Intellectual Property Taxation: Need for a Comprehensive Policy and Law in India

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Taxation of goods, services and income is a concept that has been prevalent for a long time, all over the world. Different categories are taxed with different objectives and purpose. Sometimes economies may want to discourage use of foreign goods within their countries and consequently therefore the tax on imported goods will be high. However, interestingly, taxing of intellectual property is a recent phenomenon across the globe. Developments in science and technology and rapid communication have made it accessible to every country. In India, intellectual property is taxed in many ways, though indirectly. This paper examines various provisions of intellectual property taxation under different legislations in India. It argues that the lack of a comprehensive policy on intellectual property taxation acts as a disincentive to technology transfer and IP creation in India.

Keywords: Intellectual property, IP taxation, income tax, sales tax, value added tax, customs duties, central excise, stamp duty

In recent times, intellectual property (IP) protection has got major attention in the technologically advanced contemporary world. Various nations are budgeting more in the area of protection of IP rights due to compulsions of the international agreement, the Trade-Related Aspects of the Intellectual Property Rights (TRIPS) within the system of the World Trade Organization (WTO). IP is a key component or head under international taxation. The cross border movement of multinational companies with their intellectual property rights (IPRs) offers much scope for taxation of these rights and thus a considerable income for technology receiving countries. India opened its economy in 1991 with a bundle of tax reductions in customs and central excise duties, lowering corporate tax, widening the tax net and is also one of the founding members of the WTO in 1995.

India has a well developed tax structure with a three-tier federal structure, comprising Union Government, State Governments and Urban/Rural Local Bodies. Income tax comes under the category of direct taxes and is collected by the Central Government. The Act categorizes income of a person under different heads and provides for the manner of computation of taxable income of each head. The categories are: (i) salaries, (ii) income from house property, (iii) profits and gains of business or profession, (iv) capital gains, and (v) income from other sources.

Other duties collected by the Centre are customs duties, central excise, sales tax and service tax. The taxes levied by the state governments are sales tax, stamp duty, state excise, land revenue, duty on entertainment and tax on professions and callings. The local bodies are empowered to levy tax on properties, buildings, octroi, tax on markets, user charges for utilities like water supply, drainage, etc.

Today in India, multinational companies are investing more and more in high technology industries. Even though, there are some provisions in different legislations for IP taxation, government officials and industry are unaware of the application and implications of the provisions. In TCS v State of Andhra Pradesh, Supreme Court (SC) held that ‘software sold off the shelf’ are to be considered as ‘goods’ and therefore can be taxed under the Andhra Pradesh General Sales Tax (APGS) Act.

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The accounting practices of companies differ due to lack of a uniform guideline in calculating depreciation or amortisation of intangible property. The incentives provided to industries for technology innovation are very primitive and insignificant in nature and exemptions are available only in areas like R&D and Small Scale Industries (SSI) sector. However, unfortunately there is not much study that has been conducted on this area in the Indian economy and the government does not have a clear policy on IP taxation. Neither the industry nor the public have clarity about the taxation of IP rights. There is therefore, an urgent need to create awareness in order to better understand these rights and their taxation as also a comprehensive policy that needs to be framed for providing further incentives for the development of high technology. At the same time, emphasis needs to be laid upon IP taxation which is indeed, an area where there is a huge potential for revenue for the government.

The paper addresses issues of IPR and Indian tax regime. It includes issues like tax implications of cross border use of IPR and tax avoidance, internal taxing in case of licensing, commercialization, transfer pricing of technologies, R&D deductions and opportunities to exploit IP through international licensing, etc. In India, there are provisions for taxation of IP in the Income Tax Act, 1961 (IT Act), Sales of Goods Act, 1930, Value Added Tax (VAT), Customs Tariff Act, 1975 (CT Act), Central Excise Act, 1944 (CE Act) and Service Tax (ST). There is no specific provision in the Indian Stamp Act, 1899 to cover the conveyance of technology transactions as dutiable.

**Intellectual Property Taxation and Incentives under the Income Tax Act, 1961**

The IT net provided in the Indian law is vast and there are multiple instances at which tax credits for R&D and taxation for royalties in various forms of IP are prevalent in the country. Section 9(1) (vi) provides for taxation of income by way of royalties. If the royalty is payable in respect of any right, property or information used or services utilized 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 it is not taxable. Income by way of royalty as a lump sum consideration for transfer outside India, or imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trademark or similar property, if such income is payable in pursuance of an agreement made before the 1 April 1976, and the agreement is approved by the Central Government, is not taxable.

