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"Taxation under Sales Tax Laws of Intellectual Property Rights (IPR)

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Taxation of IPR under Maharashtra Value Added Tax Act,2002

Introduction

Under Sales Tax Laws sale of 'goods' is taxable. Meaning of 'goods' under sales tax laws is settled in the sense moveable properties are considered to be goods. However, the meaning of 'movable properties' is expanding day by day. In earlier dates physical movable properties were considered to be the movable properties.

However, there came the judgments wherein even the intangible properties are considered to be the goods. Some important judgments can be referred to as under:

Vikas Sales Corporation v. Commissioner of Commercial Taxes (1996) 102 STC 106 (SC), the Supreme Court has held as under:

"Even incorporeal rights like trademarks, copyrights, patents and rights in personam capable of transfer or transmission, such as debts, are also included in its ambit." The Court, in the later part of the said judgment, again observed as follows: "Similarly, patents, copyrights and other rights in rent which are not rights over land are also included within the meaning of movable property."

Tata Consultancy Services Vs State of Andhra Pradesh (2004) 24 PHT 581 (SC)(FB), the Supreme Court has observed that the test to determine whether a property is "goods" for the purpose of sales tax, is not whether the property is tangible or intangible or incorporeal – the test is whether the concerned item is capable of abstraction, consumption and use and whether it can be transmitted, transferred, delivered, stored, possessed etc.

Accordingly the properties which are capable of bought and sold are now considered to be intangible goods.

IPR -

IPR are the kind of intellectual property. Normally it relates to Copyrights. Copyrights are of various kinds and copyright is defined in Copyright Act. It can include even Trademark, Patents, Designs or Franchises etc..

The meaning of 'Copyright' under Indian Copyright Act, 1957 is as under:

"13. Works in which copyright subsists.-

(1) Subject to the provisions of this section and the other provisions of this Act, copyright shall subsist throughout India in the following classes of works, that is to say,-

(a) original literary, dramatic, musical and artistic works;

(b) cinematograph films; and

(c) [sound recordings;]

(2) Copyright shall not subsist in any work specified in sub-section (1), other than a work to which the provisions of section 40 or section 41 apply, unless,-

(i) in the case of a published work, the work is first published in India, or where the work is first published outside India, the author is at the date of such publication, or in a case where the author was dead at that date, was at the time of his death, a citizen of India;

(ii) in the case of an unpublished work other than a [work of architecture] the author is at the date of the making of the work a citizen of India or domiciled in India; and

(iii) in the case of [work of architecture] the work is located in India.

Explanation.- in the case of a work of joint authorship, the conditions conferring copyright specified in this sub-section shall be satisfied by all the authors of the work.

(3) Copyright shall not subsist-

(a) in any cinematograph film a substantial part of the film is an infringement of the copyright in any other work;

(b) in any [sound recording] made in respect of a literary, dramatic or musical work, if in making the [sound recording], copyright in such work has been infringed.

(4) The copyright in a cinematograph film or a [sound recording] shall not affect the separate copyright in any work in respect of which or a substantial part of which, the film, or as the case may be, the [sound recording] is made.

(5) In the case of a [work of architecture] copyright shall subsist only in the artistic character and design and shall not extend to processes or methods of construction.

14. Meaning of copyright.- "copyright" means the exclusive right subject to the provisions of this Act, to do or authorise the doing of any of the following acts in respect of a work or any substantial part thereof, namely:-

(a) in the case of a literary, dramatic or musical work, not being a computer programme, -

- (i) to reproduce the work in any material form including the storing of it in any medium by electronic means;
- (ii) to issue copies of the work to the public not being copies already in circulation;
- (iii) to perform the work in public, or communicate it to the public;
- (iv) to make any cinematograph film or sound recording in respect of the work;
- (v) to make any translation of the work;
- (vi) to make any adaptation of the work;
- (vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-clauses (i) to (vi);

(b) in the case of a computer programme,-

- (i) to do any of the acts specified in clause (a);
- "(ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme:

Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental."

