BOTTLING FAME, BREWING GLORY AND TAXING THE TRANSFER OF INTANGIBLES

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ABSTRACT

With the advent of the knowledge based economy, transactions involving transfer of intangible property have increased manifold. However, the problems that were faced in taxing these transactions since the 1960s have still not found concrete solutions. There has been a constant and unsettled debate as to whether such transactions would qualify as sales or as rendition of services, the answer to which will severely affect its taxability. A Constitutional Amendment was promulgated to clarify the position. This amendment, however, resulted in further complicating the issue by creating a possibility of opposing interpretations. Thus the trend of judicial interpretations needed to be relied on for some clarity even though this trend has not been strictly linear. This paper is aimed at exploring these issues by providing the relevant aspects of law, tracing the jurisprudential history and critiquing the most recent judgment on the matter. The paper will also explore the possible alternatives to overcome these issues by discussing the appropriate interpretation of the existing statutes and the implication of the new reforms proposed in the form of the Model GST Act.

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I. INTRODUCTION

A. The importance of Intellectual Property ("IP") Transactions

The supply of intangible goods and services has fast become one of the biggest drivers of economic growth.[2] What has now come to be known as the knowledge economy[3] is powered, in large part, by transactions involving purely intellectual assets. With the transfer of intangibles accounting for ever-increasing fractions of commercial revenue, it is only natural for states to tax these transactions with renewed focus.

As we will see over the course of the following parts, India's federal structure throws up unique challenges when taxing the transfer of divisible rights, especially when the underlying subject matter that these rights cover is no more tangible than a lawfully granted monopoly. Predominant among these challenges is the fact that the extant tax regime is premised on the classification of taxable subject matter into goods and services. Given that IP transactions usually straddle this distinction [see, for example, the Software as a Service ("SaaS") business model,[4] poised to rake in billions of dollars in revenue],[5]

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2 Alessandro Sterlacchini and Francesco Venturini, *Assessing the Knowledge Economy: GDP, Productivity and Employment Growth in EU developed Regions*, THE IUP UNIVERSITY JOURNAL OF KNOWLEDGE MANAGEMENT (2009), available at: http://works.bepress.com/francesco_venturini/17/.

3 *The Knowledge-based Economy*, OECD, 1996. Doc. Ref. OCDE/GD(96)102, available at https://www.oecd.org/sti/sci-tech/1913021.pdf.

4 Gianpaolo Carraro and Fred Chong, *Software as a Service (SaaS): An Enterprise Perspective*, MICROSOFT DEVELOPER NETWORK, https://msdn.microsoft.com/en-us/library/aa905332.aspx.

5 *Indian SaaS – The Next Big Thing*, NATIONAL ASSOCIATION OF SOFTWARE AND SERVICE COMPANIES (May 2016), available at http://www.nasscom.in/indian-saas-next-big-thing.

market players have found themselves staring down the business end of the trigger-happy Indian taxman's barrel.

This paper seeks to examine the manner in which India's tax regime has responded to these challenges, and evaluate whether it has been successful in evolving a framework that adequately accommodates the knowledge economy in the digital age. Specifically, this article focuses on the assignment and licensing of intellectual property.

IP producers are essentially the first line of vendors in the market – their products are repackaged and resold successively until they either reach the end user or the point at which they are converted into physical goods. Examples are readily available: an author produces a manuscript (say, a book of bedtime stories) and assigns it to a large publication house in return for an up-front payment. This publisher could have a number of imprints, each catering to a distinct demographic of the reading public.

The publisher then assigns the book to one of its imprints that publishes children's stories, in exchange for a portion of the royalties. The imprint (usually a subsidiary of the publisher) undertakes the costs of printing, marketing and promoting the book, and puts the book on the market from which parents may purchase them to read to their insomniac offspring.[6]

[6] For a more detailed overview of the value chain in publication, *see* Richard Watt, *Copyright law and royalty contracts* and Nicola Searle and Gregor White, *Business Models*, in Ruth Towse and Christian Handke (eds.), HANDBOOK ON THE DIGITAL CREATIVE ECONOMY (Edward Elgar, 2013).