Other exemptions include income by way of royalty of lump sum payment made by a person, who is a resident, for the transfer of all rights including granting of a licence in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India. Prior to the insertion of Section 31, technical fees paid towards drawings, designs, charts, plans, etc. were to be considered as plant and machinery. Section 31 made it clear that the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.

Foreign transactions involving technical ‘know-how’ were taxed from 1969 onwards, as per a circular under the Income Tax Act, 1961. This includes sale of designs, lending services of technicians, technical assistance, royalty or licensing agreements. Treatment of fees paid for manufacturing know-how would depend upon whether the know-how has given enduring benefit. The Supreme Court in the *CIT v Ciba of India Ltd,* dispute held that payments made for the use of processes, scientific data, patent and trademark were allowable as business expenditure and held them as revenue in nature as it is not in the nature of enduring benefits. The Court followed dictum in *Atherton v British Insulated & Helsby Cables Ltd,* in which it was held that any expenditure made for ‘once and for all’ as an asset or an advantage for the enduring benefit of a trade was of a capital nature. Technical know-how was always considered as a part of the machinery. In a recent decision by the Delhi High Court in *Commissioner of Income Tax v M/s Eicher Limited (formerly Royal Enfield Ltd)*, it was held that the payment of non-compete fee by the assessee was a business expenditure and not a capital expenditure.

Direct expenditures are involved in case of creating know-how. In most jurisdictions of the world it is written off as revenue expenditure for business. Companies can treat expenses for creating IP as a capital expenditure and write it off over a period of time. It will show IP as an asset. Whenever there is an
acquisition or creation of IP, money flow will be shown as an asset. The R&D expenses are usually written off by the companies under the concept of materiality.\textsuperscript{14}

Depreciation of assets\textsuperscript{15} is explained in Section 32 (1) (ii) of the IT Act. Depreciations are allowed in the case of know-how,\textsuperscript{16} patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of a similar nature, being intangible assets\textsuperscript{17} acquired on or after the 1 April 1998. Deductions are available for expenditure (other than capital expenditure) on scientific research. Any amount equal to one and one-fourth times of any sum paid to a scientific research association which has undertaking to do scientific research or to a university, college or other institution to be used for scientific, social science or statistical research is deductible.\textsuperscript{18} The institution must be recognized or approved by the Central Government for this purpose.\textsuperscript{19}

Expenditure on acquisition of patents and copyrights are dealt with under Section 35A of the IT Act. If they are purchased for a lump sum consideration with an enduring benefit, the purchaser is entitled to claim depreciation over a period of time. In case of amalgamations, the amalgamating company sells or otherwise transfers rights to amalgamated company (being Indian company) deductions are not applicable to amalgamating company.\textsuperscript{20}

Section 35AB explains deductions on expenditure on know-how.\textsuperscript{21} Where the assessee has paid in any previous year, any lump sum consideration for acquiring any know-how for the use of his business, one-sixth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year, and the balance amount shall be deducted in equal instalments for each of the five immediately succeeding previous years. It means that the expenditure will be deductible in six equal instalments for six years. If, where the know-how referred to in Sub-section (1) is developed in a laboratory, university or institution referred to in Sub-section (2B) of Section 32A, one-third of the said lump sum consideration paid in the previous year by the assessee shall be deducted in computing the profits and gains of the business for that year, and the balance amount shall be deducted in equal installments for each of the two immediately succeeding years.\textsuperscript{22} Other deductions for scientific research are provided in Section 80 GGA.

In computing the income chargeable under the head ‘profits and gains of business or profession,’ Section 37 of the Act, enables deduction of any expenditure laid out or expended wholly and exclusively for the purpose of the business or profession, as the case may be. The treatment of capital expenditure and revenue expenditure is always a contentious issue. In \textit{Alembic Chemicals Ltd v Commissioner of Income Tax},\textsuperscript{23} the Supreme Court held that ‘There is also no single definitive criterion which, by itself, is determinative as to whether a particular outlay is capital or revenue. What is relevant is the purpose, of the outlay and its intended object and effect, considered in a common sense way having regard to the business realities. In a given case, test of ‘enduring benefit’ might break down.’ Consequently, decisions of the High Court not to allow tax deduction to the appellants were reversed. The earlier Supreme Court decision in \textit{CIT v Ciba of India Limited}\textsuperscript{24} was also referred by the Court. In \textit{Assam Bengal Cement Companies Ltd v CIT},\textsuperscript{25} Supreme Court observed that:

‘If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If, on the other hand, it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to producing profits, it is a revenue expenditure. The aim and object of the expenditure would determine character of the expenditure whether it is a capital expenditure or revenue expenditure.’

It is clear from these decisions that the purpose and object of transaction will determine the nature of expenditure.

