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IP & Taxation Policy

Taxing the Trade of the Trade Mark

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Trade marks generate recognition to businesses by providing and protecting their distinctive features, among others, in a competitive market. Trade marks, being intangible property, can be transferred to third parties by various modes like assignment/ transmission/license. Since, trade marks have the potential to be commercially exploited and thereby attract tax (direct and/or indirect) on its commercial exploitation. This paper highlights the various modes through which trade marks can be commercialised and the implication under both direct and indirect taxation of such commercialisation. The paper also discusses recent issues with respect to the taxation of the income generated from the transfer of trade marks.

Keywords: Trade mark, Economic Rights, Commercial Exploitation, Taxation, Royalty, Income Tax, GST

In this highly competitive market we live in, businesses want to be recognised and leave a lasting impression on the consumers. One of the ways by which businesses are able to create a long-lasting impression in the minds of the consumers is by using their trade mark. Be it the bottle of Coca Cola, or the red colour of the soles of Louboutin shoes, the mascot of Amul, the consumer remembers these distinctive features of the brands/businesses.Thus, businesses put a lot of money and effort to create such distinctive features of their businesses.The law protects such distinctive aspects through trade mark law.

In India, the Trade Marks Act, 1999 (TM Act) consolidates the law related to trade mark. It provides for the protection, registration of trade marks for goods and services and prevention of the use of fraudulent marks.[1] The TM Act further defines a trade mark and lays down the conditions for transfer of these trade marks from a registered proprietor to a third party. This transfer can be by way of assignment and/or transmission.

When a person (juristic or natural) transfers a trade mark by either of these modes, the transfer is liable to be taxed under the extant law because a trade mark is considered as an intangible property which can be commercialised. Thus, such transfers are liable for taxation under the Income Tax Act, 1961 (IT Act) and the Central Goods and Services Tax, 2017 (CGST Act).

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This paper is divided into three parts. The first part explains the different modes of transfer of trade mark as provided under the TM Act. The second part then analyses the tax implications of such transfers under both direct and indirect taxation (including international taxation). The third part discusses various issues pertaining to the taxation of trade mark in India.

Modes of Transfer of Trade Mark

The TM Act allows a registered proprietor/user to transfer the trade mark to a third party. Before delving into the various mode of transfer, it is important to understand the meaning of trade mark as defined under the Act.

Section 2(1)(zb) defines a trade mark as a "*mark which is capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of the others and may include shape of goods, their packaging and combination of colours*". Therefore, the purpose of a trade mark is to identify the source of the goods and/or services.[2]The TM Act further defines a mark as a "*device, brand, heading, label, ticket, name, signature, word, letter, numeral, shape of goods, packaging or combination of colours or any combination thereof*".[3] Today non conventionaltrade marks such as architectural trade-marks[4], store layouts[5], sound marks[6] are also being protected under the law. Marks such as certification trade mark[7],

collective mark[8] and/or a well known trade mark[9] are also covered under a trade mark. Recently the Delhi High Court in *Khadi & Village Industries Commission* v *Raman Gupta & Ors*[10] held Khadi to be a well-known trade mark.

Chapter V of the TM Act lays down the provisions/rules for a valid assignment and transmission of a trade mark. According to Section 2(1)(b), an assignment is an assignment in writing by act of the parties concerned while a transmission is defined as a transmission by operation of law, devolution on the personal representative of the deceased person and any other mode of transfer, not being assignment.[11] The IPAB in *Riverdale School Society* v *Riverdale High School*[12] held that there can be no oral assignment of a trade mark. However, if there is an oral agreement and the same is coupled with the evidence of payment of royalties for the use of the trade mark, the same may be construed as a license to use the trade mark and not an assignment of the trade mark. Furthermore, in case a license was made prior to an assignment, the said licence would stand automatically terminated from the day the assignment is made/comes into effect.[13]

The registered proprietor of a trade mark has the power to assign the trade mark and give effectual receipts for any consideration of such assignment. Such an assignment is subject to the other provisions of the TM Act and the right appearing in the register.[14] Section 38 of the TM Act states that a registered trade mark is both assignable and transmissible with or without the goodwill of the business concerned. Such goodwill can be in respect of all the goods or services in which the trade mark is registered or only some of the goods or services. The transfer of a registered trade mark with or without the transfer of the goodwill is in line with Article 21 of the Agreement on Trade Related Aspects of Intellectual Property Rights. An unregistered trade mark can also be assigned or transmitted with or without the goodwill of the business concerned.[15]

The term goodwill has not been defined in the Act. In *Churton*v *Dogules*[16], goodwill was defined as: *"Goodwill must mean every advantage that has been acquired by the old firm by carrying on its business, everything connected to the premises and the name of the firm, and everything connected or carrying with it the benefit of the business."*

The Hon'ble Supreme Court in *Rustom Cavasjee Copper* v *Union of India*[17] held goodwill to be an intangible asset. The relevant portion of the judgment is reproduced hereinbelow:

"98. Goodwill of a business is an intangible asset: it is the whole advantage of the reputation and connections formed with the customers together with the circumstances making the connection durable. It is that component of the total value of the undertaking which is attributable to the ability of the concern to earn profits over a course of years or in excess of normal amounts because of its reputation, location and other features: Trego v. Hunt [LR (1896) AC 7] . Goodwill of an undertaking therefore is the value of the attraction to customers arising from the name, and reputation for skill, integrity, efficient business management, or efficient service."

