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Taxation of Intellectual Property in India

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ABSTRACT

The idea of taxing money, goods, and services has long been popular throughout the world. Distinct tax categories have distinct goals and purposes. Sometimes economies may aim to discourage the domestic use of imported goods, and as a result, the tax on goods that are imported will be high. However, it's interesting to note that intellectual property taxes are relatively new phenomena worldwide. Due to advances in science, technology, and quick communication, every nation can now access it. In India, there are various indirect ways to tax intellectual property. In this essay, we look at the various taxation rules for intellectual property that are covered under Indian laws.

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Keywords: *Taxation; IPR; Copyright; Technology; TRIPS.*

1.0 Introduction

The protection of intellectual property (IP) has recently received a lot of attention in the modern, technologically advanced world. Due to requirements of the international agreement, Trade-Related Aspects of Intellectual Property Rights (TRIPS)[1] under the system of the World Trade Organisation (WTO)[2], several countries are budgeting more for the protection of IP rights. A significant section or heading under international taxes is intellectual property. The transnational distribution of multinational corporations and their Intellectual Property Rights (IPRs) provides enough opportunity to ensure the taxation of these rights and, consequently, a sizeable income for nations that receive technology. In addition to being one of the initial founding members of the WTO in 1995, India opened its economy in 1991 by slashing several taxes, including the corporate tax, central excise levies, and customs and excise duties.

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With a three-tier federal structure made up of the Union Government, the State Governments, and the Urban/Rural Local Bodies, India has a well-developed tax system. The Central Government is responsible for collecting income tax,[3] which comes under the umbrella of direct taxes. The Act divides a person's income into various categories and specifies how the taxable income for each category is calculated.

The Centre also collects central excise, sales, service, and customs taxes. Sales tax,[4] stamp duty,[5] state excise,[6] land revenue, entertainment tax, and tax on vocations and callings are among the taxes administered by the state governments. The local governments have the authority to impose taxes on land, buildings, markets, octroi,[7] and user fees for amenities like water supply and drainage.

2.0 Intellectual Property as Under the Income Tax Act

The Indian legal framework for intellectual property (IT) is extensive, and there are numerous examples where tax breaks for R&D and royalties on different kinds of IP are common in the nation. Royalty income is subject to taxation under *Section 9(1)(vi)*[8]. The royalty is not taxable if it is paid concerning any right, property, or information utilised or provided as part of a business or profession that the payer engages in outside of India or as part of efforts to generate income from sources outside of India.

If income is received in accordance with an agreement made before the first day of April 1976 and the agreement is approved by the Central Government, then the income received in the form of a royalty as a lump sum payment for the transfer outside of India or the imparting of information regarding any data, documentation, drawings, or specifications relating to any patent, invention, model, design, secret formula or process, trade mark, or similar property is not taxable.

The transfer of all rights, including the granting of a license in regard to computer software provided by a non-resident producer along with a computer or computer-based instruments under any scheme authorised under the Policy on Computer Software Exports, Development of Software and Training, 1986 of the Government of India, is another exemption.

According to a circular issued under the Income Tax Act of 1961, foreign transactions containing technological "know-how" were subject to tax starting in 1969.[9] This covers the sale of designs, the hiring of technicians on a temporary basis, technical support, and royalties or licensing contracts. Whether or not the manufacturing know-how has provided enduring benefits will determine how the costs paid for it are treated. In the *CIT v. Ciba of India Ltd. Case*[10], the Supreme Court ruled that expenditures to facilitate the use of processes, scientific information, patents, and trademarks were admissible as

business expenses and were characterized as income because they did not have the characteristics of enduring advantages.[11]

In *Commissioner of Income Tax v. M/s Eicher Limited (previously Royal Enfield Ltd.)*[12], the Delhi High Court decided that the assessee's payment of the non-compete fee was a business expense rather than a capital expenditure.