Section 80QQA provides for income from copyrights. Under this head, any income derived by him in the exercise of his profession on account of any lump sum consideration for the assignment or grant of any of his interests in the copyright of any book, or of royalties or copyright fees (whether receivable in lump sum or otherwise) in respect of such book, a deduction to the amount of 25% will be allowed on such amount.

No deduction will be allowed if the book is either in the nature of a dictionary, thesaurus or encyclopaedia or is one that has been prescribed or
recommended as a text book, or included in the curriculum, by any university, for a degree or postgraduate course of that university. And also no deduction is allowed if the book is written in any language specified in the Eighth Schedule to the Constitution or in any such other language as the Central Government may, by notification in the Official Gazette, specify in this behalf having regard to the need for promotion of publication of books of the nature referred to in clause (a) in that language and other relevant factors.  

Royalty on patents is provided in Section 80RRB. In the case of patents, deduction is allowed equal to the whole of such income or three lakh rupees, whichever is less. In case, compulsory license is granted in respect of any patent under the Patents Act, 1970, the income by way of royalty for the purpose of allowing deduction under this section shall not exceed the amount of royalty under the terms and conditions of a license settled by the Controller under that Act.

Double Taxation Avoidance Agreements (DTAA), Taxation of NRIs and International Taxation

Section 90 of the Income Tax Act has authorized Central Government to enter into Double Tax Avoidance Agreements (DTAA) with other countries. A non-resident Indian becomes liable to pay tax in India in respect of income arising here by virtue of its being the country of source and then again, in his own country in respect of the same income by virtue of the inclusion of such income in the ‘total world income’ which is the tax base in the country of residence. The objective of the DTAA may be to prevent and discourage taxation which may contribute to the free flow of international trade, international investment and international transfer of technology. India has already entered into similar DTAA with more than 60 countries. These agreements give the right of taxation in respect of the income of the nature of interest, dividend, royalty and fees for technical services to the country of residence. However, the source country is also given the right but such taxation in the source country has to be limited to the rates prescribed in the agreement. The rate of taxation is on gross receipts without deduction of expenses. Income derived by rendering of professional services or other activities of an independent character are taxable in the country of residence except when the person deriving income from such services has a fixed base in the other country from where such services are performed. Such income is also taxable in the source country if his stay exceeds 183 days in that financial year.

If the income is accrued through a permanent business connection or establishment in India, such income is taxable. This particular provision is subject to controversies. The representative offices of foreign companies cannot be taxed, because according to the RBI permissions rules, they cannot carry on any business or cannot be treated as a permanent establishment. The Bangalore Bench of the Income Tax Appellate Tribunal (ITAT), considered an interesting question in the case of sales of imported software in *Sonata Information Technology Limited v Add CIT* and examined the characterization of computer software income in international transactions. In the case mentioned, the assessee was an Indian company engaged in the business of distribution of computer software and had entered into distribution agreements with several overseas vendors which authorized the assessee to distribute computer software to end-users in India. The Tribunal held that the assessee had purchased software and not any IPR. Selling software is not exempted from any tax and can be only considered as a sale of goods. Hence, the supplier is not liable to pay withholding tax.

In *Sheraton International Inc v Deputy Director of Income Tax*, the ITAT held that various services rendered by the assessee to enable it to complete efficiently and effectively, the job undertaken by it as an integrated business arrangement to provide the services relating to advertising, publicity and sales promotion including reservations of the Indian hotels worldwide in mutual interest, cannot be relied upon by picking and choosing the same in isolation so as to say that part of the consideration received by the assessee, as attributable to the said services, was in the nature of ‘royalties’ or ‘fees for included services.’

Sections 44D and 115A provide for special methods for calculating income by way of royalties and technical services of foreign companies and non-resident Indians. The rate of tax fixed under Section 44D is 20% of the gross amount. Any income by way of dividends, interests, income from mutual funds is charged at the rate of 20%. Under Section 115A, income by way of royalty or fees for technical services is charged at the rate of 20%. Royalties include consideration for the transfer of all or any rights (including the granting of a licence) in respect
of copyright in any book to an Indian concern or in respect of any computer software to a person resident in India.\textsuperscript{32}

The activities of multinational companies are another area of taxation. Section 92 of the Finance Act, 2002 made ‘interest arises from international transaction’\textsuperscript{33} taxable. Section 92B provides for international transactions between associated enterprises in case of ‘arms length’ transactions on sale of raw materials and intangible assets. Sections 9A to 92F of the IT Act deal with income arising out of international transactions between associated enterprises or subsidiaries. These special provisions are meant for avoiding under-pricing or over pricing by multinational companies in business transactions with their subsidiaries or collaborators. It is the duty of the companies to keep ‘transfer pricing’ records for the purpose of income tax.\textsuperscript{34}