While deciding whether the transfer of goodwill will give rise to capital gains in *CIT* v *B.C. Srinivasa Setty*[18], the Hon'ble Supreme Court discussed the concept of goodwill and held:

"9. Goodwill denotes the benefit arising from connection and reputation. The original definition by Lord Eldon in Crutwell v *Lye [1810, 17 Ves 335] that goodwill was nothing more than "the probability that the old customers would resort to the old places" was expanded by Wood V.C. in Churton* v *Douglas [1859 John 174] to encompass every positive advantage "that has been acquired by the old firm in carrying on its business, whether connected with the premises in which the business was previously carried on or with the name of the old firm, or with any other matter carrying with it the benefit of the business". In Trego* v *Hunt [1896 AC 7] Lord Herschell described goodwill as a connection which tended to become permanent because of habit or otherwise. The benefit to the business varies with the nature of the business and also from one business to another. No business commenced for the first time possesses goodwill from the start. It is generated as the business is carried on and may be augmented with the passage of time.*

A variety of elements goes into its making, and its composition varies in different trades and in different businesses in the same trade, and while one element may preponderate in one business, another may dominate in another business. And yet because of its intangible nature, it remains insubstantial in form and nebulous in character. Those features prompted Lord Macnaghten to remark in CIT v *Muller & Co.'s Margarine Limited [1901 AC 217] that although goodwill was easy to describe, it was nonetheless difficult to define. In a progressing business goodwill*

tends to show progressive increase. And in a failing business it may begin to wane. Its value may fluctuate from one moment to another depending on changes in the reputation of the business. It is affected by everything relating to the business, the personality and business rectitude of the owners, the nature and character of the business, its name and reputation, its location, its impact on the contemporary market, the prevailing socio-economic ecology, introduction to old customers and agreed absence of competition. There can be no account in value of the factors producing it. It is also impossible to predicate the moment of its birth. It comes silently into the world, unheralded and unproclaimed and its impact may not be visibly felt for an undefined period. Imperceptible at birth it exists enwrapped in a concept, growing or fluctuating with the numerous imponderables pouring into, and affecting the business..."

While differentiating between goodwill and trade mark, the Hon'ble Supreme Court in *Laxmikant* V. *Patel* v *Chetanbhai Shah*[19] held*:*

"8. It is common in trade and business for a trader or a businessman to adopt a name and/or mark under which he Would carry on his trade or business. According to Kerly (Law of Trade Marks and Trade Names, 12th Edn., para 16.49), the name under which a business trades will almost always be a trade mark (or if the business provides services, a serve mark, or both). Independently of questions of trade or service mark, however, the name of a business (a trading business or any other) will normally have attached to it a goodwill that the Courts will protect. An action for passing-off will then lie wherever the defendant company's name, or its intended name, is calculated to deceive, and so to divert business from the plaintiff, or to occasion confusion between the two businesses. If this is not made out there is no case. The ground is not to be limited to the date of the proceedings, the Court will have regard to the way in which the business may be carried on in the future, and to its not being carried on precisely as carried on at the date of the proceedings. Where there is probability of confusion in business, an injunction will be granted even though the defendants adopted the name innocently.

"10. A person may sell his goods or deliver his services such as in case of a profession under a trading name or style. With the lapse of time such business or services associated with a person acquire a reputation or goodwill which becomes a property which is protected by Courts. A competitor initiating sale of goods or services in the same name or by imitating that name results in injury to the business of one who has the property in that name. The law does not permit any one to carry on his business in such a way as would persuade the customers or clients in believing that the goods or services belonging to someone else are his or are associated therewith. It does not matter whether the latter person does so fraudulently or otherwise. The reasons are two. Firstly, honesty and fair play are, and ought to be, the basic policies in the world of business. Secondly, when a person adopts or intends to adopt a name in connection with his business or services which already belongs to someone else it results in confusion and has propensity of diverting the customers and clients of someone else to himself and thereby resulting in injury."

As is evident, goodwill has no independent existence. Goodwill is always associated with the business it is associated with. Thus, where the goodwill is transferred to another along with the trade mark, the transferee gets the exclusive rights to carry on the business transferred, that is, the transferee can carry on the business under the same trade name with respect to the same goods and/or services. To evaluate if an assignment is with or without the goodwill, the assignment deed will need to be analysed on a case to case basis.

Thus, all trade-marks, whether registered or not, can be assigned or transmitted with or without the goodwill. In case an assignment of a registered or an unregistered trade mark is made otherwise than in connection with the goodwill of the business, the assignment will take effect only when the assignor obtains directions from the Registrar and advertises the assignment in accordance with law.[20] It is important to note that a certification trade mark can only be assigned or transmitted with the consent of the Registrar.[21] and an associated trade mark can only be assigned/transmitted as a whole trade mark and not just a part.[22]

The following restrictions are imposed on the assignment and transmission of a trade mark:

a. Where such assignment/transmission would create exclusive rights in more than person in relation to:
   - (i) same goods or service or
   - (ii) same description of goods or service or
   - (iii) goods or services or description of goods or services which are associated with each other

and the same is likely to deceive or cause confusion in the minds of the public.[23]

b. Where such assignment/transmission would create exclusive rights in different parts of India in different persons.[24] Since a trade mark can be commercialised by way of an assignment/ transmission/license, the proceeds received from such commercialisation are liable to tax and the same is discussed in the next part.

