IPR Transactions in India - Tax Implications for Non-Residents

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Intellectual Property Rights (IPRs) being intangible lead to different situations of taxability for Non-Residents both under the Income-tax Act, 1961 (the IT Act) and under the Integrated Goods and Services Tax Act, 2017 (the IGST Act).

Generally the transactions in IPR's may involve:

1. Licensing use of the IPR's on a yearly basis,
2. Outright Sale of IPR's for lump sum consideration or based upon future sales
3. Transfer of IPR's without consideration
4. Transfer on account of amalgamation

There is hardly any dispute that income on licensing of the IPR's (except software which is not being discussed in this article) by entities outside India to entities within India is taxable as Royalty under section 9(1)(vi) of the IT Act and is also regarded as a supply of services under section 7 of the IGST Act subject to tax under section 3 thereof.

However, on outright sale/Transfer of IPR's without consideration (usually worldwide rights are sold) or amalgamation of companies, tax implications need to be considered both under the IT Act as well as under the IGST Act.

Implications under the IT Act

In the IT Act the term "Capital Asset" is defined under section 2(14) of the Act to include property of any kind held by a person whether connected with business or not.

The decision of the Hon'ble Supreme Court of India in the case of *Vikas Sales Corporation and Ors Vs Commissioner of Commercial Taxes and Ors* reported in (1996) 4 SCC 433 has noted that the term movable property would include within its ambit "incorporeal rights like trademarks ,copyrights,patents".

Thus, IPR's would generally fall within the meaning of the term Capital Asset u/s 2(14) of the IT Act.

Income on sale of a Capital Asset in India is taxed under the IT Act as Capital Gains. There is no dispute on taxability on sale/transfer of IPR's by a person resident in India. However, when the transferor is a Non-Resident disputes may arise on right to tax by India.

For taxability under both the IT Act and the IGST Act the moot question to be considered is where the situs of the IPR is.

In the case of Cub Pty Ltd. (earlier known as Fosters Australia Ltd) the Authority for Advance Ruling (AAR) was concerned with a case where Foster's brand and logo were licensed to a related company ie. Foster's India Ltd. These were sold to another company SABMiller's nominee vide agreement dated 4th August 2006 read with agreement dated 12th September 2009. It was the argument of Cub Pty that the location

of a trademark is governed by the common law maxim of "*mobilia sequuntur personam*". According to this maxim the personal property of a person is governed by the same laws that govern that person.

The AAR observed that the trademark was also registered in India. This alongwith the feature that the said brand had generated appreciable goodwill in India being used for nearly a decade had their abode in India and that the sale proceeds were taxable in India as Capital Gains.

While deciding a Writ against the said ruling of the AAR the Hon'ble Delhi High Court in Cub Pty Ltd vs UOI and Ors reported in [TS-401-HC-2016(DEL)] observed, *"Thus the legislature, where it wanted to specifically provide for a particular situation, as in the case of shares, where the share derives, directly or indirectly, its value substantially from assets located in India, it did so. There is no such provision with regard to intangible assets, such as trademark, brands, logos i.e., Intellectual Property Rights. Therefore, the well accepted principle of 'mobilia sequuntur personam' would have to be followed. The situs of the owner of an intangible asset would be the closest approximation of the situs of an intangible asset. This is an internationally accepted rule, unless it is altered by local legislation. Since there is no such alternative in the Indian context, we would agree with the submissions made on behalf of the petitioner that the situs of the trademarks and intellectual rights ... would not be in India.*"

The Hon'ble High Court, therefore, held that the situs of the trademark would not be in India.

The said matter as I understand is currently pending before the Hon'ble Supreme Court of India [TS-5388-SC-2019-O].

The said judgment of the Hon'ble Delhi High Court, it is respectfully observed refers to a decision of the Court of Appeals of California Third Appellate District in the case of Rainier Brewing Company vs CHAS which in turn refers to the decision of the Hon'ble Supreme Court of the United States in the case of Curry vs McCanless 307 US 357.

In the said decision of Curry vs McCanless the Hon'ble Supreme Court of United States was concerned with a case where a person domiciled in one State say A had transferred to a trustee in another state B certain stocks and bonds on specific trust where evidences of the intangible property was kept. The net income was to be paid to her during her lifetime and was to be held in trust for specific beneficiaries after her death. Until her death the trust was being administered by a trustee in state B. Issue was which of the States could levy inheritance taxes on transfer of intangibles (shares and stocks regarded as intangibles evidenced by certificates). It was held that both States could levy the tax on transfer of intangibles.