When shares are transferred to a non-resident Indian for consideration of transfer of technical know-how or services rendered in India or profits are made in India, the income to that extent is taxable in India. If payments of royalty are made by way of a free issue of equity shares, the value thereof will be liable to tax. It is only those shares which are issued at the time of incorporation of the Indian company in lieu of a lump-sum payment for the technical know-how delivered abroad, that will be exempt from income-tax except capital gains. If the shares issued in consideration for technical know-how at the time of the incorporation of the Indian company are subsequently sold, the capital gains realized there from would be subject to tax.\textsuperscript{35} The IP acquired has to be accounted along with plant and machinery as a depreciable asset. If the licensing or transfer is for a recurring amount and for a limited period, then it is considered as revenue receipts. If any income is accruing for less than three years, it is considered as short term capital and taxed at the rate of 30%. Any long term capital is taxed at the rate of 20%. In a recent decision by the Authority of Advanced Ruling (AAR) on an application filed by Airports Authority of India (AAI) regarding its transactions with US-based Raytheon, the AAR held that the applicant must pay tax for the software maintenance agreement between AAI and Raytheon but not on the supply of equipment and services outside the country.\textsuperscript{36} In general, it can be concluded that withholding tax rates for royalties are 10%, for technical services 10% and for any other services 30% for individuals and 40% for corporates.\textsuperscript{37} This will change according to the DTAA signed between nations.

**Sales Tax on Intellectual Property**

Sales tax was charged on sale of goods under the Sales of Goods Act, 1930. Central Sales Tax (CST) is generally payable on the sale of all goods by a dealer in the course of inter-state trade or commerce or, outside a state or, in the course of import into or, export from India. Usually the CST rate is 4% and is levied on inter-state sales and would be eliminated gradually. Value Added Taxes (VAT) is collected on the retail sale of goods. Sales tax is levied on the sale of movable goods. Most of the Indian states have replaced sales tax with a new VAT system from 1 April 2005. Value Added Taxes or VAT is imposed on goods only and not services and it has replaced the sales tax system.

The controversial question that arose was whether IPRs could be treated as goods \textit{vis a vis} taxing. According to Articles 286 and 269 of the Constitution of India, states cannot tax inter-state transfer of goods. According to Section 4(2) of the Central Sales Tax Act, 1956, the sale or purchase of goods are taking place within the state only. This provision is in accordance with the Court of Appeals decision in \textit{Inland Revenue Commissioners v Muller & Company Margarine Ltd.}\textsuperscript{38} According to the Sale of Goods Act ‘goods’ means every kind of movable property other than actionable claims and money. The Supreme Court, in many cases held that intangible goods like electricity,\textsuperscript{39} lottery tickets,\textsuperscript{40} import license,\textsuperscript{41} software put in a tangible media,\textsuperscript{42} drawings and designs,\textsuperscript{43} trademark,\textsuperscript{44} copyrights,\textsuperscript{45} patents, technical know-how\textsuperscript{46} are goods for the purpose of ‘sales tax.’

The SC, in the case of \textit{Tata Consultancy Services v State of Andhra Pradesh} has observed that all the tests required to satisfy the definition of goods are possible in the case of software and in computer software, the IP has been incorporated on a media for the purpose of transfer and software and media cannot be split up. Therefore, sale of computer software falls within the scope of sale of goods. The SC has also observed that they are in agreement with the view that there is no distinction between branded (canned) and unbranded software. The Court observed that ‘in the case of unbranded/customized software also, the IP namely, software is incorporated in a media for use. Hence, that software in a media is goods.’\textsuperscript{47}
The 46th Constitutional Amendment 48 made it easy for the state to tax ‘works contracts.’ 49 By this amendment the states are entitled to tax goods which are ‘deemed to be goods and deemed sales.’ It means that execution of any contract includes the technical know-how and assignment or license of IPRs also considered as ‘deemed sales’ and will be taxed under this head. The import or export of goods cannot be taxed by any states. However, the moot question is whether anybody imports technical know-how along with a machine for domestic sale is taxable along with the goods. It is the settled position of law that the actual movement of goods is necessary for the purposes of sale. 50 This position may be true with regard to tangibles, but the question that occurs is as to how it would be applicable to intangibles. Whether the movement of goods through Internet-like software are taxable is again a technical matter. And also there is no mechanism in India to monitor the movement of IPRs inter-state for the purposes of taxing.