Trade mark and Taxation

The use of trade mark and the transfer of trade-mark generate income for the registered proprietor of a trade mark which is subject to income tax and such activities are a transaction which is subject to Goods and Services Tax (GST).

Income Tax

The provisions that were discussed in the previous paper titled "Commercializing Copyright – A Taxing Event for the Copyright Owner?"[25] related to taxation of the transfer of copyright are similar to trade mark since the IT Act, generally, does not create a distinction between the taxation of different kinds of intangible assets. For ease of reference/understanding, the same is discussed here in under:

Under the IT Act, tax levied on the income of a 'person'[26] which is earned by such 'person'.[27] The income of such a 'person' is taxable based on the residential status of the person,[28] that is,– (1) a 'person' resident in India under the IT Act; and (2) a 'person'[29] not a resident in India. Different rules determine the residential status of a person, which *inter-alia*[30] includes an individual, company and partnership firm.[31]

The 'income' of a 'person' resident in India is subject to income tax in India. It includes all 'income' that (a) is received or is deemed to be received in India in such FY by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to such person in India during such FY; or(c)accrues or arises to such person outside India during such FY.[32]

In case of a 'person' not a resident of India, only such 'income' that (a) is received or is deemed to be received in India in such FY by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to such person in India during the FY is subject to income tax in India under the IT Act.[33]

For the computation of 'total income'[34] under the IT Act , 'income' is classified under five heads : (a) Salaries; (b) Income from house property; (c) Profits and gains of business or profession (PGBP); (d) Capital gains; and (e) Income from other sources (IoS). Broadly, income from the commercialisation of a trade mark can be generated in two ways: (i) Licensing of trade mark, or (ii) Assignment of trade mark.

Licensing of Trade Mark

I. A 'person' resident in India

The 'income' arising to a 'person' from licensing of trade-mark may be taxable under either the head (a) PGBP, or (b) IoS. The profits and gains of any 'business' or 'profession' which is carried on by a taxpayer at any time during the FY is chargeable to income tax under the head PGBP as per the IT Act. The term 'profession' is generally *"associated with the exercise of intellectual or technical equipment resulting from learning or service"*.[35] It involves *"occupation requiring purely intellectual or manual skill"*.[36] The term 'business' is inclusively defined to include any *'trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture'*.[37]

Accordingly, when licensing of trade mark qualifies as the 'business' of a 'person', the profits derived from such 'business' is chargeable to income tax under the head PGBP. These profits are computed in accordance with Sections 30 – 43D of the IT Act.

An expenditure, not in the nature of capital expenditure (or personal expenses of the taxpayer), which is laid out or expended wholly and exclusively for the purposes of the 'business' is allowed as deduction in computing the income chargeable under the head PGBP.[38] Further, 25% of the 'written down value'[39] of a trademark acquired on or after 1st April 1998 by a taxpayer and used for the purposes of the 'business', forming part of a 'block of assets'[40],is allowed as deduction in computing the income chargeable under the head PGBP.[41]

In case, 'income' arising to a 'person' from licensing of trademark is not connected with the 'business', if any, carried out by the taxpayer, such 'income' is chargeable to income tax under the head IoS.[42] Any expenditure (not in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such 'income' is allowed as deduction in computing 'income' chargeable to income tax under the head IoS.[43]

A 'person', not being an individual or a Hindu undivided family, responsible for paying to a resident 'person' any sum by way of 'royalty' is required to deduct tax at 10% of the sum.[44]

The term 'royalty' means consideration for, *inter-alia*, (a) the transfer of any rights in respect of a trade mark, (b) the imparting of any information concerning the working of, or the use of, a trade mark, (c) the use of any trademark, and (d) the rendering of any services in connection with the activities referred to in (a), (b) and (c). It includes any lump sum consideration but excludes any consideration which is chargeable to income tax in under the head 'Capital gains' in the hands of the recipient of such consideration.[45]

II. A 'person' not a resident in India

In case of a 'person' not a resident of India, 'income' that is deemed to accrue or arise to such person in India during the FY is subject to income tax in India under the IT Act.

As per Section 9(1)(vi) of the IT Act, the 'income' by way of 'royalty' is deemed to accrue or arise in India, when it is payable by:

a. the Indian Government; or
b. a 'person' who is a resident in India, excluding the case where the 'royalty' is payable in respect of any right, property or information used or services utilised for the purposes of a 'business' or 'profession' carried on by such 'person' outside India or for the purposes of making or earning any 'income' from any source outside India; or
c. a 'person' who is not a resident in India, where the 'royalty' is payable in respect of any right, property or information used or services utilised for the purposes of a 'business' or 'profession' carried on by such 'person' in India or for the purposes of making or earning any 'income' from any source in India.

The IT Act provides a concessional income tax regime for the 'income' by way of 'royalty' earned by a 'person' not a resident in India, in pursuance of an agreement made with the Indian Government or an Indian concern after 31st March 1976, and in case of the agreement with an Indian concern, either the agreement is approved by the Central Government or the agreement is in accordance with the industrial policy of the Indian Government, where the agreement relates to a matter included in the industrial policy.[46]On qualification of these conditions, the 'income' by way of 'royalty' will be subject to income tax at 10%[47], as against the standard rate of 30%[47] to 40%[47,] depending on the type of 'person' earning such 'income'.

