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LEGAL AND TAX COUNSELING WORLDWIDE

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Emerging Tax Issues in the Broadcasting Industry

The Need to Remove Ambiguities, Retrospective Operation and Facilitate Doing Business in India

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The Need to Remove Ambiguities, Retrospective Operation and Facilitate Doing Business in India

The issues around taxation of payments in the broadcasting sector are perhaps amongst the most litigious in the recent years. This industry has been at the forefront of tax controversies owing to the specific nature of cross-border business operations in the broadcasting sector, and the disputed nature of taxation of these transactions. Foremost amongst these are the issues of charaterisation of such payments as *'Royalty'* or otherwise, and their taxation as such.

I. Scheme of Taxability of Foreign Broadcasters

Royalty payments are considered taxable under section 9(1)(vi) of the Income Tax Act, 1961 (**"ITA"**) if the payer is an Indian resident, unless such resident makes the royalty payment for a business carried on outside India. However, under section 90(2) of the ITA, if the non-resident is situated in a country with which India has a double taxation avoidance agreement (**"Tax Treaty"**), the taxpayer would, at his option, be taxable according to the provisions of the Tax Treaty or the ITA.

The significant distinction between taxation of payments made to foreign broadcasters under the ITA vis-à-vis the Tax Treaty, is that under the Tax Treaty, unlike under the ITA, the mere receipt of income in India will not make the taxable in India. Furthermore, the concept of permanent establishment (**"PE"**) under a Tax Treaty is more restricted in comparison with the concept of business connection under the ITA. Consequently taxation of payments relating to foreign broadcasters under the provisions of the Tax Treaty are typically more favorable as compared to the ITA.

II. Taxability Under the ITA

Section 9 is the deeming provision relating to the income of non-residents that are considered to have its source in India. Section 9 (1) (vi)(b) of the ITA deals with royalty paid by an Indian resident and received by a non-resident, and Explanation 2 thereto defines 'Royalty' as:

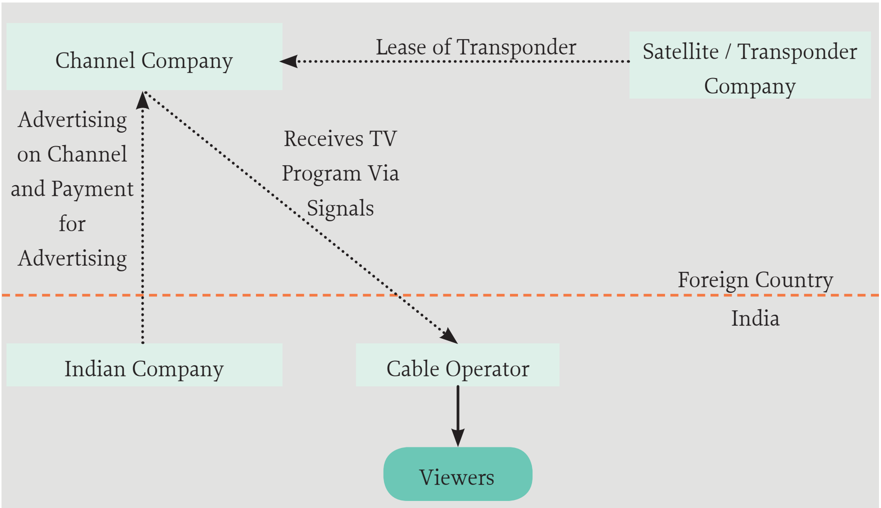
> *"Explanation 2.—For the purposes of this clause, "royalty" means consideration ... for—*

i. the transfer of all or any rights... In respect of... a process...;
ii. the imparting of any information concerning the working of... a process...;

iii. The use of any...process;

It may be important to note in this regard that, through a *retrospective* amendment to the ITA by the Finance Act, 2012 the expression "*process*", through Explanation 6 has been made to include transmission by satellite, including a blinking, amplification or conversion for down linking of any signal. This explanation is significant owing to the fact that the term 'process' now explicitly includes the use of transponders for satellite communication.

However, regardless of changes to the ITA, the definition of royalty under the DTAA remains unchanged and the provision beneficial to the assessee will apply. This position has been upheld by the Income Tax Appellate Tribunal in the case of *B4U International Holdings Ltd. v. DCIT.*[1]



As may be gathered from the figure above, issues surrounding the characterization of payments, as royalty or otherwise, emerge of two main streams of income, being (i) Use of the satellite or transponder company for the transmission of signals, or (ii) payments made to the broadcasting company in the nature of subscription or advertising revenue. The following illustrate some of the key concerns surrounding the same.