Service Taxation of Intellectual Property

In India, for the first time a new category of tax known as ‘service tax’ was imposed under the Finance Act, 1994. There is no separate legislation dealing with service tax other than the Finance Act, 1994. Imposing service tax on ‘consulting engineers’ 51 started in 1997. But the consultancy service is also not devoid of controversies and judicial interpretations. In Bharat Sanchar Nigam Ltd & Another v Union of India & Ors, 52 SC held that ‘the consulting engineers services includes not only advisory/consultative assistance involving cerebral activity of professional but also implementation of their advice and no distinction can be made between the two. It would also include training of personnel, software support, operation/maintenance, emergency support, technical consultancy, etc.’ 53 The liberalization of the Indian economy in 1991 saw most of the companies going for joint ventures and consequent technology transfer, support and management of various services. The government saw this as a chance to tax the technology transfer and indirectly the intangible property in each transaction. In Navinon Ltd v CCE, 54 it was held that payments of royalty were not considered as payments for services provided and consequently cannot be taxed. This position was later confirmed in Bajaj Auto Ltd v Commissioner of Central Excise. 55 It was held that amounts received towards transfer of technology or royalty are not liable for service tax under the category of consulting engineering services. 56

The Finance Act, 2004, explicitly included ‘IP services’ other than copyrights under the purview of service tax under Clause 9.1 of the Act. The definition of taxable service includes only such IPRs (except copyright) that are prescribed under law for the time being in force. IPRs covered under Indian law in force at present, alone are chargeable to service tax and IPRs, like integrated circuits or undisclosed information (not covered by Indian law) would not be covered under taxable services.’ It is clear that if there is no clear mandate of the legislature the governments cannot charge service tax on any IP which is not covered under the Indian law for the time being in force.

Since the passing of Taxation of Services (Provided from Outside India and Received in India) Rules, 2006 57 and Taxation of Services (Provided from Outside India and Received in India) (Amendment) Rules, 2008, if any service provider is situated outside India and is receiving the service in India, it is the duty of the recipient to pay the service tax. With the introduction of the 2006 Rules, the scope of the service tax widened and it clearly states that it shall be treated as if the recipient of the service himself has rendered the service. It can be summarized that if both IPR holder and recipient is in India, then the service provider has to pay tax. If the IPR holder is in India and the recipient is outside India, the IPR holder has to comply with the stipulations under the Export of Services Rules and no tax is to be paid. If the IPR holder is situated outside India and the recipient is situated in India, the service recipient has to pay service tax.

Customs on Intellectual Property

Customs duties are probably the oldest form of taxation in India. It was originated in 1786, when the Britishers formed the first Board of Revenue in Calcutta. In 1808, a New Board of Trade was established. The provincial import duties were replaced by uniform Tariff Act through Customs Duties Act, 1859 which was made applicable to all territories in the country. The Constitution of India (Article 265) lays down that no tax shall be levied or collected except by authority of law. The law for the levy and collection of Customs duties is the Customs Act, 1962 and the Customs Tariff Act, 1975.
Goods become liable to import duty or export duty when there is ‘import into, or export from India. ‘Import’, as defined in Section 2(23), means ‘bringing into India from a place outside India’. ‘Export’, as defined in Section 2(18), means taking out of India to a place outside India’. The IPRs are always territorial in nature. Customs duty is on ‘goods’ as per Section 12 of Customs Act. The basic duty levied under the Customs Act varies for different items from 5% to 40%. Customs duty calculated on the percentage of ‘value’ called ‘assessable value’ or ‘customs value.’ It may be either ‘value’ defined in Section 14(1) of the Customs Act, 1962 or tariff value under Section 14(2) of the Customs Act, 1975. The IP is indirectly mentioned in two places in Rule 9 of the Customs Valuation (Determination of Price of Imported Goods) Rules 1988, viz:

Rule 9 (1)(b)(4) provides that the value, apportioned as appropriate, of the following goods and services where supplied directly or indirectly by the buyer, free of charge or at reduced cost for use in connection with the production and sale for export of imported goods, to the extent that such value has not been included in the price actually paid or payable, namely:-

(iv) Engineering, development of facilities, art work, design work and plans and sketches undertaken elsewhere than in India and necessary for the production of the imported goods;
(c) Royalties and licence fees related to the imported goods that the buyer is required to pay, directly or indirectly, as a condition of the sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable.

Indian rules are based on the WTO Agreement on Customs Valuation. It is clear that any fees paid as royalties or licence fee must be added to the customs value. Any machinery or equipment designed specifically using patent or technical know-how and implementation of such know-how, the value of such technical know-how is to be valued along with the machinery. License fee or royalty paid for use of certain trademarks along with imported goods are also to be valued. India clearly adopted the transaction value method in case of non-related parties. However, the right to reproduce the imported goods in the country is excluded for the purpose of custom valuation. Similarly, anything imported for the purpose of re-distribution shall not be added to the price of the imported goods.