It is worth to note that the above-mentioned concessional income tax regime is not applicable where (a) the 'royalty' income from the Indian Government or an Indian concern is received under an agreement entered into with the non-resident after 31st March 2003, (b) where the non-resident carries on business in India through a 'permanent establishment'[48] in India, or performs professional services from a fixed place of profession situated in India and (b) the right, property or contract in respect of which the 'royalty' is paid is effectively connected with the 'permanent establishment' or fixed place of profession. In such a case, a special mechanism[49] is provided for taxation of such 'royalty' income under the IT Act.

India has entered into Double Taxation Avoidance Agreement (Tax Treaty) with various countries. The provisions of the IT Act or the respective Tax Treaty apply, whichever are more beneficial to the taxpayer.[50]

Assignment of Trade Mark

Any profits or gains arising from 'transfer' of a 'capital asset' is chargeable to income tax under the head 'Capital Gains'.The 'income' chargeable to income tax under the head 'Capital Gains' is computed by:

Gains = Full value of consideration - (expenditure incurred wholly and exclusively in connection with such transfer + the 'cost of acquisition' of the 'capital asset' + the 'cost of any improvement' thereto).[51]

The term 'capital asset' is defined as a property of any kind held by a taxpayer whether or not connected with the taxpayer's 'business' or 'profession' and it excludes, *inter-alia*, any 'stock-in-trade' held for the purpose of 'business' or 'profession'.[52]Given a wide definition of 'capital asset' in the IT Act, a trade mark owned by a taxpayer can qualify as a 'capital asset', unless it qualifies as 'stock-in-trade'[53] of the taxpayer.

The term 'transfer' in relation to a 'capital asset' includes, *inter-alia,* (a) the sale, exchange or relinquishment of the asset, and (b) the extinguishment of any rights therein.Where the 'capital asset', being a trade mark, is held for a period of more than 36 months preceding the date of 'transfer', such 'capital asset' is considered as a 'long-

term capital asset', else it is considered as a 'short term capital asset'.[54]

The Hon'ble Delhi High Court in *CIT* v *Mediworld Publications Pvt. Ltd*[55] confirmed that transfer of brand names, trademark, copyright and goodwill in journals, qualifying as 'capital assets', by the taxpayer is subject to income tax under the head 'Capital Gains'

In case of 'transfer' of 'long-term capital asset' by a 'person', indexation benefit is available for the 'cost of acquisition' and 'cost of improvement'.[56] Indexation benefit for the 'cost of acquisition' refers to stepping up of the 'cost of acquisition' amount based on the ratio of the Cost Inflation Index between the year of 'transfer', and either (a) the first year in which such 'capital asset' was held by the taxpayer or (b) the year beginning on 1st April 2001, whichever is later. Indexation benefit for the 'cost of improvement' refers to stepping up of the 'cost of improvement' amount based on the ratio of the Cost Inflation Index between the year of 'transfer', and the year in which the improvement to the 'capital asset' took place.

Further, the 'transfer' of a 'long-term capital asset' is subject to concessional income tax at 20%[57], while 'transfer' of a 'short-term capital asset' is subject to income tax at the rate prescribed depending on the type of 'person' transferring such 'short-term capital asset'.

The terms 'cost of acquisition' has not been defined in the IT Act. However, it has been a subject matter of various judicial decisions. In *CIT* v *TrikamlalManeklal (HUF):*[58]

"Capital gains tax is thus levied on the profit or gain that arises on the transfer of a capital asset. This, ordinarily, is the actual profit or gain. It is to be computed by deducting from the consideration received on the sale of the capital asset, inter alia, the cost of its acquisition. Ordinarily, it is the actual cost of acquisition that has to be taken into account. If the actual cost of acquisition is nil, it is that nil figure that must be taken into account……. In the context of Sections 45 and 48 of the Income-tax Act, 1961, what is required to be considered is the actual cost of acquisition of the capital asset by the assessee. It cannot be calculated on any notional basis, except in the circumstances mentioned in sections 49 and 55 of the said Act. The notional basis which is employed for the purposes of calculating the cost of acquisition for the purposes of a claim for depreciation has no application in the context of the computation of capital gains." [*Emphasis supplied*]

Accordingly, unless a cost on notional basis has been prescribed in the IT Act, the actual cost incurred for acquisition of the 'capital asset' is considered as the 'cost of acquisition', where the trademark is purchased by the taxpayer. However, in case of a self-generated trade mark by the taxpayer, the 'cost of acquisition' for the purposes of computing the 'income' chargeable to income tax under the head 'Capital Gains' is nil.[59] It is worth noting that a special mechanism[60], to compute 'income' chargeable to income tax under the head 'Capital Gains', is applicable where the 'capital asset', such as a trade mark, form part of a 'block of assets' in respect of which depreciation has been allowed under the IT Act, that is such 'capital asset' is used for the purpose of business.