III. Taxation of Distribution Income

In a contract where foreign broadcasters grant rights to distribute data content in Indian territory to Multi-System Operators ("**MSO**") / cable operators / DTH operators, a percentage of the revenues derived from the distribution of such content is paid to the foreign broadcasters as 'license

1. TS-358-ITAT-2012.

fees' for such distribution rights. There are conflicting opinions on whether such distribution income would be taxable in India, as contingent on the question of whether such income 'accrued or arises' in India. For instance in two rulings, *Performing Rights Society Ltd. v. CIT*[2] and *Metro-Goldwyn-Mayer v. CIT*[3], it was held that such distribution in fact would be taxable in India, on the grounds that the fees payable are predicated on the exploitation of television content in India. On the contrary, the Supreme Court in the case of *CIT v. Carborandum*[4] held that merely on account of the fact that the quantum of income accruing to the non-resident is contingent on exercise of such rights in India, the inference that operations were carried on by the non-resident in India, does not logically follow; in the absence of any operations carried out by the non-resident in India the income accruing to him from distribution of such rights cannot be said to accrue or arise in India.

IV. Payment for use of 'Satellite Broadcasting Rights' as Constituting 'Royalty'

Taxability of income for the use of the satellite or transponder is an issue that has found conflicting opinions from various adjudicatory fora. As regards characterisation of subscription revenues, the question arises as to whether it is in the nature of business income or royalty, and this has been a matter of much controversy. While foreign broadcasters claim such revenues are business income, and therefore not subject to tax in India, tax authorities term such income as royalty and subject to 25% tax on a gross basis. The question here is whether payments for the use of a satellite by broadcasting companies, constitutes 'royalty' under section 9(1)(iv) of the ITA. There have been differing viewpoints on this issue; for instance in *Asia Satellite Telecommunication Co. Ltd.*[5] the Delhi High Court held that no income accrued in India from the use of satellite outside India to beam signals for viewing in India even if the bulk of revenue arises from India. Similarly, in *ADIT v. Neo Sports Broadcast Pvt. Ltd.*[6] the ITAT held that payment for licences for live broadcast of cricket matches was not 'royalty' under the ITA. The position has expectedly changed pursuant to the amendment to the ITA vide Explanation 6; accordingly, the Chennai ITAT in *Balaji Communications*[7] held that payment for satellite broadcasting rights constituted royalty under section 9(1)(iv) of the ITA and should be taxed.

One would notice that even though the ITA has been retrospectively amended to specifically include satellite

2. 106 ITR 11.
3. 7 ITR 176.
4. 108 ITR 335.
5. 85 ITD 478.
6. TS-649-ITAT-2011.
7. 140 ITD 687.

transmissions within the purview of section 9 and consequently held to be taxable, the position under the Tax Treaty remains unaffected by such amendment. Resultantly, since the taxpayer has the right to be governed by either the ITA or the Tax Treaty, whichever is more beneficial, the position would have no bearing in the context of foreign broadcasters claiming under a Tax Treaty. This position was reiterated by the Mumbai Tribunal in *B4U International Holdings Ltd.* [8]

V. Impact of Retroactivity of the Amendment

Given that Explanation 6 to section 9(1)(vi) has been introduced with retrospective effect from 1976, certain questions arise with respect to the of disallowance in respect of payments made in lieu of broadcasting rights previous years; In such cases, taxes may not have been deducted relying on the position of law prior to 2012. Resort, in such situations may lie generally with principles of interpretation of statutes, interpretations to the Constitution against retroactivity of statutes and lastly, judicial precedent.

In this respect, the Mumbai tribunal in a recent case of *Channel Guide Limited*[9] relied on the legal maximum '*lex non cogit ad impossibilia*' and thereby ruled out disallowance (in the context of Explanation 4 on account of non-deduction of taxes in respect of satellite payments made for earlier years. Based on the principle underlying the Tribunal's decision in this ruling and in the case of *Sonata Information Technology*,[10] it could be argued that Explanation 6 to section 9(1)(vi) of the ITA is not relevant for determining the disallowance under section 40(a)(i) and accordingly payments made prior to 2012 are not to be disallowed.

VI. Position under the Direct Taxes Code, 2010 ("DTC")

Along the same lines, the definition of 'royalty' under the Direct Taxes Code, 2010, is expanded to include the use or right to use of transmission by satellite, cable, optic fibers of the technology of the transfer of all or any rights in respect of live coverage of any event. Accordingly, lease payments made for the use of transponders would be taxable as royalties under the DTC.