In the case of Union of India v Mahindra and Mahindra Ltd, SC considered the question of valuation based on the ‘best judgment assessment’ methodology in the valuation of CKD packs imported from Peugeot for making diesel car engines under a collaborative agreement between the parties for a period of 10 years. In the technology transfer agreement, Mahindra agreed to pay a lump sum amount of 15 million French francs to the foreign collaborator. The Customs Department charged 15% of the lump sum payment towards designs, patents and trademarks and they argued that the invoice price was not the real price. Finally the Department raised the value of the CKD packs to the extent of 1.5%. The SC observed that there is no ‘arms length’ transaction between the parties and held that ‘the collaboration agreement for the technical know-how and the supply of CKD packs and spares are independent commercial transactions; in other words, there existed no nexus between the lump sum payment under the agreement for the technical know-how and the determination of the price for supply of CKD packs or spares.’ The Court confirmed the view taken by the Bombay High Court that unless the Department shows that the price shown in invoice is not the real price, they have to accept the invoice price and dismissed the appeal by the Department with costs. The same position was taken in an earlier dispute between Collector of Customs, Bombay v Maruti Udyog Limited, Gurgaon. In this case, the Tribunal held that a one-sided interest in a joint venture is not enough to prove ‘arms length’ transactions under Section 14(a).

One of the major decisions, whether import of software is dutiable was discussed in State Bank of India v Collector of Customs, Bombay. In this case, SBI imported a consignment of Computer Software and Manuals from Kindle Software Ltd, Dublin, Ireland, of the value of US $ 4,084,475.00 (equivalent to Rs 10,75,70,267.25). The SBI argued that they are liable to pay only for the cost of software for one time installation and the fee paid for countrywide use of the same software cannot be dutiable as it was not for resale in the country. The duty was initially paid on the value of the invoice by the SBI and later on they claimed a refund of the same. The SC held that the cost of software is not mentioned separately, only the license fee was mentioned, license fee paid for
countrywide use cannot be considered as reproduction charges. The Court observed that reproduction and use are separate things and the transaction is to be seen as a whole. Hence, the licence fee charged for the countrywide use is part of the transaction value and therefore the SBI is not entitled for refund of the duty paid.61

In the dispute between Associate Cement Companies Ltd v Commissioner of Customs,62 it was held that valuation for the purpose of customs duties on drawings, designs and technical material and IP when put on a media is to be regarded as an article on the total transaction value of which customs duty is payable. There is no scope for splitting the engineering drawing or the encyclopaedia into intellectual input on the one hand and the paper on which it is scribed on the other. The concept of ‘transaction value’ is quite different from the classic concept of price of goods and is based on GATT protocol and WTO Agreement introduced through Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 framed under Section 14 of Customs Act, 1962. The SC made it clear that the concept of ‘goods’ under the Sales Tax Act and Customs Act are different. It may include intangible assets also for the purpose of custom duties.

In BPL Display Devices Ltd v Commissioner of Customs,63 SC held that the cost of drawings, designs and know-how fees is includible in the assessable value of imports. Whether it is termed as royalty, license fee or ‘technology fee’ is immaterial, the importer is liable for payment of duty.64 In the case of Andhra Petrochemicals v Commissioner,65 SC held that it is immaterial whether supply of machinery, transfer of technical know-how and drawings are transferred under different contracts, the fact to be looked into is whether it is a single package deal or not. In Jindal Photo Films Ltd v Commissioner of Customs, Bombay,66 it was held that license fee related to know-how embedded in the machine has to be added to assessable value.

From the relevant provisions and judicial interpretations, it is clear that equipments that are imported with any technical know-how or IPRs are to be considered for the determination of transaction value. In conclusion, it can be observed that the present law is not in favour of technology transfer and that there is no incentive for acquisitions of technical know-how and IPRs by the domestic industry, which will help them in increased production and competition in the international market.

Most importantly, the Government of India notified the Intellectual Property Rights (Imported Goods) Enforcement Rules in 2007.67 These rules empowered the Central Government to restrict or prohibit import and export of goods infringing trademarks, patents and copyrights under clause (n) of Sub-section (2) of Section 11 of the Customs Act, 1962. Thus, the border measures with regard to the export and import of goods which violate IPRs come under the Customs Act.