As mentioned above, consideration which is chargeable to income tax under the head 'Capital gains' in the hands of the recipient of such consideration is excluded from chargeability of income tax as 'royalty'.[61]

Goods and Services Tax

The taxable event under GST law[62] is 'supply'[63] of 'goods' or 'services'. The following transactions fall under the scope of 'supply':[64]

a. *"all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business;*
b. *the activities or transactions, by a person, other than an individual, to its members or constituents or vice-versa, for cash, deferred payment or other valuable consideration;*
c. *import of services for a consideration whether or not in the course or furtherance of business;*
d. *the activities specified in Schedule I, made or agreed to be made without a consideration."*

The term 'goods' means *"every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply".* [65]

The term 'services' means *"anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash*

or by any other mode, from one form, currency or denomination to another form, currency, or denomination for which a separate consideration is charged".[66]

Certain transactions are specified to be treated either as 'supply' of 'goods' or 'services', where such transaction constitutes a 'supply'.[67] A temporary transfer or permitting the use or enjoyment of any intellectual property right is treated as 'supply' of 'services'.[68]

As was the case in copyright, a permanent transfer of a trade mark is considered as 'supply' of 'goods' and is subjected to GST at the rate of 18%.[69] A temporary or permanent transfer or permitting the use or enjoyment of trade mark, is considered as 'supply' of 'services', is also subjected to GST at the rate of 18%.[70] Given that a 'permanent transfer' is being considered both as 'supply' of 'goods' or 'supply' of 'services', the nature of assignment of trade mark is still an open question.[71]

Issues in Trade Mark and Taxation: A Judicial Discourse

Situs of Trade Mark

An income arising to a 'person' not a resident in India on transfer of a 'capital asset' situated in India is deemed to accrue or arise in India. Accordingly, where the 'capital asset', being a trademark, is situated in India i.e., the situs of such trademark, a 'person' not a resident in India will be subject to income tax in India arising on transfer of such trademark, whether a trademark, registered in India, owned by a 'person' not a resident in India is a 'capital asset' situated in India is a vexed issue and is pending determination at the Hon'ble Supreme Court[72] against the decision of Hon'ble Delhi High Court in *CUB Pty Ltd.* v *Union of India*.[73] The Hon'ble Delhi High Court had accepted CUB's contention that the trademark is a 'capital asset' situated in India based on the doctrine of '*mobiliasequunturpersonam*', meaning movables follow the law of the person, in the common law being consistently maintained in determining the taxable situs of an intangible property. It is worth to note that factually the trademark, only with respect to the India territory, was sold by CUB and it was contended by the Income Tax Authorities that the value of such trademark clearly represented the value it had earned/gained from its Indian operations.

In the authors opinion, even if the registered proprietor/user is not situated in India but the trade mark is registered in India and derives its value from its commercialisation in India, the same ought to be liable for taxation in India even if the registered proprietor is a 'person' not a 'resident' in India. This is similar to a situation where a share of a foreign company derives its substantial value from the assets located in India and is subject to income tax in India in the hands of a 'person' not a 'resident' in India as per Explanation 5 to Section 9(1)(i) of the IT Act. The relevant portion is extracted here in below:

"Explanation 5—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India:" [Emphasis supplied]

Marketing Intangibles

The Supreme Court[74] is considering the qualification of Advertising, Marketing & Promotional expenses ("AMP expenses") incurred by a 'person' resident in India ("Indian Party")as an 'international transaction' which adds value to the 'marketing intangibles' owned by such Indian Party's 'associated enterprise', being a 'person' not a resident in India ("Foreign Party"), and thereby requires to be remunerated at an arm's length price ("ALP") under the Indian Transfer Pricing Provisions[75] (Indian TPP).[76]

In order to understand, the background in which the Supreme Court has to answer the above question, it is important to understand concepts such as 'marketing intangibles', Indian TPP, 'international transaction' and 'associated enterprise'.

Marketing Intangibles is defined by the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Transfer Pricing Guidelines") as follows[77]:

An intangible (within the meaning of paragraph 6.6) that relates to marketing activities, aids in the commercial exploitation of a product or service and/or has an important promotional value for the product concerned. Depending on the context, marketing intangibles may include, for example, trademarks, trade names, customer lists, customer relationships, and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers [Emphasis supplied]

The Indian TPP provides that any 'income' arising from an 'international transaction' by a 'person' is to be computed at an ALP[78], that is, if any 'income' arises from an 'international transaction', irrespective of tax residence of such 'person' in India, then such 'income' will be computed at an ALP for the purposes of computing tax liability of such 'income' under the IT Act.

The term 'international transaction' means a transaction between two or more 'associated enterprises', where at least one of the enterprises is a 'person' not a resident in India, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises.[79]

An 'associated enterprise', in relation to another enterprise, means[80] an enterprise—

a. Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
b. In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

A deeming fiction is provided for two enterprises to be considered as 'associated enterprises'.[81]

The Income Tax Authorities are contending before the Supreme Court that such AMP expenses incurred by the Indian Party add value to the 'marketing intangibles', legally owned by the Foreign Party, by way of further building their 'marketing intangibles'. Accordingly, Indian Party must be compensated by the Foreign Party for such benefit at ALP.

The counter-argument by the taxpayers is primarily two fold (a) AMP expenses are not specifically included in the definition of the term 'international transactions' which are subject to Indian TPP; and (b) even though Foreign Party is the legal owner of the 'marketing intangibles', the Indian Party is the economic owner of such 'marketing intangibles' and accordingly, the Indian Party is not required to record ALP for such AMP expenses given it is the receiving the benefit from incurring such AMP expenses.