S.32 (1) (ii) of the IT Act explains asset depreciation[13]. When it comes to intangible assets acquired on or after April 1, 1998, depreciations are permitted for know-how, patents, copyrights, trademarks, licenses, franchises, and any other business or commercial rights of a similar sort.[14] Scientific research expenses (other than capital expenses) are eligible for deductions.[15] Amounts paid to universities, colleges, or other organisations for the purpose of conducting scientific, social science, or statistical research are deductible up to one and one-fourth times the amount given to scientific research associated with the intent to conduct research.

Furthermore, S. 35A of the IT Act, addresses the expenditures for the acquisition of patents and copyrights. The deductions for know-how-related expenses are prescribed under Section 35AB. The provision pertaining to income derived specifically from copyrights is provided in Section 80QQA. "*In the case of an individual resident in India, being an author, the gross total income of the previous year relevant to the assessment year commencing on 1 April, 1980, or to any one of the nine assessment years next following that assessment year or 1 April, 1992 or to any one of the four assessment years next following that assessment year, 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 per cent will be allowed on such amount.*"[16]

The provision pertaining to royalty on Patents are provided for in S. 80RRB. "*Where in the case of an assessee, being an individual, who is resident in India, a patentee, in receipt of any income by way of royalty in respect of a patent registered on or after the 1st day of April, 2003 under the Patents Act, 1970, and his gross total income of the previous year includes royalty, be allowed a deduction, of an amount equal to the whole of such income or three lakh rupees, whichever is less.*"[17]

3.0 Double Taxation Avoidance Agreements (DTAA) and IP

The Central Government is permitted to enter into Double Tax Avoidance Agreements (DTAA) with foreign nations under *Section 90 of the Income Tax Act*. A non-resident Indian who receives income from India is subject to tax in India because India is

the country of source, and he is also subject to tax in his own country because the income is included in the "total world income," which is the tax base in his country of residence. The DTAA's goal may be to prohibit and discourage levies that could impede the free flow of global trade, global investment, and global technological transfer.

These contracts grant the nation of the resident the authority to tax income in the form of interest, dividends, royalties, and fees for technical services. The source country is likewise granted this option, although any taxes levied there must not exceed the limits outlined in the agreement.

In Sonata Information Technology Limited v. Addl. CIT[18], a case involving sales of imported software, the Bangalore Bench of the Income Tax Appellate Tribunal (ITAT) reviewed the characterization of computer software income in international transactions. In the aforementioned case, the assessee was an Indian business involved in the distribution of computer software. The assessee had signed distribution contracts with many foreign suppliers, allowing it to offer computer software to Indian end customers. The assessee argued that it had acquired copyrighted works and as a result, only *Article 7 of the applicable DTAA* applied to the income represented by payments for software purchases made to foreign suppliers. It wasn't taxable in India because the foreign merchants didn't have a Permanent Establishment (PE) there. According to the Tribunal, the Assessee had just bought software—not any intellectual property—when making their purchase. Selling software is solely regarded as a sale of products and is not tax-exempt in any way. As a result, the supplier is exempt from withholding tax obligations.[19]

In the case *of Sheraton International Inc. v. Deputy Director of Income Tax, the ITAT*[20] determined that the assessee's performance of various services rendered to enable it to carry out the task it was given as part of an integrated business arrangement to provide services related to advertising, publicity, and sales promotion, including reservations of Indian hotels around the world in the interest of both parties, could not be relied upon by picking and choosing the same in isolation.