Alternatively, a university research centre could discover a ground-breaking new gene therapy for chronic hepatitis C, file for a patent, and assign it to a small pharmaceutical company in exchange for a fixed payment. This company could be acquired by a major international player, sometimes with the sole intent of acquiring control of its ongoing research. The larger player could now develop the therapy and embody it in the form of a drug, and put this drug on the world market for doctors to prescribe.[7]

The importance of licensing in the knowledge economy cannot be understated. Since intellectual assets are non-exclusive, commerce in IP is much more likely to take place through licensing agreements that allow a downstream party to commercially exploit the asset without necessarily excluding the upstream party (or anyone else, for that matter). Thus, a patentee could, in order to augment her supply of patented drugs to the market, enter into licensing agreements with numerous other manufacturers to supply the market globally.[8]

Such "technology transfer" agreements can spur economic growth and industrial development in low and middle income countries, acting as a

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7 This example closely resembles the manner in which the "block-buster" hepatitis C drug sofosbuvir (marketed by Gilead Sciences as Sovaldi) was developed and marketed. *See* Ivan Gentile, et. al., *The discovery of sofosbuvir: a revolution for therapy of chronic hepatitis C*, 10(2) EXPERT OPINION ON DRUG DISCOVERY 1363 (2015).

8 This, too, has occurred in the Sovaldi saga. *See* CH Unnikrishnan, *Gilead to license Sovaldi to Indian generics drug firms*, MINT, 15 Sep. 2014, http://www.livemint.com/Industry/no7AnbJi4dRkjJY7dn4SOI/Indian-companies-to-sign-generic-licensing-deal-for-Hepatiti.html.

vital equalising force in the international economy.[9] Global ramifications aside, the most basic upshot of the "licensing economy" is the huge amount of revenue that is generated by market players that deal in intellectual assets.[10] From a taxing perspective, this revenue represents both a valuable resource and an intricate challenge, especially when attempting to apply legacy tax statutes to the ground realities of an entirely new set of business models.

B. Sale v. Service: Constitutional Implications

The federal structure of India's constitution provides for a distributed scheme of legislation and taxation,[11] in which the states are given a broad power to tax sales (but not services), while the union is given a broad power to tax services and inter-state sales. This is achieved through a combined reading of the entries in the Seventh Schedule. In the Union List:

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9 *See generally* Adam Liberman, et. al., INTERNATIONAL LICENSING AND TECHNOLOGY TRANSFER: PRACTICE AND THE LAW (Wolters Kluwer, 2008).

10 *See generally* CORPORATE COUNSEL'S GUIDE TO LICENSING (Thomson Reuters, 2014).

11 Article 246 of the Constitution reads:
"246. (1) Notwithstanding anything in clauses (2) and (3), Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule (in this Constitution referred to as the "Union List").
(2) Notwithstanding anything in clause (3), Parliament, and, subject to clause (1), the Legislature of any State also, have power to make laws with respect to any of the matters enumerated in List III in the Seventh Schedule (in this Constitution referred to as the "Concurrent List").
(3) Subject to clauses (1) and (2), the Legislature of any State has exclusive power to make laws for such State or any part thereof with respect to any of the matters enumerated in List II in the Seventh Schedule (in this Constitution referred to as the "State List").
(4) Parliament has power to make laws with respect to any matter for any part of the territory of India not included in a State notwithstanding that such matter is a matter enumerated in the State List."

"92A. Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-State trade or commerce.

92C. Taxes on services."[12]

In the State List:

"54. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of Entry 92A of List I."

The upshot of this scheme is that an IP transaction will generally be taxed by the Union if it is classed as the rendering of a service, and taxed by the States if it is classed as a sale of goods. This has led to the development of a considerable body of jurisprudence, in which assessees have attempted to dodge either a central or a state levy on the ground that the nature of the transaction put it outside the scope of the imposing power's constitutional authority.[13]

12 The Constitution was also amended in 2003 to insert Art. 268A, which reads as follows:
"268A. (1) Taxes on services shall be levied by the Government of India and such tax shall be collected and appropriated by the Government of India and the States in the manner provided in clause (2).
(2) The proceeds in any financial year of any such tax levied in accordance with the provisions of clause (1) shall be—
(a) collected by the Government of India and the States;
(b) appropriated by the Government of India and the States, in accordance with such principles of collection and appropriation as may be formulated by Parliament by law."