In computing the ALP of such alleged 'international transaction', the Income Tax Authorities have contended the applicability of 'bright line test' laid down in the judgement of *DHL Corporation & Subsidiaries* v *Commissioner of Internal Revenue*.[82] The 'bright line test', discussed in the Income Tax Appellate Tribunal's ("ITAT") Special Bench Ruling in *L.G. Electronics India Private Limited*[83], explained as follows: *"Bright line is a line drawn within the overall amount of AMP expense. The amount on one side of the bright line is the amount of AMP expense incurred for normal business of the assessee and the remaining amount on the other side is the cost/value of the international transaction representing the amount of AMP expense incurred for and on behalf of the foreign AE towards creating or maintaining its marketing intangible."*

Thus, AMP expense incurred beyond the routine expenses that would be incurred by comparable companies in India are the non-routine expenses, that ultimately lead to the enhancement in the value of the 'marketing intangibles', should be compensated with ALP by the Foreign Party to the Indian Party in line with the Indian TPP.[84]

This issue of development and enhancement of 'marketing intangibles' has also been discussed in the OECD Transfer Pricing Guidelines.

"6.77. The analysis of this issue requires an assessment of (i) the obligations and rights implied by the legal registrations and agreements between the parties; (ii) the functions performed, the assets used, and the risks assumed by the parties; (iii) the intangible value anticipated to be created through the marketer/distributor's activities; and (iv) the compensation provided for the functions performed by the marketer/distributor (taking account of the assets used and risks assumed). One relatively clear case is where a distributor acts merely as an agent, being reimbursed for its promotional expenditures and being directed and controlled in its activities by the owner of the trademarks and other marketing intangibles. In that case, the distributor ordinarily would be entitled to compensation appropriate to its agency activities alone. It does not assume the risks associated with the further development of the trademark and other marketing intangibles, and would therefore not be entitled to additional remuneration in that regard.

6.78. When the distributor actually bears the cost of its marketing activities (for example, when there is no

arrangement for the legal owner to reimburse the expenditures), the analysis should focus on the extent to which the distributor is able to share in the potential benefits deriving from its functions performed, assets used, and risks assumed currently or in the future. In general, in arm's length transactions the ability of a party that is not the legal owner of trademarks and other marketing intangibles to obtain the benefits of marketing activities that enhance the value of those intangibles will depend principally on the substance of the rights of that party. For example, a distributor may have the ability to obtain benefits from its functions performed, assets used, and risks assumed in developing the value of a trademark and other marketing intangibles from its turnover and market share when it has a long-term contract providing for sole distribution rights for the trademarked product. In such a situation the distributor's efforts may have enhanced the value of its own intangibles, namely its distribution rights. In such cases, the distributor's share of benefits should be determined based on what an independent distributor would receive in comparable circumstances. In some cases, a distributor may perform functions, use assets or assume risks that exceed those an independent distributor with similar rights might incur or perform for the benefit of its own distribution activities and that create value beyond that created by other similarly situated marketers/distributors. An independent distributor in such a case would typically require additional remuneration from the owner of the trademark or other intangibles. Such remuneration could take the form of higher distribution profits (resulting from a decrease in the purchase price of the product), a reduction in royalty rate, or a share of the profits associated with the enhanced value of the trademark or other marketing intangibles, in order to compensate the distributor for its functions, assets, risks, and anticipated value creation." [Emphasis supplied]

In the author's opinion, non-routine AMP expenses certainly build the goodwill of a business and the popularity of a trade mark thereby increasing its value, accordingly, an arm's length remuneration ought to be provided to the Indian Party.

Apportionment of Returns Earned on Exploitation of Trade Mark

An entity, being part of a Multinational Enterprise (MNE) group, as a legal owner of a trademark earns 'royalties', i.e., upon exploitation of such trade mark. However, other members of the MNE group, by performing certain functions, using their assets, or assumed certain risks, may also have contributed value for the entity to earn returns from such exploitation as a legal owner. Accordingly, such other members of the MNE group must be compensated for their contributions at ALP as per the Indian TPP.

The OECD Transfer Pricing Guidelines provides a framework for identifying the commercial or financial relations between the members of the MNE Group[85]:

(i) Identification of the intangibles involved in the transaction between members of the MNE group and economically significant risks associated with the development, enhancement, maintenance, protection, and exploitation of the intangibles (DEMPE);

(ii) Identification of the full contractual arrangements between members of the MNE group (including determination of the legal ownership of intangibles and the contractual rights and obligations such as the contractual assumption of risks);

(iii) Identification of the members of the MNE group performing functions, using assets, and managing risks related to DEMPE by means of the functional analysis (FAR Analysis);

(iv) Confirmation of the consistency between the contractual arrangement and actual conduct of the members of the MNE group, and determination whether the member, assuming economically significant risks, controls the risks and has the financial capacity for assumption of DEMPE risks;

(v) Delineation of the actual transactions related to DEMPE in light of the legal ownership of the intangibles, the contractual relations, and the conduct of the members in their contribution as per FAR Analysis;

(vi) Determination of the ALP for the transactions in DEMPE a per each member's contribution as per FAR Analysis.