Central Excise and Intellectual Property

Central Excise duty is an indirect tax levied on goods manufactured in India. It is a duty collected by the Central Government on manufacture of ‘goods’ and is levied at the time of removal from the factory. The excise duty is levied in pursuance of entry 45 of the Central List in Government of India Act, 1935 as adopted by entry 84 of List I of the seventh Schedule of the Constitution of India. Charging section is Section 3 of the Central Excises and Salt Act, 1944. There is much controversy on the definition of ‘goods.’ There are many judicial decisions with regard to the question of including drawings, designs, etc. in the definition of goods. Drawing and designs relating to machinery or technology are ‘goods’, even if payment is made for technical advice or information technology, which is an intangible asset. But the moment it is put on a media, whether paper or diskettes or any other things, that what is supplied becomes chattel.68

Central Excise Act defines ‘manufacture’ by an inclusive definition as any process incidental or ancillary to the completion of a manufactured product. ‘manufacture’ under Central Excise can be understood as a process wherein the name, characteristic and use of the input are changed or is/becomes distinct and different after the process. Thus, a process which simply changes the form or size of the same article or enhances the value of the article would not constitute manufacture. Repairing or reconditioning does not constitute manufacture. Assembling would constitute manufacture. The value of the goods is arrived on the basis of Maximum Retail Price (MRP) and transaction value.

Section 4(1)(a) of the Central Excise Act, 1944 prescribes that the taxing will be not entirely based on
the transaction value. It includes the value of engineering, development, artwork, design work and plans and sketches undertaken elsewhere than in the factory of production and is necessary for the production of such goods.

In case of contract workers or job workers who affix the brand name of the principal IP holder, no value towards brand name would be included in the value of the goods manufactured by the job worker. The SC held that the job worker who works on principal to principal basis would similarly be the manufacturer liable for central excise duty if any applicable. The Valuation Rules, 2000 will be the basis of valuation and in accordance with the Supreme Court decisions in Pawan Biscuits and Ujagar Prints Ltd cases. The valuation circular made it clear the liability of a job worker in CD-writing. According to Rule 11 and Rule 6, the value of additional costs like materials supplied free by a music company to the job worker, jackets, boxes, etc. have to be taken into consideration for the purposes of valuation. The price of the disc includes the royalties paid to acquire the copyright of the music also. It means that the 2000 circular includes the IPR charges also in the value of goods made by the job worker. The SC in Re Pepsi Foods Ltd held that the royalty paid has to be included in the value. There is an exemption allowed under the rules these are for Small Scale Industries. However, this concession is not available to SSIs using the brand name of big companies. The SC in Union of India v Paliwal Electricals (P) Ltd held that the exemption is designed to enable the small manufacturer to survive in the market in competition with big players. If the manufacturers use a big brand or use it in their names, the exemption will not apply. From the above discussion it is clear that exemptions are rare in Central Excise and payment towards any kind of IPR is chargeable towards valuation.

**Stamp Duty and Intellectual Property Rights**

Stamp duty has to be paid for any type of ‘conveyance’ of movable or immovable property under the Indian Stamps Act, 1899. The dutiable transactions prescribed in the Act are bill of exchange, cheques, transfer of shares, transfer of immovable property, etc. The rate of duties differs from state to state. Any instrument mentioned in Schedule I to Indian Stamp Act 1899 is chargeable to duty as prescribed in the Schedule.

Intellectual property documents like transfer of IP rights in the form of licenses, assignments, sales, etc. come under the purview of the Indian Stamp Act, 1899. If one instrument is dealing with several transactions, stamp duty is payable at the aggregate amount of all transactions. It means that all kinds of IPR licensing should adequately pay the stamp duties on conveyance. In case of trademarks, if the Registrar has reason to believe that the market value of the trademark has not been truly set forth in the deed, he can impound the document under Rule 72 of the Trade Mark Rules, 2002 and also charge the stamp duty according to Section 47 of the Indian Stamp Act, 1899. The commercialization of IPR is mainly by assignment and transmission. Both can be considered as conveyance. The registration of documents dealing with IPR is not mentioned in any IP legislations in India.

Transfer of IPR between parent company and subsidiary is also subject to stamp duty. Some states like Tamil Nadu exempted IPR transactions from taxation, but now that exemptions no longer exist, these are taxed under the Stamp Act. Other countries like the United Kingdom abandoned stamp duty on assignment and transmission of trademarks through the Finance Bill, 2000 was terminated. In US and Japan, there is no provision or practice of stamp duty on IPR. In Ireland, there is no duty on transfer of IPR. Other countries like Australia announced that stamp duties for transfer of business assets like goodwill, IPR and other licenses will be abolished from 1 July 2012.