13 Sudhir Chandra Nawn v. Wealth Tax Officer, 1969 AIR 59,Union of India v. H.S. Dhillon, 1972 AIR 1061, Federation of Hotel Association of India v. Union of India, (1989) 3 SCC 634 are some instances of cases where the competency of the taxing authority was challenged citing that the respective entry fell outside its constitutionally granted taxing jurisdiction.

In Part II, we examine the evolution of Indian jurisprudence concerning the taxation of intangible assets, with a focussed eye on how case law could be interpreted to guide the taxation of divisible right transfers through licensing transactions. In Part III, we turn our attention to a case in which the Bombay High Court got it all wrong. We investigate what can only be termed a jurisprudential train-wreck, piecing together the sequence of events that led a Division Bench of the most respected High Courts of our country to deliver a ruling that unceremoniously brushed aside all precedent, singlehandedly swinging a juridical wrecking-ball to reduce a towering body of common law to rubble. In Part IV, we evaluate the options before the Supreme Court and Parliament, especially in light of the GST Bill which has sought to mitigate the effects of this disaster by proposing a regime that altogether rejects the need for classification of IP transactions

II. THE EVOLUTION OF INDIA'S IP TAXATION REGIMEN

A. State of Madras v. Gannon Dunkerley

One of the first cases to deal with the conflict of classification was *State of Madras v. Gannon Dunkerley* (1958),[14] where the Supreme Court observed that works contracts, such as construction contracts, were indivisible and therefore could not be separately taxed for their sale and service components. It devised the *dominant intention test*, observing that the primary intention of the parties was to render and accept services, rather than to sell or purchase goods that were

[14] AIR 1958 SC 560.

merely incidental to the contract. Therefore, on facts, the court held that sales tax was not attracted. More pertinent for our purposes, the court also enumerated the essential conditions of a sale:

> "*...to constitute a valid sale, there must be a concurrence of the following elements, viz., (1) Parties competent to contract; (2) mutual assent; (3) a thing, the absolute or general property in which is transferred from the seller to the buyer; and (4) a price in money paid or promised.*"[15]

B. AV Meiyappan v. Commissioner of Commercial Taxes

Just over a decade later, the Madras High Court dealt with a similar conflict, this time with respect to a copyright transaction. The question under consideration in *AV Meiyappan v. Commissioner of Commercial Taxes*[16] was whether the "lease"[17] of the copyright in certain cinematograph films. The court firstly held that a copyright would qualify as moveable property capable of being transferred despite its intangible, incorporeal nature. However, it went on to observe that in the particular transaction in question, the transfer was only for a period of 49 years, thus it was temporary and in the nature of a lease and therefore does not fulfil the conditions of a valid sale.

15 *Ibid.*

16 AIR 1969 Mad 284.

17 Although the parties to the contract styled it as a lease, the transaction was more properly in the nature of a time-limited non-exclusive licence.

C. Legislative response: the Forty-Sixth Amendment

Parliament enacted the Forty Sixth Amendment to the Constitution of India in 1982. This amendment expanded the base of Entry 54 of List II by introducing the concept of 'deemed sales'. The Amendment included under Article 366(29A) all those transactions which were sales "in substance".[18] The legislature argued that the amendment was necessary to nullify tax avoidance resulting from *Dunkerley* jurisprudence, which effectively freed indivisible contracts from sales tax.[19] Thus, the dual requirements of dominant intention of the parties to effect a sale and of an actual transfer of title in order for a transaction to qualify as sale were effectively negated through the Amendment.

D. State of Andhra Pradesh v. Rashtriya Ispat Nigam Limited ("RINL")

State of Andhra Pradesh v. Rashtriya Ispat Nigam Limited (2002)[20] discussed the meaning of the words "transfer of right to use". Third party contractors hired machinery from RINL for the sole purpose of using this machinery to execute the contract they had entered into with RINL. The question was

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18 The Constitution (Forty Sixth Amendment), 1982. See: https://india.gov.in/my-government/constitution-india/amendments/constitution-india-forty-sixth-amendment-act-1982.