(c) in the case of an artistic work,-

- (i) to reproduce the work in any material form including depiction in three dimensions of a two dimensional work or in two dimensions of a three dimensional work;
- (ii) to communicate the work to the public;
- (iii) to issue copies of the work to the public not being copies already in circulation;
- (iv) to include the work in any cinematograph film;
- (v) to make any adaptation of the work;
- (vi) to do in relation to an adaptation of the work any of the acts specified in relation to the work in sub-clauses (i) to (iv);

(d) In the case of cinematograph film, -

- (i) to make a copy of the film, including a photograph of any image forming part thereof;
- (ii) to sell or give on hire, or offer for sale or hire, any copy of the film, regardless of whether such copy has been sold or given on hire on earlier occasions;
- (iii) to communicate the film to the public;

(e) In the case of sound recording,-

- (i) to make any other sound recording embodying it;
- (ii) to sell or give on hire, or offer for sale or hire, any copy of the sound recording regardless of whether such copy has been sold or given on hire on earlier occasions;
- (iii) to communicate the sound recording to the public. Explanation: For the purposes of this section, a copy which has been sold once shall be deemed to be a copy already in circulation."

Thus, number of copyrights can arise, which can be referred to as IPR. Under Service Tax there may be different situation but for general discussed about IPR the above can be considered as relevant.

Taxation under MVAT Act

Under MVAT Act, the taxable intangible goods are specifically notified. Entry C-39 of MVAT Act is about such intangible goods and prescribes rate of 5% on sale of IPR. The entry and the relevant notification issued under said entry is as under.

"39.	Goods of intangible or incorporeal nature as may be notified, from time to time, by the State Government in the Official Gazette.	5%	1.4.2010 to till date
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"Finance Department

Mantralaya,
Mumbai 400 032,

Dt. 1.6.2005

Notification

Maharashtra Value Added Tax Act, 2002

No.VAT-1505/CR-114/Taxation 1 In exercise of the powers conferred by entry 39 of schedule 'C' appended to the Maharashtra Value Added Tax Act, 2002 (MAH. IX of 2005), the Government of Maharashtra hereby or specifies the following goods of intangible or incorporeal nature for the purposes of the said entry, namely:-

Sr. No.	Name of the goods of intangible or incorporeal nature
(1)	Patents
(2)	Trademarks
(3)	Import licences including special import licences, duty free advance licences and any other scrip issued under the foreign trade policy, from time to time, under the Foreign Trade (Development and Regulation) Act, 1992]
(4)	Export Permit or licence or quota
(5)	Software packages

(6)	*****
(7)	Technical know-how
(8)	Goodwill
(9)	Copyright excluding those for distribution and exhibition of cinematographic films in theatres and cinema halls.
(10)	Designs registered under the Designs Act, 1911.
(11)	SIM cards used in Mobile Phones
(12)	Franchise, that is to say, an agreement by which the franchisee is granted representational right to sell or manufacture goods or to provide service or undertake any process identified or associated with the franchisor, whether or not a trade mark, service mark, trade name or logo or any symbol, as the case may be, is involved.
(13)	Live telecasting rights of events performed in Maharashtra.
(14)	***

By order and in the name of the Governor of Maharashtra

(SUDHAKAR JAMODE)

Deputy Secretary of the Government"

The IPR, other than those covered by entry C-39 are exempt from tax. Entry A-27 grants the said exemption, which reads as under.

"27.	Goods of incorporeal or intangible character, other than those notified under entry 39 in Schedule C.	Nil	1.4.2005 to till date"
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Sale of IPR

There can be two situations about sale event of IPR.

Normal Sale

Under this category the outright sale of IPR can be covered. For example, if copyright is sold forever then it can be considered as outright sale and the tax will be applicable as normal sale. There cannot be more debate about taxation of such sale.

Sale vis-à-vis Service

However, there is major litigation in respect of IPR as to whether the receipt by the receiver against IPR is due to sale of IPR or towards services of IPR.

The issue can be discussed with reference to IPR in Software. The controversy is recently discussed in the judgment of Karnataka High Court

in case **Infosys Ltd. (Writ Petition no. 57023-57070/2013 dated 9.2.2015)**.

The facts in this case are that the appellant M/s Infosys was having 3 separate transactions. One, for sale of ready software like "Finacle". The further transaction was that it could be customized as per requirement of the customer. The above both transactions were considered as sale and VAT on the same was discharged.

The third transaction was about implementation of the software supplied to the customer. Appellant was contending that this is separate transaction for only rendering services and cannot be liable to VAT. However, the sales tax department authorities considered such implementation part as also part of the total transaction of supply and customization. So assuming, VAT was levied on the full implementation charges also.

