Transfer of right to use brand name – deemed sale or service : 16-09-2015

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ONE of the most controversial tax subjects that has not found an ideal solution has been the one involving the transfer of right to use the brand or the brand name. As is well known, large and well known Industrial Groups allow their Group outfits as also their franchisees to use the Group brand or name by collecting a fee which is largely based on the sales turnover achieved by the users of the brand. The definition of 'goods' as contained in the various State VAT Acts as well as the CST Act clearly include patents, intellectual property, brand names, etc., and the VAT Authorities have only been too eager to subject these transactions to the levy of VAT considering these as 'deemed sale' transactions. Not to be left behind insofar as the tax potential of these transactions is concerned, the Central Government has incorporated Section 66E(c) with effect from 1-7-2012, in terms of which, a 'temporary transfer or permitting the use of enjoyment of any intellectual property right' is a declared service. We have had multiple decisions of the Supreme Court as well by the High Courts that has led to a fair amount of confusion surrounding this subject.

Before we consider the impact arising out of the decision rendered in *Tata Sons* - 2015-TIOL-345-HC-MUM-CT, it would do us good to recall Para 98 of the *BSNL* decision - 2006-TIOL-15-SC-CT-LB, viz.

Quote :

> *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 there for 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.

Unquote:

While admitting that the concepts involving delivery, etc. might not be relevant for brand name etc., the pre-requisite for levy of sales tax/VAT, as per the *BSNL* decision, would be that the transferee should have been given an exclusive right to use the brand name by way of a legal right and a mere license to use the brand cannot be treated as a deemed sale.

The recent decision of the Bombay High Court in the *Tata Sons* case - **2015-TIOL-345-HC-MUM-CT**has rekindled interest in the subject matter. The question that arose before the High Court was whether the royalty received by Tata Sons Ltd from its group subsidiary companies for use of the 'Tata' brand name can be said to be a 'service' or a 'deemed sale' to attract sales tax under Section 2 of the Transfer of Right to use any Goods for any Purpose Act, 1985(popularly known as Maharashtra Lease Act) . After elaborate arguments and after discussing the binding precedent in the form of the Apex Court's decision in the BSNL case, the Bombay High Court held that such royalty received for permitting usage of the brand name is to be subjected to the levy of sales tax under the said Act, notwithstanding the fact that service tax was already being paid on such transaction.

While trying to apply the ratio laid down in this decision, one must appreciate the fact that, this decision was rendered in the context of the Transfer of Right to use any Goods for any Purpose Act, 1985, a special Act covering levy of sales tax on leasing transactions. Most States do not have such an Act and the levy of lease tax is sought to be covered under their existing sales tax / VAT laws.

Be that as it may, the Bombay High Court has, in Para 40 of the order observed that Transfer of Right to use any goods for any purpose Act, 1985 does not give any indication that the right to use the incorporeal / intangible goods should be exclusively transferred in favour of the transferee. This, to my mind, is the key differentiating factor between the law prevailing in Maharashtra and in other States which do not have similar provisions.

It seems surprising that the decision of the Kerala High Court, in *Malabar Gold Private Limited, Calicut v Commercial Tax Officer, Kozhikode and Others* - **2013-TIOL-512-HC-KERALA-ST**,wherein it had been held that, based on the terms of the franchise agreement, the mere permission granted by the owner of a registered brand name/trade mark to a franchisee, cannot be treated as a transaction involving transfer of right to use the brand name, was not considered by the Bombay High Court.

Another very relevant case that has not been considered is that of the Karnataka High Court in *Indus Towers Limited, Bangalore v The Deputy Commissioner of Commercial Taxes, Enforcement I, South Zone, Bangalore and others (2012) 56 VST 369 (Karn.),* wherein, it was held that the owner of a property has a bundle of rights, namely, right to possess, right to use and enjoy, right to usufruct, right to consume, to destroy, to alienate, transfer, etc. and therefore, to constitute a deemed sale under Article 366 (29-A)(d) of the Constitution of India, it is only such transactions wherein under a contract, all the bundle of rights are transferred by the owner of goods, except the title, the transaction constitutes deemed sale of transfer of right to use goods.

The *Tata Sons* decision, while referring to the RINL case, has stated that the RINL case*State of Andhra Pradesh and Another vs Rashtriya Ispat Nigam Ltd* - **2002-TIOL-560-SC-CT** dealt with goods, while, in the instant case, it was one of transfer of intangible property. In my humble view, the concept related to 'effective control' is applicable, in equal measure, to intangible goods.

Be that as it may, it is interesting to note that the Bombay High Court, in a subsequent decision, viz. *Commissioner of Sales Tax v. M/s General Cranes, reported in* **2015-TIOL-1214-HC-MUM-CT** has taken the view that, in the case of leasing of tangible goods, in order to constitute a transaction for the transfer of the right to use the goods, it is necessary that there must be a consensus *ad idem* as to the identity of the goods and that, after 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.

It would then seem that, notwithstanding any issue that might arise vis-à-vis the Tata Sons decision, the fundamental requirement that, a transfer of right to use goods, whether tangible or intangible, on a non-exclusive basis cannot attract sales tax/VAT (at least, in States other than Maharashtra) remains intact. With specific reference to the licensing, franchise agreements, etc., wherein, the brand name, etc. is transferred for use by the transferee on a non-exclusive basis, for a consideration referred to as license fee, royalty, branding fee, etc., on a non-exclusive basis, VAT/sales tax cannot be levied. More so, when such activity has been declared to be a service under Section 66E(c) of the Finance Act, 1994 and when the Courts have not struck down this entry as being unconstitutional.

Before concluding

Vis-à-vis the *Tata Sons* case if VAT is held to be leviable on the royalty received for use of the brand name, it is obvious that service tax cannot be levied on such fee. It might have been wiser to rope in the Central Government as a Respondent, considering Section 66E(c) of the Finance Act, 1994. Ultimately, the States and the Central Government would need to fight such cases in the Courts, as to which of these Governments is entitled to levy tax.*Above all, the taxpayer cannot be made to suffer.*