19 "This position [stemming from *Gannon Dunkerley*] has resulted in scope for avoidance of tax in various ways." *Statement of objects and reasons appended to the Constitution (Forty Sixth Amendment) Bill, 1981 which was enacted as the Constitution (Forty Sixth Amendment) Act, 1982*. The Statement of Objects and Reasons also specifically engages with tax avoidance in copyright transactions – a consequence of *Meiyappan*, no doubt – in the following words: "Device by way of lease of films has also been resulting in avoidance of sales tax. The main right in regard to a film relates to its exploitation and after exploitation for a certain period of time, in most cases, the film ceases to have any value. It is, therefore, seen that instead of resorting to the outright sale of a film, only a lease or transfer of the right to exploitation is made."

20 (2002)3SCC 314

whether such hiring would amount to a transfer of the right to use the machinery.

The Supreme Court observed that the effective control of the machinery remained with RINL as the contractors could not use the machinery in any other manner or for any other purpose other than those mentioned in the RINL contract; they could not move the machinery away from RINL's premises and the contractors merely had 'custody' while the 'control and possession' remained with RINL. The Court thus established that in order for a transaction to qualify as 'transfer of a right to use', there has to be transfer of exclusive and effective control.

E. BSNL v. Union of India

Most important in the series of cases that have diverged from the *Duke* position is *BSNL v. Union of India,*[21] which examined whether the rendition of mobile telephony services (accomplished in large part through the distribution of SIM cards) would qualify as a deemed sale. In his separate and concurring opinion, AR Lakshmanan, J. clearly laid out the essential conditions for a transaction to qualify as a transfer of the right to use goods:

"a. There must be goods available for delivery;

b. There must be a consensus ad idem as to the identity of the goods;

[21] (2006) 3 SCC 1.

> *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;*
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> *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;*
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> *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.'*[22]

It is of vital importance to note that Lakshmanan, J.'s opinion is *ex facie* wide in its scope – the above cited paragraph does not restrict itself to telecommunications transactions, but purports to be applicable to *all* transfers of the right to use goods.

F. Post-BSNL: Ripples in the Juridical Pond

While it is true that the *BSNL* test has served to dispel several issues that were earlier faced while deciding whether transactions fell under the purview of Article 366(29A)(d), there have been cases even after *BSNL* that have relied upon *Duke* to return judgement contrary to the Supreme Court's settled position. Exemplary are the cases of *Jojo Frozen Foods v. State of Kerala*[23]

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22 *Ibid.* Para 96.
23 (2009) 24 VST 327.

and *Kreem Foods v. State of Kerala*.[24] The question in both these cases was whether the royalty received by the assessee from its franchisees for the non-exclusive and temporary use of its trademark attracted sales tax. The High Court of Kerala, in both the cases, relied on *Duke* to hold that such transactions amounted to deemed sales under Article 366(29A)(d) and thus attracted sales tax.

G. The Ripples Settle Down South: AGS and Malabar Gold

A constitutional challenge to Section 65(105)(zzzzt) of the Finance Act, 1994 arose before the Madras High Court in *AGS Entertainment Pvt. Ltd. & Ors. v. UoI & Ors.*[25] The relevant provision reads as follows:

> *"In this Chapter, unless the context otherwise requires, --"taxable service" means any [service provided or to be provided],- to any person, by any other person, for— (a) transferring temporarily; or (b) permitting the use or enjoyment of, any copyright defined in the Copyright Act, 1957, except the rights covered under sub clause of clause (1) of section 13 of the said Act;"*

Challenging this, AGS Entertainment argued that transfers of divisible interests in a copyright, being deemed sales under Article 366(29A)(d) and therefore subject to state sales tax, could not be covered by a central service tax. In a nutshell, the petitioners questioned Parliament's power to tax as a

24 (2009) 24 VST 333.
25 (2013) 262 CTR 471.

service, transactions that were specifically deemed to be sales by the Constitution.