Therefore, where the member of the MNE group as a legal owner of the trademark in substance (a) performs and controls all of the functions related to DEMPE, (b) provides all assets, necessary for DEMPE, and (c) assumes all of the risks related to DEMPE, such legal owner is entitled to all the returns on exploitation of such trademark. However, where other members of the MNE group performs functions, uses assets, or assumes risks related to DEMPE, such

members are also entitled to be compensated on ALP for their contribution in the value of the trademark.[86]

The apportionment of return based on DEMPE was a subject matter of discussion in ITAT's ruling in *L'Oreal India Pvt. Ltd* v *DCIT*.[87] The Income Tax Authorities proposed adjustment to the profits earned by L'Oreal India, an exclusive licensee for the right to import, manufacture, market, distribute and sell the products of the brand owned by L'Oreal France, on the alleged performance of DEMPE functions and not being remunerated an ALP for such activities. The Income Tax Tribunal didn't accept this contention on the factual position that the contractual relationship of L'Oreal India with its parent didn't provide for performance of DEMPE functions in relation to the trademarks whose legal owner was L'Oreal France and accordingly, no additional profits could be attributed to L'Oreal India on such alleged performance of DEMPE functions.[88]

Franchise Agreements

One of common mode of exploiting trademark of repute is through franchise agreement. As highlighted above, assignment or licensing of trademark, whether it be temporary or permanent would fall under either 'goods' or 'services' for the purpose of GST. It is worth to note that the applicable tax rate in either case, that is 'goods' or 'services', is the same. Hence the nuance in considering the transfer of trade mark as a transfer of goods or services fails to garner judicial interpretation. As per the Services Accounting Codes (SAC Codes) 997336 under the GST regime, makes it clearer that licensing services for the right to use trademarks and to operate franchises will attract 18% GST.

Under Section 37(1) of the IT Act, an expenditure, not in the nature of capital expenditure (or personal expenses of the taxpayer), which has been laid out or expended wholly and exclusively for the purposes of the business is allowed as deduction in computing the income chargeable under the head PGBP.

The Hon'ble Delhi High Court in the case of *CIT* v *Jubilant Foodwork (P.) Ltd*[89] held that that payment made for trade mark 'Dominos', being used for the purpose of selling their products/goods, is revenue in nature and allowed as business deduction under Section 37 of the IT Act in computing the income subject to tax under the head PGBP. This was observed based on the rationale that the taxpayer did not own the trade mark and upon termination of the agreement or on failure in payment of the franchise fee, taxpayer would lose the right to use the said trademark. Accordingly, on account of payment of franchise fee no new asset came into existence in the hands of the taxpayer and no enduring benefit was derived by the taxpayer as the rights under the agreement were only for the tenure of the agreement.

Conclusion

From the above discussions, it is evident that the proceeds received from commercialisation of trademarks by way of assignment, transmission and license are liable to tax and such transactions are subject to GST. In the authors' view having differential and preferential tax treatment for Indian residents will encourage businesses to set up in India and register trade marks in India. This in turn would help strengthening the economy.

References

1 *Meghraj Biscuits Industries Ltd* v *CCE,* (2007) 3 SCC 780.
2 *Ramdev Food Products Pvt Ltd* v *Arvind bhai Rambhai Patel & Ors,* (2006) 8 SCC 726.
3 Section 2(m) of the TM Act.
4 Taj Mahal Palace Hotel and the BSE Building.
5 Mary Cohr Store Layour.
6 Yahoo's yodel.
7 Section 2(1)(e) of the TM Act.
8 Section 2(1)(g) of the TM Act.
9 Section 2(1)(zg) of the TM Act.
10 CS(COMM) 133/2022, dated 26 July 2022.
11 Section 2(1)(zc) of the TM Act.
12 (2008) 36 PTC 131 (IPAB).
13 *BDA Ltd* v *State of Uttar Pradesh,* (1996) IPLR 93.
14 Section 37 of the TM Act.
15 Section 39 of the TM Act.
16 (1859) 28 LJ Ch 841.
17 (1970) 1 SCC 248.
18 (1981) 2 SCC 460.
19 (2002) 3 SCC 65.
20 Section 42 of the TM Act.
21 Section 43 of the TM Act.
22 Section 44 of the TM Act.
23 Section 40 of the TM Act.
24 Section 41 of the TM Act.
25 Singhal S, Agrawal A & Sakthivel M, Commercializing Copyright–A Taxing Event for the Copyright Owner? *Journal of Intellectual Property Rights,* 27(4) (2022) 290.
26 Section 2(24) of the IT Act.
27 Section 4 of the IT Act.
28 Section 2(31) of the IT Act.
29 Section 5 of the IT Act.
30 Section 6 of the IT Act. For instance: A company is a resident in India under the IT Act in a FY when either (a) it is an 'Indian company'; or (b) its 'place of effective management'. The phrase 'place of effective management" means 'a place where key management and commercial

decisions that are necessary for the conduct of business of an entity as a whole are, in substance made'.