High Court's observations

So far as implementation part is concerned, Hon'ble High Court did not agree with the understanding of the authorities. The relevant observations of the Hon'ble High Court are as under;

"52. The understanding of the authorities is that the assessee has developed a software viz., 'Finacle software' which is a basic software relating to banking activities and is the copyright holder for the same. Whenever customer namely a bank approaches the assessee to develop software for their business activities, the assessee will take steps to develop the said software as per the requirement of the customers. In this activity, the assessee will make changes to the Finacle software held by it by customizing the same to the requirement of the customers and will deliver the improved/modified version of the Finacle software to them. Here, what is transferred is the software with all modifications as per the request and the proposal made by the customers. This implementation process is nothing but value addition to the Finacle software, but the dealer while declaring the turnover, splits the said transaction into two parts namely, sale part and service part. This act of the dealer in splitting the contract as one for sale and the other for implementation of finacle software, thereby claiming exemption on the latter part is not correct because in almost all the instances, what is supplied by the assessee to the customers is the software as per the

requirements and the amount received towards the whole process of customization has to be considered as the amount received for the supply of customized Finacle software.

53. From the aforesaid findings, it is clear that the Assessing Authority is of the view that the customization is equivalent to implementation. During customization when scripting or code writing is done in order to make the standard or package software useful to the client, the consideration paid for customization constitutes the consideration for transfer of goods. The said aspect is not disputed by the assessee.

54. What the assessee contends is that the assessee has the packaged software 'Finacle' a banking solution. If the said software cannot be used as such by the banks, then they make known their requirements to be incorporated in the said packaged software either by way of modifications, additions and so as to make it customer specific, which is called as customization. What is sold by the assessee to the bank is the customized software and not the packaged software. It is clear from the invoice that for the consideration received for this customized software, the assessee has paid VAT because the assessee has copyright not only in the packaged software but also in the customized software and what is transferred to the bank is only the right to use the said software which is a deemed sale. After this customized software is installed in the premises of the bank, before bank starts using it, the process of integration with other systems has to be carried out. It is for that purpose a separate contract called service contract is entered into. The terms of the said contract as set out above involves only rendering service and rendering training to the employees of the bank, so that the installed software starts functioning. The terms of the agreement makes it clear that it is not obligatory for the bank/ customer to have the services rendered only by the assessee as a part of contract of sale or a condition of sale. It is open to the customers to have the services rendered by any other competent agency. Therefore, the Assessing Authority has misconstrued this implementation to that of customization of the software and erred in holding that the customization involves transfer of goods and the assessee cannot avoid payment of VAT by describing the same as implementation."

Thus, the Hon'ble High Court has appreciated independency of the transactions. Further, where there is no transfer of copy right and only services are involved, no VAT can be levied.

As on today the issue about VAT & Service Tax is burning. The customers are sufferer due to double levy by vendors. The clarity of law is

therefore very much required. We hope that with the help of above judgment both the concepts about independent nature of transactions and nature of transactions involving sale/purchase of software will become more clear and will bring certainty to the levy of correct tax.

Such examples can be for other items also. Due to uncertainty today the dealers charge both VAT and Service Tax and therefore, ultimately the customers/consumers are sufferers.

Deemed Sale

Under this category, the transaction of works contract and transfer of right to use goods (lease) can be covered.

When there is execution of contract and during such execution any intangible goods gets transferred there can be said to be deemed sale by way of works contract. There can be very few instances where such transactions can take place. One example can be about supply of software where it is also required to be installed. Under such contingency it can be said to be works contract as supply and services are involved. Reference can be made to the judgment of Hon. Karnataka High Court in case of **Infosys Ltd. (Writ Petition no. 57023-57070/2013 dated 9.2.2015)**, in which there is analysis about such type of transaction.

Lease transaction

The main controversy arises when the IPR are falling under this category. The first major controversy is about nature of transaction. There is very thin line as to whether the transaction of IPR amounts to Service Transaction or Lease. The discussion has to be made with reference to decided cases. There are number of judgments dealing with levy of VAT, some in favour of dealers and some against dealers.

The back ground and contrary judgments can be noted as under:

By deeming clause in Article 366 (29-A) of the Constitution, the transaction of "Transfer of Right to Use Goods" (Lease transaction) are made taxable under Sales Tax Laws. The nature of lease transaction is not defined in the Constitution or in any Act. The interpretation is done in light of various judicial pronouncements.