The High Court, however, relied on the *BSNL* test to hold that Article 366(29A)(d) would only cover permanent and exclusive transfers, leaving temporary, non-exclusive transfers of divisible interests under a copyright free to be taxed as services by the Finance Act. Merely two days before Madras woke up to *AGS*, a division bench of the Kerala High Court arrived at a nearly identical finding in *Malabar Gold v. Commercial Tax Officer*.[26].

III. TATA SONS V. STATE OF MAHARASHTRA

It is this context that *Tata Sons*[27] must be viewed in. Coming as it did in 2014, there was really just one way it should have been decided. For reasons we explore in this part, a Division Bench of the Bombay High Court chose to obstinately turn a blind eye when confronted with compelling precedent. The transaction in question here was the TATA Brand Equity and Business Promotion Agreement, entered into between Tata Sons and its group companies, through which the subsidiaries were allowed to use the 'Tata' trademark in respect of their products, subject to the fulfilment of certain standards.

The Bombay High Court cited abundant case law on the proposition that a trademark is "goods" for the purposes of taxation, and then interpreted

[26] (2013) 32 S.T.R. 3 (Ker.)
[27] (2015) 80 VST 173 (Bom)

the Agreement as transferring a right to use the trademark to the subsidiary companies. While the first limb appears to be sound, the second is seriously suspect, and on more than one ground.

For one thing, the court bases its entire analysis on its elucidation of the law in *Commissioner of Sales Tax v. Duke and Sons Pvt. Ltd.*[28] In itself, this would not have been a problem. However, the *Duke* court seems to have had a particularly difficult time navigating the intricacies of trademark law, especially the difference between the transfer of rights to a trademark and the grant of a license to use one. In pertinent part, BP Saraf, J. holds:

> *"There is a distinction between transfer of right to use a trade mark and assignment of a trade mark. "Assignment" of trade mark is taken to be a sale or transfer of the trade mark by the owner or proprietor thereof to a third party* inter vivos. *By assignment, the original owner or proprietor of trade mark is divested of his right, title or interest therein. He is not so divested by transfer of right to use the same. Licence to use a trade mark is thus quite distinct and different from assignment. It is not accompanied by transfer of any right or title in the trade mark. The transfer of right to use a trade mark falls under the purview of the Maharashtra Sales Tax on the Transfer of Right to use any Goods for any Purposes Act, 1985 ("Act of 1985") and not the assignment thereof. The manner of transfer of the right to use the goods to the transferee would depend upon the nature*

28 1999 (1) Mh.L.J. 26.

> *of the goods. For transfer of right to use a trade mark, permission in writing as required by law may be enough.”*[29]

We humbly submit that it is at this point that the *Duke* court has made a right little mess of the law – having recognised that assignment and licensing are two different things, Saraf, J. promptly goes ahead to snatch defeat from the jaws of victory, holding that a “permission in writing” would suffice for a “transfer of [the] right to use” to take place. All the monkey bridge-builders in the Ramayanic army cannot traverse the logical leap contained in the span of that single sentence, as is evident from its plain words.

A license is plainly and conceptually different from the transfer of a right. In simple terms, a license is a permission or an authorisation that is, in effect, a legally enforceable promise by the licensor not to sue the licensee.[30] A license does not create, nor does it transfer, any right to the underlying property itself (whether intellectual or real) – it merely creates a right that protects the licensee from legal proceedings in respect of the property, as long as the licensee is in compliance with any other requirements that the license sets out.

This distinction is further buttressed by a plain reading of the relevant statute – the Trade Marks Act, 1999. Section 45 of the Act requires assignees to register their title in the prescribed manner, and is conspicuous in its omission of licensees. The simple explanation for this omission is that

[29] Id., para. 7.

[30] Raman Mittal, LICENSING INTELLECTUAL PROPERTY: LAW & MANAGEMENT (2011).

licensees do not have *title* in the mark, and therefore no cognizable interest in the eyes of the Registrar under Section 45. In the alternative, a licensee must approach the Registrar along with the licensor under Section 49 to be recorded as a registered user of the mark.