4.0 GST on Intellectual Property

Specifically with respect to the transfer of intellectual property from its owner, the taxability of the same under indirect tax legislation has long been surrounded by conundrums. The question of whether to categorize a transfer of intellectual property as "goods" or "services" for tax obligation lingered even before the implementation of the GST regime in India. Earlier, the state governments had the authority to levy sales tax or VAT if the transaction involving Intellectual Property Rights was classified as a sale or deemed to be a sale of goods. While on the other hand, the union government had the right

to charge service tax on transactions connected to IPR if the same were categorized as services. Hence, this in many situations led to double taxation, especially in cases where the industry practice was to pay both the sales tax and the service tax out of fear of being penalized for tax evasion. However, the requirement of classifying an IPR-related transaction as stated above, relating to a service provision, a sale, or a deemed to be the sale of goods by the state and the union government respectively was eliminated with the introduction of GST.

With the introduction of GST, transfers pertaining to Intellectual Property can be either temporary or permanent in nature. Here, in accordance with the GST, the temporary transfer of any IPR or allowing either the use or enjoyment of any IPR is categorized as a "*supply of services*" under the CGST Act[21] and is made subject to GST@ 12% (6% CGST + 6% SGST). The only caveat is that the intellectual property in question does not relate to any information technology software. Herein granting permission to use or enjoy IPR concerning IT software is subject to taxation at a rate of 18% (9% CGST + 9% SGST) as "*Licensing services for the right to use the intellectual property and similar products*."

Permanent Transfer of Intellectual Property Rights, on the other hand, is considered to be a "*supply of goods*". IPR that is permanently transferred is viewed as a supply of products. According to the Notification dated 14.11.2017[22], the permanent transfer of an IPR is as mentioned above regarded as the supply of goods and is subject to GST @12%. However, just like temporary transfers, the aforesaid GST rate is applicable if the IPR has no reference to IT software. The reason is, that IT software which is regarded as both a good and a service, presents quite a conundrum with regard to the transfer of intellectual property rights. It is interesting to note here that while the aforesaid goods notification previously mentioned has had the GST rate of the permanent transfer of IPR inserted the service notification has not been subsequently deleted. When it comes to the timing, location, invoicing, accounting, and effective utilization of ITC credits, this dual GST model will complicate procedures needlessly. It is pertinent to note here that permanent transfer was not previously regarded as a service. In Bharat Sanchar Nigam Ltd Vs Union of India[23], the Supreme Court established an exclusivity test, that is, whether the transfer, assignment, or license is exclusive to the transferee so as to assess whether or not the transfer constitutes a sale. It is crucial to remember that under the current GST legislation, it makes absolutely no difference because the transaction will be subject to the same concurrent tax regardless of how it is carried out. Here, a license is a permission granted to do or enjoy something that a person would not otherwise be legally permitted to do so. The recipient or in this case, the licensee, is simply permitted to use or enjoy IPR in question, therefore there is no transfer of title or ownership as such. Therefore, no interest in the property is transferred by the licensor to the licensee. In situations where the

title or ownership of the intellectual property has changed hands, then in that case the transaction is referred to as an "assignment," which as explained above results in the permanent transfer of IPR and makes the assignee the new owner of the right. Since a license is just permission granted for consideration and is not a transfer of the IPR; it is treated as a supply of goods under the Goods and Services Tax. So, where on one hand IPR licenses are granted under GST as services, the assignment of the IPR under GST would be categorized under the sale of goods.

The question looms whether permanent transfer of IPR is covered by heading 99733 to the system of classification of services (which provides for allowing, granting, or authorizing the use of intellectual property products, wherein a license is issued by the supplier to the recipient to enjoy or use an IPR) or Serial No. 243/452P to the scheme of classification of goods as GST regulations have treated the permanent transfer of IPR as goods and services?

Under the reverse charge method, tax is required to be placed on a subset of supplies of goods, services, or both. "*Reverse charge means the liability to pay tax is on the recipient of supply of goods or services instead of the supplier of such goods or services in respect of notified categories of supply.*"[24] Relating this to the notion of copyright, say when an author, musician, photographer, artist, or any other individual involved in work of the same or similar nature provides services by giving away or allowing the use of a copyright protected by the Copyright Act of 1957, the recipient of those services is responsible for paying any applicable taxes.