31 Section 5(1) of the IT Act.
32 Section 5(2) of the IT Act.
33 Section 2(45) of the IT Act.
34 CIT vBhagwan Broker Agency [1995] 212 ITR 133 (Rajasthan).
35 CIT v Manmohan Das [1966] 59 ITR 699 (SC).
36 Section 2(13) of the IT Act.
37 Section 37(1) of the IT Act.
38 Section 43(6)(c) of the IT Act.
39 Section 2(11) of the IT Act. It means a group of assets falling within a class of assets comprising either (a) tangible assets, or (b) intangible assets, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession, in respect of which the same percentage of depreciation is prescribed.
40 Section 32(1)(ii) of the IT Act read with Rule 5(1) of the Income Tax Rules, 1962 ("IT Rules") and Part B of Appendix I of IT Rules.
41 Section 56(1) of the IT Act.
42 Section 57(iii) of the IT Act.
43 Section 194J(1) of the IT Act.
44 Explanation 2 to Section 9(1)(vi) of the IT Act.
45 Section 115A(1)(b) of the IT Act.
46 Plus applicable surcharge and cess
47 As per Explanation (c) to Section 44DA of the IT Act, the term 'permanent establishment' is defined to include *"a fixed place of business through which the business of the enterprise is wholly or partly carried on"*.
48 Section 44DA of the IT Act.
49 Section 90(2) of the IT Act.
50 Section 48(1) of the IT Act.
51 Section 2(14) of the IT Act.
52 As per *H. Mohmed & Co. v. CIT* [1977] 107 ITR 637 (Gujarat), a 'stock-in-trade' is *"something in which a trader or a businessman deals; whereas his capital asset is something with which he deals. It is possible that one and the same commodity may in the case of one assessee be his stock-in-trade, whereas in the case of another assessee it may be his capital asset. For example, in the case of an assessee who carries on the business of buying and selling land, land may be his stock-in-trade but in the case of an assessee who has invested his savings in land and gets income from the land or the structures put up on the land, the land is his capital asset. Therefore, one of the indications for deciding as to what is stock in-trade is whether a particular assessee is buying or selling the commodity or whether he has merely invested his amount with a view to earn further income or with a view to carry on his other business. It may be pointed out that 'trade' means that particular business activity where the person engaged in the profession buys or sells. All businesses may be carried on for the purpose of earning a profit but that particular kind of business where the businessman buys and sells a commodity can only be designated as 'trade'." [Emphasis supplied]*
53 Section 2(42A) of the IT Act.
54 [2011] 11 taxmann.com 374 (Delhi).
55 Second proviso to Section 48 of the IT Act.
56 Plus applicable surcharge and cess. Section 112(1) of the IT Act.
57 [1987] 168 ITR 733 (Bombay).
58 Section 55(2)(a) of the IT Act.
59 Section 50 of the IT Act.
60 Explanation 2 to Section 9(1)(vi) of the IT Act.
61 'GST laws collectively refers CGST Act and Integrated Goods and Services Tax Act, 2017 ("IGST Act").
62 Section 9(1) of the CGST Act and Section 5(1) of the IGST Act.
63 Section 7(1) of the CGST Act.
64 Section 2(52) of the CGST Act.
65 Section 2(102) of the CGST Act.
66 Schedule II to the CGST Act.
67 Entry 5(c) of Schedule II to the CGST Act.
68 Serial No. 452P of Notification No. 1/2017 Central Tax (Rate), dated 28-6-2017 read with Notification No. 13/2021 Central Tax (Rate), dated 27-10-2021.
69 Serial No. 17 item (ii) of Notification No. 11/2017 Central Tax (Rate) dated 28-6-2017 read with Notification No. 6/2021 Central Tax (Rate), dated 30-9-2021.
70 *USV (P.) Ltd., In re*, [2021] 133 taxmann.com 296 (AAR - MAHARASHTRA), the question of classification of transfer of registered trademarks as either supply of goods or supply of services under GST law was raised. However, based on the certain procedural the application for advance ruling was rejected as being not maintainable under section 95 of CGST Act.
71 *Union of India* v *CUB Pty Ltd.* (SLP(C) No. 19060/ 2017).
72 [2016] 71 taxmann.com 315 (Delhi)
73 *CIT* v *Sony Mobile Communications India Pvt. Ltd.* (SLP(C) No. 12971/2020) against the decision of Hon'ble Delhi High Court decided on 16th March 2015. *CIT* v *Maruti Suzuki India Ltd*. (SLC (C) No. 22181/2016) against the decision of Hon'ble Delhi High Court decided on 11th December 2015.
74 Chapter X of the IT Act.
75 Raffaele Petruzzi, GiammarcoCottani and Michael Lang, Fundamentals of Transfer Pricing: Industries, Regions, New Technologies, and Other Topics, Chapter 25 (Kluwer Law International BV 2022).
76 OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, OECD Publishing, Paris, https://doi.org/10.1787/0e655865-en.
77 Section 92 of the IT Act.
78 Section 92B(1) of the IT Act.
79 Section 92A(1) of the IT Act.
80 Section 92A(2) of the IT Act.
81 Some of the instances of such deeming fiction are:

a. one enterprise holds, directly or indirectly, shares carrying not less than 26% of the voting power in the other enterprise; or
b. any person or enterprise holds, directly or indirectly, shares carrying not less than 26% of the voting power in each of such enterprises; or
c. more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or

d. more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or

e. the manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights.

82 United States Court of Appeals, Ninth Circuit decided on April 11, 2002 (Nos. 99-71580, 00-70008, 99-71592 and 99-71675).

83 2013 SCC OnLine ITAT 483.

84 *Maruti Suzuki India Ltd.* v *CIT,* [2015] 64 taxmann.com 150 (Delhi).

85 Para 6.34 to the OECD Transfer Pricing Guidelines.

86 Para 6.71 to the OECD Transfer Pricing Guidelines.

87 ITA No. 7194/Mum/2017 decided on 23rd August 2019.

88 Karol Dziwinski, The DEMPE Concept and Intangibles: Definition, Practical Approach and Analysis in the Context of Licence Model (Chapter 3, Section 3.3.4) (Kluwer Law International BV 2022).

89 [2014] 52 taxmann.com 215 (Delhi).