Assignees become the registered proprietors of the mark in question, thus stepping into the shoes of the assignor. It is this element of exclusive substitution that is absent in a license, and the Act draws this distinction by providing for licensees to be treated as registered users, rather than proprietors. Elsewhere, it can be argued that the assignment-license distinction can be drawn in an even sharper manner in copyright law.[31]

The position in *Duke*, we submit, is wholly unsupported by law or reason. From a perusal of the preceding part,[32] it is clear that jurisprudence has evolved substantially since. The world's leading cosmologists admit the viability of forward time travel via time dilation in a relativistic environment, but confidently rule out the possibility of travelling back in time.[33] This merely serves to prove that it would not only be ill-advised, but also impossible for the *Tata* court to move back to the law as it stood in 1998.In order to appreciate the true failings of the *Duke* judgement (and therefore the failings of its

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31 Section 18(2) of the Copyright Act, 1957 provides that as respects the rights assigned, the assignee shall be treated as the owner of copyright. Section 30, which provides for licenses, makes no mention of a change in ownership.

32 *See* Part II, *infra.*

33 Stephen Hawking, *How to build a time machine*, THE DAILY MAIL, 27 Apr. 2010, http://www.dailymail.co.uk/home/moslive/article-1269288/STEPHEN-HAWKING-How-build-time-machine.html.

approval by the division bench in *Tata Sons*), it is important to try and trace the line of reasoning employed by the bench.

It is easy to see the beginnings of the approach taken by Saraf, J. in *Duke*. There exists considerable jurisprudence, as well as statutory backing, to support the proposition that IP is "goods" for the purposes of taxation.[34] In consequence, the right to use a trademark must undoubtedly constitute the right to use goods, and the transfer thereof must be (naturally) the transfer of a right to use goods. Once the court arrives at this point, the attraction of Article 366 of the Constitution is hard to resist.[35] For our purposes, the pertinent portion is Article 366(29A)(d), which reads as follows:

366. Definition

> *In this Constitution, unless the context otherwise requires, the following expressions have, the meanings hereby respectively assigned to them, that is to say*
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> …
>
> *(29A) tax on the sale or purchase of goods includes*

[34] This position would be further bolstered by future rulings, such as the decision of the AP High Court (later quoted with approval by the Supreme Court) in *Tata Consultancy Services v. State of Andhra Pradesh*, [2001] 122 STC 198. There, when deciding the applicability of sales tax on computer software, the court held:
"A 'goods' may be a tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold; and (c) capable of being transmitted, transferred, delivered, stored and possessed. If a software, whether customised or non-customised, satisfies these attributes, the same would be goods."

[35] *See* Section 2.3, *infra*.

…

(d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration

The transfer of a right to use any goods, for the purposes of taxation, is deemed to be a sale by the Constitution. The existence of Article 366(29A)(d) means that once the court glosses over the transfer/licensing distinction, it can comfortably slip into a rabbit-hole whose only conclusion is the holding that trademark licensing is subject to sales tax.

Despite its wholly illogical application of the law and its plain misreading of the English language, the bench in *Duke* can be forgiven (to a limited extent) for its errors. With the judgement being delivered in 1998, it can be argued that the bench was not confronted with compelling precedent to interrogate the distinction between a transfer and a license with greater rigour. *Tata Sons*, being delivered in 2014, can hide behind no such defence.

A. What might have been: Re-imagining Tata Sons in light of Alternative Approaches

In 2000, a five-judge bench of the Supreme Court comprehensively enumerated the characteristics of a transfer for assessing the applicability of sales tax in *Twentieth Century Finance Corp. v. State of Maharashtra.*[36] There, the

[36] (2000)6 SCC 12.

court understood the necessity to interpret Art. 366(29A)(d) in a manner that retained fidelity to the plain meaning of the word "transfer", and held:

> *"Coming to the question that a transaction in question is in the nature of a contract of bailment, it is true that the High Court of Bombay in the judgment under appeal has taken the view that the transactions of the transfer of the right to use goods are in the nature of bailment. If such a view is taken then the State would not have the power to levy sales tax on such transactions. Unless such transaction is held to be a sale or deemed sale in law and it is only then the State legislature would be competent to enact law to levy tax under Entry 54 of List II of Seventh Schedule. The levy of tax is not on use of goods but on the transfer of right to use goods. The High Court proceeded on the footing that the transfer of right to use is different from sale or deemed sale without considering the legal fiction engrafted in clause (29A) of Article 366 of the Constitution."*[37] (emphasis supplied)

Having set up the framework for its reasoning above, the Supreme Court goes on to lay down the law on the scope of Article 366(29A)(d) "deemed sales" as taxable events:

> *"The 'deemed sale' envisaged in Sub-clause (d) involves not only a verbal or written transfer or right to use any goods but also an overt act by which the transferor places the goods at the disposal of the transferee to make*

[37] Id., para. 32.

> *their use possible. On this construction, it is explicit that the transfer of right to use any goods involves both passing of a right in as well as domain of the goods in which right to use is transferred."*[38] (emphasis supplied)

The immediate consequence of this ruling must be the realisation that IP licensing transactions do not constitute sales because they contain neither the passing of a right, nor the passing of the domain of the goods themselves. In addition, another precedent from the Supreme Court was ignored by the bench in *Tata Sons – BSNL v. Union of India*.[39]The paragraph of Lakshmanan, J.'s judgement in which he laid out the essential features of a sale was brought to the notice of the *Tata Sons* bench, which addressed it as follows:

> *"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.*
>
> *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*

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38 Id., para. 66.

39 *See* Section 2.6, *infra.*

> *contemplated therein to be unconditional. Therefore the tests in para (d) and (e) cannot be read in the Act of 1985."*[40]

The *Tata Sons* court seems to hold the opinion that *BSNL*'s interpretation of "transfer" in Art. 366(29A)(d) must be restricted to its facts – where there exists what is plainly the rendition of a service rather than a sale of goods. What the court does not say is *why* the interpretation taken by the Supreme Court cannot be applied to the transaction between Tata Sons and its subsidiaries, especially given that paragraph 98 of *BSNL* was, in fact, worded generally and broadly, and the applicability of *BSNL* to IP licensing agreements was affirmed in *AGS Entertainment*[41] and *Malabar Gold*.[42] There exists an argumentative burden upon the court to provide sound justification where it ignores or reads down principles laid down by a court of higher standing, and this burden has plainly not been discharged by the *Tata Sons* bench where it has distinguished itself without making any concrete distinction between the facts of the two cases.

Applying the *BSNL* test to the facts of *Tata Sons*, it is clear that there is no conceivable way in which the TATA Brand Equity and Business Promotion Agreement could be construed to transfer any right – requirements (d) and (e), which provide for exclusivity of the transferred good from the buyer and from any third party, are obviously unmet. A plain application of

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40 *Tata Sons*, supra n. 29 at paras. 51-52.
41 Supra n. 27
42 Supra n. 28

BSNL, therefore, would result in a ruling diametrically opposed to the one arrived at by the division bench.

Another consequence of applying the *BSNL* test *simpliciter* is that exclusive licenses (regardless of how short the time period of the license is), in situations where the license excludes all third parties including the licensor himself, would constitute transfers of the right to use goods, and therefore fall within the definition of a "deemed sale" under Article 366(29A)(d), with sales tax becoming applicable on the transaction.

In all instances where there exists even an iota of non-exclusivity, however, we submit that *BSNL* lays down the law that no taxable event has occurred for the levy of sales tax, since the deeming provision in Article 366(29A)(d) cannot be interpreted in such an overbroad manner. For this reason, we argue that *Tata Sons* is bad law and liable to be overturned.

