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TAX FLASH NEWS

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Since the situs of the IPR was not in India, income accruing from the transfer of its right title and interest is not taxable in India. The Situs of the intangible asset is attached to its owner

Background

The Delhi High Court in the case of CUB Pty Limited[1] (the taxpayer) observed that there is no specific provision in the Income-tax Act, 1961 (the Act) for determining the situs of the intangible asset. Therefore, following the international principle[2], the situs of the intangible is attached to its owner. The High Court held that since the situs of trademarks and intellectual property rights (IPR) was not in India, income accruing from transfer of its right title and interest is not taxable in India.

Facts of the case

- The taxpayer, an Australian Company, is in the business of brewing beer, also owned various trademarks and IPRs in relation to its business. By entering into Brand license agreements (BLA), certain trademarks and IPRs were licensed to its subsidiaries in various jurisdictions (including its step-down subsidiary in India (I Co).

- Such trademarks and IPRs were also registered in India. The BLA provided I Co, an exclusive right to use the 4 registered trademarks and IPRs in the Indian territory for a royalty fee which was subject to withholding taxes in India.

- In 2006, the taxpayer entered into a composite sale-purchase agreement (ISPA) with X Ltd for transfer of shares of one of its down-stream subsidiary along with the trademarks and IPRs (including the ones licensed to I Co.) and grant of perpetual license in relation to its brewing IP confined to India.

- Pursuant to the terms of the ISPA, the BLA between I Co. and the taxpayer was terminated in respect of the 4 trademarks and IPRs licensed to it. Also, as per the ISPA, the trademarks and IPRs were assigned to the nominee of X Ltd (Y Ltd).

- The taxpayer approached the Authority of Advanced Ruling (AAR) seeking a ruling on whether the receipts on the transfer of rights, titles and interest in trademark and grant of an exclusive perpetual license to Y Ltd is taxable in India.

- The AAR held that income attributable to the grant of perpetual license was not taxable in India. However held that income from transfer of rights, title and interest in trademarks and IPRs accrued in India by observing that:

  - The IPRs had tangible presence in India

  - Registration of the IPRs in India is one of the relevant factors in determining the roots

  - The brand had generated appreciable goodwill in the Indian market and its value was nurtured by I Co along with taxpayer

  - The termination of BLA was not antecedent to the deed of assignment

- The taxpayer challenged the ruling of the AAR before the High Court.

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[1] CUB Pty Limited v. UOI & Ors [2016] 71 taxmann.com 315 (Del)
[2] "*mobilia sequuntur personam*"- means movables follow the person

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High Court's ruling

- The termination of the BLA was a precondition to the ISPA and descended with the ruling of the AAR.
- The situs of the IPRs was a tricky issue, unlike the tangible assets which had a physical presence in India.
- The Act does not currently provide for any deeming fiction to determine the situs of the intangible asset, unlike the case where Explanation 5 to Section 9(1)(i) of the Act provided for situs in respect of shares or interest in a company incorporated/registered outside India.
- In the absence of specific provisions governing the same, internationally accepted principles may be adopted to determine the situs of the intangible asset.
- The situs of the IPRs may thus be determined using the principle of '*mobilia sequuntur personam*' whereby a fiction is created to effect that the situs of the owner of the intangible asset would be the closest approximation of the situs of the intangible asset.
- As the situs of the IPR is not in India, the income received from the transfer of right, title or interest in the IPRs is not taxable in India.

Our comments

Taxability on the transfer of rights in intangibles has been a matter of debate before the courts due to the complexities involved in determining the situs of such intangibles. In recent times the complexity of the issue has increased as multinational entities create and operate through complex value chains dividing the economic and legal ownership in the IPRs.

In the instant case, the Delhi High Court observed that in the absence of any specific provision under the Act for determining the situs of the intangible asset, the international principle will apply and accordingly the situs of the intangible is attached to its owner.

Under the Transfer Pricing regime, the returns on the exploitation of the IPRs are attributable based on the functions performed, assets employed and risks assumed by the entity. The concept of economic ownership in addition to the legal ownership of the asset would also assume importance in ascertaining who is entitled to the income arising from the exploitation of the asset.

However, the issue of whether I Co. can be constituted as an economic owner for contributions made by it to the value of the IPR and whether any share of income could be attributable to such activities have not been examined by the Delhi High Court in this case.

Final Action Plan 8 to 10 issued by the Organisation for Economic Co-operation and Development under the Base Erosion and Profit Shifting (BEPS) project have attempted to address some of these issues and have made recommendations in respect of the treatment of intangible assets and its taxation. As per the BEPS Action Plans, legal ownership alone does not create right to return generated from exploitation of IPRs. Group companies performing important functions, controlling economically significant risks and contributing to assets, will be entitled to returns reflecting the value of their contributions.

It will be interesting to watch how India incorporates BEPS recommendations with respect to intangibles as a part of its international commitment under G20.

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