It is a known notion that goods which are unbranded are exempted under the GST Act. These very same goods, however, become subject to GST when they are sold under a registered brand name. The word "registered brand name" refers to a brand/trade name that has been registered under the Trademarks Act of 1999. Therefore, a situation could develop where a company selling say honey under an unregistered brand would be free from GST. This might lead to a loophole to get an exemption under the current GST regime, which would undoubtedly have a bad impact on the intellectual property sphere because companies might get enticed to sell their goods under unregistered brands.

5.0 Singapore's Way

Countries nowadays, by way of tax incentives are delving into their R&D development. Some recent examples are that of *inter alia* the US, Singapore, the European Union, and Malaysia. The paper will now elucidate how Singapore has taken certain measures to achieve the aforementioned. Although, it is implied understand ding that application of Singapore's methodology cannot be mirrored or applied immediately when

it comes to India, nonetheless, it is important to analyze how India may monetize or capitalize on its strengths like Singapore. Singapore aspires to be the intellectual property centre for the entire of Asia[25], not only in terms of holding but also when it comes to creation. In 2001, for the purpose of examining Singapore's advantage and incorporating a thorough development with regard to intellectual property assets, an Economic Review Committee was set up. This set as the embarkment of Singapore's path to becoming its aspiration, that is, Asia's IP hub. To attain the same, Singapore started to make investments in niche industries such as *inter alia* IT, biotechnology, and life science research to help small and medium-sized enterprises become more comparably competitive. The purpose of enacting such a measure was to shift Singapore's economy from a manufacturing-based to a knowledge centric one.[26] A little over ten years later, in 2010, Singapore unveiled the Productivity and Innovation Credit Scheme, which incentivized people that created or invested in IP there. The aforesaid benefits pertained to registering and acquiring IP rights, engaging in R&D activities, and investing in authorized design projects.[27] Apart from this, Singapore also has a Research Incentive Scheme for Companies[28] which is a cash award programme run by the Singaporean government that strives towards supporting the establishment of R&D centres. However, the only caveat is that these grants are at the government's discretion and are only provided to those initiatives that it deems to be strategic.[29]

As per the Income Tax Act of Singapore, the first $100,000 in yearly IP protection costs are eligible for a 200% tax deduction. And any sum over the aforesaid cap is qualified for a further 100% tax deduction.[30] It is pertinent to note here that only patents, designs, trademarks, and plant varieties are eligible for the above-mentioned incentive in the act. The small and medium enterprises in Singapore made up around 85% of the 770 enterprises that claimed the aforesaid higher R&D incentives in 2016.[31] Furthermore, the pioneer tax incentive is an additional incentive available to businesses producing high-technology content.[32] Singapore also has an approved royalty incentive, which grants access to cutting-edge technology by offering a low or zero withholding tax rate on royalty payments.[33] In consonance with its Patent Box Regime, Singapore introduced its IP Development Incentive, which was based on the idea of efficient utilization of IP rights. In accordance with the modified nexus strategy supported by the OECD, Singapore now requires that the same tax incentive be connected to R&D investment in the country.[34] Different nations have likewise adopted comparable tax incentives.[35] The main tax benefits offered in different nations are summarised in the Table 1.[36]

Table 1: R&D Incentives Offered in Different Nations

Benefits	Brazil	China	South Africa	Japan	Republic of Korea	Thailand	USA
Tax Allowance/Deductions	✓	✓	✓			✓	
Tax Credit				✓	✓		✓
Accelerated depreciation on R&D assets/capitals	✓	✓	✓				
Reduced tax rates	✓	✓				✓	
Tax Holiday							
Tax deferrals							✓
Tax exemptions (Excise & Custom Duty)		✓					

Source: Authors' compilation based on official website of DSIR-India, OECD Innovation Policy China report, Thailand Board of Investment guide, KPMG (2012/13), EY (2013-14), PWC (2014), Deloitte (2014).