Bharat Sanchar Nigam Ltd.(145 STC 91)(SC)

The issue in this case was about levy of lease tax on services provided by Telephone Companies. Supreme Court held that no sales tax is applicable as the transaction pertains to service. While so holding, one of the learned judges on the Bench, observed as under in para 98, about taxable lease transaction.

"98. To constitute a transaction for the transfer of the right to use the goods the transaction must have the following attributes:

- a. There must be goods available for delivery;
- b. There must be a consensus ad idem as to the identity of the goods;
- c. The transferee should have a legal right to use the goods - consequently all legal consequences of such use including any permissions or licenses required therefore should be available to the transferee;
- d. For the period during which the transferee has such legal right, it has to be the exclusion to the transferor - this is the necessary concomitant of the plain language of the statute - viz. a "transfer of the right to use" and not merely a licence to use the goods;
- e. Having transferred the right to use the goods during the period for which it is to be transferred, the owner cannot again transfer the same rights to others."

Based on above parameters there are further judgments at various forums where the nature of lease transaction is decided. Reference can be made to following judgments. The common feature is that if use is allowed on non exclusive basis it is not considered as lease.

Smokins Joe's Pizza Pvt. Ltd. (A 25 of 2004 dt.25.11.2008)(MSTT)

The facts in this case were that the dealer was holding registered Trade mark "Smokin Joes" and allowed its use to its franchisees. The franchise agreement provided for non exclusive right to use the registered Trade mark. The agreement also provided for providing various services to Franchisee. Lower authorities held the transaction as taxable lease transaction. Tribunal held that it is not a lease transaction as it is not exclusive. This judgment is before Hon. Bombay High Court by way of Reference.

Malabar Gold Pvt. Ltd. vs. Commercial Tax Officer, Kozhikode (63-VST 497)(Ker)

This is the judgment of Kerala High Court. In this case also the transaction was about granting of franchise right on non exclusive basis. Hon. High

Court has held that when the grant of franchise is non exclusive it is not lease transaction and not liable to VAT.

On other hand there are also contrary judgments like as under:

Nutrine Confectionery Co. Pvt. Ltd. v. State of Andhra Pradesh (40 VST 327)(A.P)

In this case also the transaction was for allowing use of trade mark. The said use was also on non exclusive basis. Still Hon. High Court has held that the transaction is lease transaction. Hon. High Court felt that the judgment of BSNL about exclusive use cannot apply in relation to intangible goods like trade mark.

AGS Entertainment Private Limited V. Union of India and Other (65 VST 88)(Mad).

In this case, it is held that unless all the rights of the films are transferred, there cannot be lease transaction. On the same service tax is applicable. Thus, the law laid is that if in a intangible goods like copy right only singular rights are transferred and all rights are not transferred then there is not lease transaction and service tax can remain applicable.

Thus, regarding intangible goods, there are different judgments. However, it appears that the courts are treating intangible goods separately as compared to tangible goods. When "goods" include intangible goods also, the interpretation as applicable to tangible goods should equally apply to intangible goods also. However, there is distinction made by the courts which is required to be reconsidered by the courts.

Tata Sons Ltd.vs. State of Maharashtra (W.P.No.2818 of 2012 with Notice of Motion (L) No.214 of 2013 dt.20.01.2015).

In this case the use of brand name was allowed on non exclusive basis. Before Hon. Tribunal judgments including in case of Smokin Jeo's was relied upon for non liability. However, Tribunal has confirmed the liability. Therefore, this matter before Hon. Bombay High Court, on behalf of assessee. After referring the facts and judgments including in case of BSNL, Hon. High Court has held that even if use of right is given on non exclusive basis, still it will be lease transaction. The observations of Hon. Bombay High Court are as under:

"50. Para 98 is relied upon by Mr. Chinoy. However, that cannot be read in isolation and out of context. It must be read in the backdrop of the underlying controversy, namely, relationship between a telephone connection service provider and its customer. Such a transaction is essentially of service.

51. It is in relation to such a controversy that the observations, findings and conclusions must be confined. We do not see as to how they can be extended and in the facts and circumstances of the present case to the enactment that we are dealing with. Going by the plain and unambiguous language of the Act of 1985 we cannot read into it the element of exclusivity and a transfer contemplated therein to be unconditional. Therefore the tests in para (d) and (e) cannot be read in the Act of 1985.