Argument considered was whether based upon the principle of mobilia sequuntur personam only State A could levy taxes. It was held that *"in cases where the owner of intangibles confines his activities to the place of his domicile it has been found convenient to substitute a rule for a reason... by saying that his intangibles are taxed at their situs and not elsewhere or perhaps less artificially by invoking the maxim mobilia sequuntur personam which means only that it is the identity or association of intangibles with the person of their owner at his domicile which gives jurisdiction to tax. But when the taxpayer extends his activities with respect to his intangibles so as to avail of the protection and benefit of the laws of another state in such a way so as to bring his person or property within the reach of the tax gatherer there, the reason for a single place of taxation no longer ordains and the rule is not even a workable substitute..."*

The minority judgment in the said decision held that the taxation could only occur at State B where the intangibles were held and used, since they were never held in State A and observed that the meaning of the term business situs is not limited to investment or actual use as an integral part of business.

Varied instances of IPR's connection to India may arise as under:

- IPR's registered principally outside India and also in India.
- IPR's registered outside India and registration in India not sought or pending registration in India.

Such IPR's may:

(a)be licensed to Indian entities who may use them for manufacturing etc. or

(b)such IPR's may not be licensed to Indian entities but be used to sell goods or offer services to India while enforcing the IPR's in India by not permitting any entity to use the IPR's.

In both situations i.e., (a) and (b) above the "Business Situs" of the IPR's may arguably be partly situated in India on account of (i)the income by way of royalty from India, (ii) income by way of sale of goods having protection of the IPR's to entities in India. Another argument supporting this view is that IPR's exercisable and enforceable in India and not in any other country naturally are situated in India and not elsewhere. The proposition that rights exercisable and enforceable in India (movable property) are situated outside of India would be like stating that a car which one is driving in India is at that time stationed outside India.

Hence when these IPR's are sold based upon latest figure of proportion of India related sales/income to worldwide sale /income on account of the goods one can arguably attribute a part of the sale consideration to be towards the sale value of IPR's (being movable property) in India.

After allowing deductible expenses, the net consideration so received may be subject to Income-tax in India under the IT Act subject to treaty restrictions.

Most Tax treaties in case of movable property other than shares and those connected with a permanent establishment permit taxation of sale of capital assets only in the country of which the alienator is a tax resident.

However, the tax Treaties for example between Indian and Australia, India and USA, India and UK and India and China also permit the Country where the movable property is situated to tax such gains.

Where the consideration for the IPR's sold is payable based upon future sales it is likely to be taxed as and when received as contingent consideration as Capital Gains under the IT Act (subject to treaty provisions) or as Royalty under the Tax Treaty applicable.

Under the Indo-US tax treaty under Article 12 such contingent consideration is treated as Royalty.

If the alienator is resident of a Tax Haven like Bahamas/Bermuda with whom India does not have a comprehensive tax treaty then also taxability under the IT Act would have to be considered.

Hence:

Under the IT Act if the business situs of the IPR's is relatable to India the same to that extent may be taxable in India in certain cases. Transfer Pricing provisions (which require transactions between related entities to be calculated at arm's length) would also arise when the transactions are with a related entity.

Such a transaction from the point of view of the buyer of the IPR's may also attract liability to deduct tax at source under section 195 of the IT Act.

Taxability may also arise under the IT Act in case of transfer of IPR's without consideration under section 56(2)(x)(c) of the IT Act for the recipient of such IPR's.

In case of transfer on account of amalgamation section 47 of the IT Act which deals with transaction not regarded as a transfer is relevant. This section in case of non-residents transfer of movable property, does not regard transfer of movable property other than shares as a transaction not regarded as a transfer. Income tax implications may therefore arise since section 2(47) of the IT Act which defines the term "Transfer" would include transfer by way of amalgamation.

Implications under the IGST Act

Under the IGST Act as per section 7(5)(c) thereof, supply of goods or services in the taxable territory (now whole of India), not being an intra state supply of goods is treated as a supply of goods or services in the course of interstate trade or commerce.

The term "Goods" is not defined under the IGST Act but the definition of the term "Goods" as contained

in the Central Goods and Services Tax Act 2017(CGST Act) is applicable as per section 2(24) of the IGST Act which states that all words used and not defined in the IGST Act but defined under the CGST Act shall have the same meaning.

The term “Goods” as defined under section 2(52) of the CGST Act includes movable property.

Hence any transfer of IPR’s registered in India/pending registration in India by any person to any other person based upon business situs may be taxable in India under the IGST Act.

Transfers without consideration are also regarded as a supply for the purpose of the IGST Act as per section 7 of the CGST Act r.w.s. 2(24) of the IGST Act.

However, amalgamation as I understand is treated as a transfer as a going concern and specifically exempted from payment of IGST.

With thousands of transactions involving transfer of ownership of IPR’s taking place on a yearly basis the view which the Hon’ble Supreme Court of India may take in the SLP pending against the Delhi High Court judgment in Cub Pty’s case in respect of relevance and nature of Business Situs of the IPR’s assumes significance and will form the basis of taxability or otherwise of consideration received on transfer of IPR’s by Non-Residents under both Direct as well as Indirect taxes.