6.0 Conclusion

In a developing nation like India, where income is the primary source of funding for governmental expenditures, income taxation is important. Intellectual property rights have a high monetary and labour value, and their holder has to put a lot of effort and money into acquiring them. The nature of the transaction will determine how to charge the invested funds and the worth of these rights for tax purposes. It is simple to charge the income or expenses in accordance with the various provisions of the Income Tax Act once the nature has been established. It is required to ascertain if the transaction is one of revenue or capital in order to charge tax.

Additionally, a number of people or organisations derive the majority of their income from their intellectual property rights, making the intellectual property very important and consequently requiring attention to its tax structure. Therefore, as intellectual property is currently taxed indirectly, the provisions of taxation for those rights need to be written separately for better administration.

Endnotes

1. The TRIPS Agreement is Annexure 1C of the Marrakesh Agreement Establishing the World Trade Organization, signed in Marrakesh, Morocco on 15 April 1994.
2. The World Trade Organization is the only global international organization dealing with the rules of trade between nations and was established in 1995.
3. Except the tax on agricultural income which the state can levy.

4. For intra-state sale of goods.
5. Duty on transfer of property.
6. Manufacture of alcohol.
7. Tax on entry of goods for use, consumption within areas of the Local Bodies.
8. Explanation 2 to Section 9(1)(vi) provides that, 'for the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'Capital gains') for-
   (i) the transfer of all or any rights (including the granting of a license) in respect of a patent, invention, model, design, secret formula or process or trademark or similar property;
   (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trademark or similar property;
   (iii) the use of any patent, invention, model, design, secret formula or process or trademark or similar property; (iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
   (iv) (a) the use or right to use, any industrial, commercial, or scientific equipment but not including the amounts referred to in Section 44BB;
   (v) the transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic, or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films; or
   (vi) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (vi), (iv a) and (v).'
9. Paragraph 3 of the circular provides that 'technical know-how' is a term of wide connotation and includes several kinds of technical knowledge, assistance, and services. There are several ingredients constituting technical know-how, such as (i) the design of the product to be manufactured, (ii) the design of the process for manufacture, (iii) the design and engineering of the plant, (iv) the erection and commissioning of the plant, etc.
10. 69 ITR 692.
11. Circular No. 21 issued by the Ministry of Finance on 9.07.1969.
12. ITA No. of 1094/2006, delivered on 16 April 2008.
13. Section 2(11) defines; 'block of assets' means a group of assets falling within a class of assets comprising: (a) tangible assets, being buildings, machinery, plant, or furniture; (b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed.
14. For the purpose of the 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 searching for discovery or testing of deposits for the winning of access thereto (Explanation 4 to Section 31).
15. For the purpose of section 31 [Explanation 3(b)] intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature.
16. S.80QQA of IT Act.
17. S.80RRB of IT Act.
18. 103 ITD 324.

19. The withholding tax are at the following rates: Royalties and fees for technical services would be taxable in the country of source at the following rates:
    a. Ten per cent in case of royalties relating to the payments for the use of, or the right to use, industrial, commercial or scientific equipment;
    b. Twenty per cent in case of fees for technical services and other royalties.
20. 106 TTJ 620.
21. Entry 5(c) to Schedule II of Section 7 of the CGST Act, 2017.
22. No. 41/2017-CT (Rate).
23. (2006) 3 SCC 1.
24. REVERSE CHARGE MECHANISM under GST, Directorate of Commercial Taxes, West Bengal.
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36. Saha S & and Shaw P, A Review of R&D and Sectoral Incentives in Manufacturing in Industrialised and Emerging Economies: Lessons for "Make in India" (Research and Information System for Developing Countries 2018) Discussion Paper 233, https://ris.org.in/sites/default/files/DP%20233%20Sabyasachi%20Saha%20and%20Prativa% 20 Shaw-T.pdf.