58. We are of the opinion that the Tribunal did not act perversely or committed an error apparent on the face of record in rejecting the petitioner's appeals. May be the Tribunal could have rendered a detailed finding and conclusion. However, upon perusal of the order passed by the Tribunal we find that it referred to the facts. It has also adverted to the contentions of the parties. It also referred to its own conclusions rendered in the case of M/s. Smokin Joe etc. However, it concludes that the facts and circumstances in the present case are not identical to the cases dealt with by it and of the above franchisees. We do not express any opinion as to whether the Tribunal's conclusions in the case of M/s. Smokin' Joe (supra) and M/s. Diageo India (supra) are accurate or correct. We are informed that separate proceedings in that regard are pending in this Court. However, the Tribunal did not err in holding that the cases which have been dealt with by it including the Supreme Court judgment in the case of BSNL (supra) are on distinct facts."

Not only Hon. High Court distinguished judgment of Hon. Supreme Court in case of BSNL, but also relied upon earlier judgment in case of Dukes and Sons and followed the same. The relevant observations are as under:

"52. We are in agreement with Mr. Kumbhakoni that the judgment of this Court in the case of **Commissioner of Sales Tax Vs. Duke and Sons Pvt. Ltd.**, reported in 1999 (1) Mh.L.J. 26 cannot said to be no longer good law in the light of the judgment of the Hon'ble Supreme Court in BSNL's case. That was the argument canvased by Mr. Chinoy and his further submission is that relying upon BSNL (supra), the Tribunal rendered its decisions in favour of the franchisees, namely, M/s. Smokin' Joe (supra) and M/s. Diageo India (supra). In M/s. Duke & Sons Pvt. Ltd, similiar controversy fell for consideration and determination of

this Court. There, M/s. Dukes was holder of a registered trade mark, namely, Duke's, Mangola, Pineola, Tango. It manufactured concentrates for manufacturing aerated waters, beverages etc. There were written agreements between the assessee M/s. Dukes and purchasers of the concentrates. The assessee sold the concentrates to the customers for use in manufacturing aerated waters, beverages etc. at their bottling plants. Pertinently such purchasers of the concentrates were permitted to market their beverage by using the trademark of the assessee. The assessee charged royalty for use of the trade mark by the customers. They were styled as Franchise Agreements. One such Franchise Agreement wherein the assessee permitted the customer M/s. Salstar Foods and Beverages Ltd. to use the trade mark of the assessee on the bottles of the beverage manufactured by them in Maharashtra and to market the same under the trade mark of the assessee was subjected to the tax under the Act of 1985. There was some doubt and, therefore, an application under Section 52 of the Bombay Sales Act, 1959 was made by the assessee to the Additional Commissioner of Sales Tax. This was for determination of the question, where it was liable to pay tax on the amount of royalty received by it for transfer of trade mark under the Act of 1985. The Additional Commissioner of Sales Tax (Enforcement Branch) by his order dated 3.3.1989 held that by the agreements in question there was a transfer of right to use the trade mark of the assessee to its customers and amounted to sale under Section 2(10) of the Act of 1985. The assessee was thus held to be liable to pay tax. That order was appealed to the Tribunal. The Tribunal set aside the order of the Additional Commissioner and held that the transaction did not amount to transfer of right to use the trade mark by the assessee to its customers and no tax could be levied on the royalty received on said transfer. The Revenue applied for reference of the ground of law arising from this order of the Tribunal. That is how the question of law framed by this Court at para 1 came up for consideration."

After this Hon. High Court reproduced portion from judgment of Dukes and Sons and observed as under:

"57. Thus, far from the judgment of the Division Bench of this Court in M/s. Dukes and Sons (supra) being no longer a good law, that judgment and the ratio therein has been consistently referred and quoted with approval by the Kerala High Court and Andhra Pradesh High Court. This was subsequent to the judgment of the Hon'ble Supreme Court in BSNL (supra). With respect, we concur with all the aforesaid decisions and rulings."

Thus, amongst others, Hon. High Court has considered case of intangible goods as separate category. Further important aspect in this judgment is that no reference is made to the judgment of Kerala High Court in case of Malabar Gold Pvt. Ltd.

Thus, the issue is very debatable, more particularly in light of contrary judgments from the Hon. High Courts.

The controversy is ultimately affecting the consumers as the dealers to be on the safer side charge both VAT and CST.

Conclusion

There can be various aspects of taxation of intangible goods / IPR. The above is only indicating one to initiate the subject. I hope the above will generate further discussion and will be helpful in bring some finality to the subject matter.