The wrongness of the bench in *Tata Sons* has had serious effects on IP transactions, with the Commissioner of Sales Tax, Mumbai issuing a Trade Circular in July 2015 in which he extends the ruling of the division bench to the Maharashtra VAT Act, thus making trademark licensing transactions VAT-able.[43]

[43] Trade Circular No. 11T of 2015, *Bombay High Court judgement in the case of Tata Sons Ltd., Writ Petition No. 2818 of 2012 decided on 20.01.2015*, available at http://www.mahavat.gov.in/Mahavat/MyFold/KNOWLEDGE%20CENTER/TRADE%20CIRCULARS/DateWise/KNOW_TRADEC_DW_MVAT/KNOW_TRADEC_DW_MVAT_07_13_15_4_38_19PM.pdf

B. Wrong on every Aspect

If one last piece of clinching evidence is required to condemn *Tata Sons* to the purgatory of bad law, it is contained in the direct conflict of law created by the interpretation of licensing as a deemed sale with the provisions of the Finance Act dealing with service tax. Section 66E(c), which contains a list of "declared services", provides as follows:

> *"c. temporary transfer or permitting the use or enjoyment of any intellectual property right"*

It is therefore undeniable that legislative intent at the Union level was to deem temporary IP transactions or permissive transactions (such as licensing) as services, for which service tax liability is incurred. If the interpretation taken by the *Tata Sons* court is adopted, then parties to IP licensing transactions will suffer double taxation – once as a service, and once as an instance of sale. Such double taxation would be impossible to justify, since the licensing of an IP right does not involve multiple taxable aspects. The transaction is not divisible into a sale aspect and a service aspect, since the entire licensing transaction is a single event that cannot be split to accommodate the vagaries of any aspect theory-based defence of the taxation regime.

IV. THE WAY FORWARD

Over the course of this paper, it has (hopefully) become clear that the *Tata Sons* ruling is egregiously bad law. However, this does not solve the underlying problem: how must a taxation regime account for the temporary vesting of divisible rights in intellectual assets? Clearly, deeming them as sales is not the correct answer, and deeming them as a service also seems to be an incongruous solution – an attempt to force the round peg of licensing transactions into the square hole of the sale/service distinction. Another possible solution could be in the form of judge-made law through the route of Article 141 of the Constitution. Tata Sons, the aggrieved petitioner, has already appealed the judgement discussed in this paper, and the outcome will hopefully lay down the law on this matter.

While Article 141-based interventions are in the nature of delicate surgical procedures, it appears that the taxability of IP licensing will ultimately be decided by a policy intervention more in the nature of an amputation in its scope and ambit. In an effort to overhaul the indirect taxation regime of the country, the Union Government recently rolled out the Model Goods and Services Tax Law[44] which attempts to resolve the sale/service conflict. Section 2(48) of the act defines 'goods' and explicitly provides that intangible property shall not qualify as 'moveable property' and hence will not be considered goods; Section 2(88) defines 'services' and specifically includes intangible property within its ambit.

Further, Entry 5 under Schedule II annexed to the draft deals with transactions that will be treated as 'supply of services'' and includes *'temporary*

[44] Available at http://www.finmin.nic.in/reports/ModelGSTLaw_draft.pdf.

transfer or permitting the use or enjoyment of any intellectual property right'.[45] And finally, Section 3 that deals with the meaning and scope of 'supply' provides that supply includes all forms of transactions such as sale, transfer, license, lease etc. A cumulative reading of these provisions will lead us to conclude that all transfers of intellectual property rights, whether permanent or temporary, divisible or otherwise, will be considered as 'supply of services' and accordingly taxed as services. In its present form, the Model Act does seem to aid in overcoming the issues faced in taxing intangibles by providing a clear categorization that greatly reduces the potential for double taxation.

While the current regime constantly grapples with the problem of categorising IP transactions into sales and services, the GST regime seems equipped to end such confusion by eliminating the very need for such categorisation. With the passage of the Constitution (122nd Amendment) Act, 2016,[46] the GST regime is ever closer to materialising. The aim of academic research is to highlight deficiencies and lacunae in the law with an aim to correct it. In a sense, legal criticism only succeeds at the point when it is rendered redundant by a change in the regime. To that end, we hope that the speedy adoption of the GST will limit the relevance of our scholarship at the earliest.

45 Entry 5(c), Schedule II, Model GST Law.
46 Act no. __ of 2016. *See http://www.prsindia.org/billtrack/the-constitution-122nd-amendment-gst-bill-2014-3505/*.