VII. Payments to Multi-System Operators as Constituting 'Royalty'

Another significant issue on which the broadcasting industry is at loggerheads with the tax authorities relates to withholding tax on payment for production of TV programs, carriage fees/ placement charges paid to MSOs and cable operators, and so on. Broadcasting

8. 18 ITR 62.
9. 139 ITD 49.
10. 343 ITR 397.

companies claim that such payments attract tax deductible at source ("**TDS**") of 2 per cent as payment for 'work' carried out by the recipients. Their rationale is that since the term 'work' has been defined in section 194C(iv)(c) of the ITA-as including broadcasting and telecasting including production of programs for such broadcasting and telecasting- it must consequently be taxed as such. The tax authorities contend that such payments are in the nature of royalty/fees for technical services and consequently liable to be taxed at 25% and liable to be withheld under section 194J of the ITA. This aspect has come up particularly often over the last two years with a large number of initial assessments by the Assessing Officer characterizing such payments in the nature of Royalty. One must note here that while 194J is the provision for withholding of taxes on 'royalty', section 194C is the provision that specifically applies to withholding in case of broadcasting and telecasting; based on established norms of interpretation, that the specific provision would over-rule the general provision, it should follow that tax on such payments must be withheld pursuant to section 194C.

In case where the distribution rights granted by foreign broadcasters are in fact termed as 'royalty', the same would be taxed in case of foreign companies under section 115A (1)(b) at the rate of 30%, 20% or 10% based on date on which such agreement was entered into.

VIII. Payments for Advertising to Broadcasting Channels

The primary controversy relating to taxation of advertising income in India that relates to determination of the place of accrual of advertising income so derived. In this respect, the case of *Star Ltd. vs. DDIT* [11] held that advertisement contracts will not contract for sale of goods; consequently the nature of advertising agreements could essentially be considered in the nature of contract for rendering of services. Based on this ruling, advertisement income would be said to accrue or arise at the place where the primary obligations under the contract for advertisement up formed. Under the down linking model, given that the primary activity of displaying advertisements, broadcasting of the television channels carry on outside India, income accruing of such contracts would be said to accrue or arise outside India, and consequently not taxable under the ITA.

Similarly, taxability of advertising revenues remains disputed despite the broadcasters paying an arm's length remuneration to their Indian Associated Enterprises ("**AE**"), which act as agents for advertising sales. The position on attributability of profits in the event of arms' length compensation, has been settled by several rulings, most significantly in *Set Satellite (Singapore) Pte. Ltd. , BBC Worldwide v. DCIT* [13], and

11. 99 ITD 91.
12. 307 ITR 205.
13. 203 Taxman 554.

the Mumbai Tribunal in *B4U International Holdings v. Department of Income Tax.*[14] However, at the levels of lower authorities, there seems to be a persistent attempt to attribute profits of the non-resident to a permanent establishment ("**PE**") even on arms' length compensation.

The disallowance of advertising sales and promotion expenditure incurred by the Indian Associated Enterprises of foreign broadcasting companies has raised several concerns. While it is contended that such expenditure is purely business expenditure and consequently should be allowed as a deduction, the tax authorities deny the deductibility of such expenses on the ground that such expenditure is primarily incurred for the benefit of the foreign broadcasting company, and therefore such companies ought to bear it. On this position, the Bombay High Court recently ruled in favour of allowing expenditure; However the matter has been appealed by the authorities in the Supreme Court and is therefore *sub judice.*

The controversy also arises on the question of whether tax should be withheld on the payments made to the entities as agency commission by broadcasters on advertising agencies, or as royalty payments, with broadcasting companies and tax authorities differing on this point. Resultantly, the non-withholding or short-withholding of taxes has led to huge tax burdens on the broadcasting companies.

14. 18 ITR 62.

IX. The Way Forward

Industry-wide issues such as those faced by the broadcasting sector are typically resolved by binding judicial precedent. However, since most of the issues in this sector have emerged only recently in the past few years, the law has not yet been settled by higher courts and tribunals. In the absence of judicial precedent, the parliament, by way of a law and the Central Board of Direct Taxes, by way of notification under section 295 of the ITA, have the power to clarify the legal position in this regard. Pending the resolution of such issues, there is bound to be significant litigation around disputes with the tax authorities.

It is also noticed that the tax environment governing the broadcasting sector in India is contrary to international practices. This increasing attempt by the authorities to tax payments made to foreign broadcasters de hors application of the principle of territoriality of tax laws has led to creating an environment that dis-incentivizes foreign companies from doing business in India. In this regard, it is of utmost importance for policy makers and the government to take quick and adequate steps to clear the ambiguities in the emerging tax framework and ensure that laws are tailored to facilitate growth and not stifle it.

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