start with Article 5 of the tax treaty and not with section 9 of the IT Act for three specific reasons including: (a) if the court concludes in favor of a PE then there is no need to examine the meaning of business connection under section 9 of the IT Act as the existence of PE will necessarily imply the existence of a business connection; and (b) if the court concludes that there is no PE then section 9 of the IT Act anyway becomes redundant as Article 5 of the tax treaty will restrict taxation of business profits in the absence of a PE.

In this regard, I welcome the Supreme Court's approach taken in Formula One and hope that this approach will be followed in future cases on PE/business connection.

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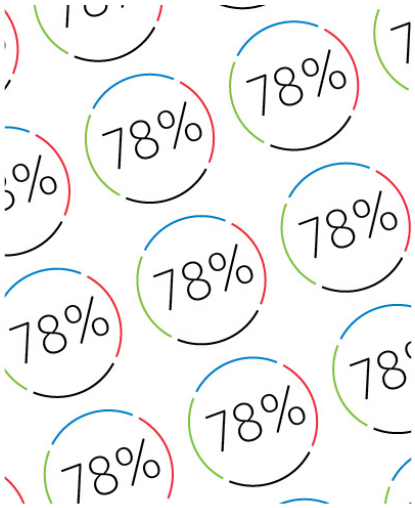

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This entry was posted on Tuesday, May 23rd, 2017 at 9:32 am and is filed under OECD, Permanent Establishments
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