**Conclusion**

Any IP tax policy should encourage IP creation and innovation to create wealth. Presently, there is no incentive for IP creation or technology transfer under the Income Tax Act, 1961, Sales Tax or Value Added Tax, Customs Tariff Act, 1975, Central Excise Act, 1944 or the Service Tax Act. The Government of India should legislate upon a comprehensive law on taxation of IP which gives incentives for the industry to further grow and add impetus to the economic growth of the country. Presently, IPRs are indirectly taxed at many levels. Barriers to scientific progress should be removed. Double taxation avoidance agreements are not working properly in favour of the industry. There is no incentive for the employees who are instrumental in innovation and inventions. The investment needed for innovation is so high that there
is no guarantee of returns to corporates and individuals. In order to facilitate limited liability in business, the pending Limited Liability Partnership Bill, 2006 should be passed. The tax policy may encourage employee stock option and equity based compensation in start-up companies to give incentives to employees who are instrumental in innovation.

The capital value of business in the country should be re-assessed by the taking into account of intangible property of every company in India. Empirical evidence may be collected to check the relationship between IP taxation at different levels in India and its effect on innovation and IP creation and acquisition. Transaction cost of IP creation should be minimised by adopting different policies for start up low-end enterprises and big companies. A comprehensive IP taxation regime should be developed, that could achieve a pro-growth momentum in the country. A uniform IP tax policy should be adopted throughout the states. All the present taxing under different statutes and court decisions may be inculcated in the new legislation. The service tax regime should not put a burden on rendering IP services when the country’s service sector contributes the highest level to the GDP in the country. More and more technology ventures should be groomed with tax deductions on research and development. It can be concluded that the horizon of taxing the income from IPRs are increasing day by day. The provisions need to be codified for better assessment and administration.

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References

2. Except the tax on agricultural income which the state can levy.
3. For intra-state sale of goods.
4. Duty on transfer of property.
5. Manufacture of alcohol.
6. Tax on entry of goods for use, consumption within a area of the local bodies.
11. 69 ITR 692.
12. 10 TC 155.
14. The concept of materiality allows accountants to use estimated amounts and even to ignore other accounting principles if these actions will not have a material effect on financial statements. A material effect is one that might reasonably be expected to influence the decisions made by users of financial statements. Thus, accountants may count for immaterial items and events in the easiest and most convenient manner; http://highered.mcgraw-hill.com/sites/0072396881/student_view0/chapter4/chapter_summary.html (18 April 2008).
17. Income Tax Act, 1961, Explanation 3(b) to Section 31.
18. Income Tax Act, 1961, Section 80GGA (a) and (aa).
19. Income Tax Act, 1961, Section 32(1) (ii) and (iii).
20. Income Tax Act, 1961, Section 36A (vi) and (vii).
21. Income Tax Act, 1961, Section 35AB. For the purpose of this section, ‘know-how’ means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto).
23. 69 ITR 692.
24. 106 TTJ 620.
26. Income Tax Act, 1961, Section 80QQA (2)(a) and (b).
28. 103 ITD 324.
29. The royalties and fees for technical services would be taxable in the country of source at the following rates:
   (i) 10%, in case of royalties relating to the payments for the use of, or the right to use, industrial, commercial or scientific equipment;
   (ii) 20%, in case of fees for technical services and other royalties.
30. ACC 4 SCC 593 (SC).
33. Income Tax Act, 1961, Section 32(1)(ii) and (iii).
34. Income Tax Act, 1961, Section 35AB. For the purpose of section, ‘know-how’ means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits (including the searching for, discovery or testing of deposits or the winning of access thereto).
35. Income Tax Act, 1961, Section 36A (vi) and (vii).
36. Income Tax Act, 1961, Section 80GGA (a) and (aa).

Clause 29A provides that ‘tax on the sale or purchase of goods’ includes—29A (b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract.


Taxable service under this head means - Engineering consultation service by a consulting engineer in relation to advice consultancy or technical assistance in any manner in one or more discipline of engineering.

2001 CTR 346 (SC).

The Court also made a distinction between selling of software as a goods and servicing. The Court observed that ‘Software engineers services provided under a contract by consulting engineer are altogether different thing from selling software as goods. Software support services such as fault repair requiring preparation of software, corrections and updates, operation and maintenance assistance, help desk and emergency support services cannot be equated with sale of software as goods but are advisory/consultative services involving technical assistance’.


(2004) 179 ELT 481. Again the decision was confirmed in CCE, Indore v Pinnacle Industries Ltd 2006 (1) STR 258 (Tri-Del).

India Pistons Ltd v CCE (2006) 2 STR 216 (Tri-Chennai).


(1997) 90 ELT 275 (SC).


Knowledge in the form of drawing and design relating to machinery are ‘goods’—Prerna Textiles v CCE 2000(117) ELT 241 (CEGAT)—civil appeal dismissed by SC (2001) 134 ELT A169.

CCE v SHS Electronics 183 ELT 374.


158 ELT 552.
