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Indian Court clarifies tax treatment of foreign-owned intangibles

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In a decision that offers the much-needed certainty in the tax treatment of income arising from the cross-border transfer of rights in intangibles used by Indian subsidiaries of multinational corporations, India's Delhi High Court recently ruled that income arising from the transfer of foreign-owned intangible assets between two non-resident companies cannot be subject to Indian tax. The Court's decision, which was delivered on July 25, 2016, in the case of *Cub Pty Limited (formerly known as Foster's Australia Limited) vs. Union of India* (WP(C) 6902/2008), answers the crucial question as to whether the intangibles transferred by and through the India Sale Purchase Agreement (read with the Deed of Assignment) were situated in India for tax purposes, in line with section 9(1) (i) of the Income Tax (IT) Act.

Factual background

In 1997, the taxpayer (non-resident company) executed a brand license agreement with its step down subsidiary in India, by virtue of which the trademarks owned by the taxpayer were licensed to its Indian subsidiary for use as a licensee in consideration of royalty. The brand license agreement did not transfer any other right in the trademarks and the taxpayer continued to be the absolute owner of the licensed trademarks. Subsequently, in 2006, the taxpayer executed an India Sale Purchase Agreement and a Deed of Assignment in Australia in favor of Skol Breweries Limited, a nominee of SABMiller (another non-resident company) which *inter alia* assigned/sold trademarks to SABMiller. As a result of the India Sale Purchase Agreement read with the Deed of Assignment, SABMiller became the owner of FBG Mauritius and in turn owner of Foster's India Limited and 16 trademarks owned by the taxpayer.

The taxpayer moved an application before the Authority for Advance Ruling (AAR) asking whether the income arising from the transaction of the transfer of the licensed trademarks is taxable in India, having regard to the provisions of the IT Act and the India/Australia double tax avoidance agreement. Interestingly, the AAR concluded that the licensed intangibles had its tangible presence in India at the time of the transfer; the intangibles had taken roots in India and were used, nurtured, and registered in India; and therefore the intangibles are deemed to be situated in India (and hence taxable in India).

The writ petition

Aggrieved by the decision of the AAR, the taxpayer moved a writ petition before the Delhi High

Court. The primary contention of the taxpayer was that the "situs" of intangibles should be determined by the "situs" of the owner, as intangibles (unlike tangibles) do not exist in any physical form. The taxpayer strenuously argued that the common law principle of *mobilia sequuntur personam* should be followed in case of intangibles because they are subject to the immediate control of the owner. The taxpayer continued to argue that since intangibles do not have any specific physical place or location, any income accruing from such a transfer should be subject to tax in the owners' country of residence.

In the main, the taxpayer's arguments were as follows:

- The taxpayer, an Australian company, is the owner of the licensed trademarks;
- The taxpayer granted license to use the trademarks, which confers only a limited right to use the trademarks and there is no assignment of any proprietary interest;
- The license to use trademarks or the fact that the trademarks were registered in India cannot shift the situs of the trademarks; and therefore
- The situs of the trademarks is in Australia, not India.

The Court's decision

The Court began with the observation that the issue of situs of an intangible asset, such as intellectual property rights in trademarks, brands, logos etc. is indeed a tricky one. Distinguishing between tangible and intangible assets, the Court observed that tangible assets exist in physical form and their existence is at specific locations (and therefore fixing their situs does not pose any problem), whereas intangible capital assets, by their very nature, have neither any physical form nor any particular location. The Court hastened to add that the legislature could have, through a deeming fiction, provided for the location of an intangible capital asset, but has not done so until now.

The Court accepted the taxpayer's contention that the well accepted principle of *mobilia sequuntur personam* must be followed in the given facts of the case, according to which the situs of the owner of an intangible asset would be the closest approximation of the situs of an intangible asset. In coming to its conclusion, the Court reiterated that, the legislature, where it wanted to specifically provide for a particular situation, as in the case of shares, where the share derives, directly or indirectly, its value substantially from assets located in India, it did so. The Court pointed out that there is no such provision with regard to intangible assets, and therefore, section 9(1)(i) of the IT Act is not attracted. Naturally, the Court reversed the findings of the AAR.

Concluding remarks

Under section 9(1)(i) of the IT Act, any income arising from the transfer of capital assets situated in India is deemed to be taxable in India. The definition of capital assets is found in section 2(14) of the IT Act and includes intellectual property or intangible property (read with the judgments delivered by Indian courts from time to time). Transfer has been defined in section 2(47) of the IT Act to include sale, relinquishment of the asset, or the extinguishment of any right. In the present dispute, it was common ground that the description of the intellectual property fell under the definition of capital assets and that the said capital asset was in fact transferred. The only crucial question that merited the Court's consideration was whether the capital asset transferred was situated in India, and hence, liable to tax in India under section 9(1)(i) of the IT Act.

Readers may recall that the Revenue took an identical stand in the celebrated case of *Vodafone* by

arguing that a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India where the share of interest derives (directly or indirectly) its value substantially from the assets located in India. There, the Supreme Court rejected the Revenue's contention and categorically ruled that offshore transfer of shares of a foreign company having underlying assets in India is not taxable in India because the situs of shares is located outside India. Soon after the Court's judgment, however, the Government retrospectively amended the law, through the 2012 Finance Act, by adding an Explanation 5 to section 9(1)(i) of the IT Act with a view to bypassing the Supreme Court's verdict. The Delhi High Court while adjudicating the present case has largely echoed the Supreme Court's reasoning given in *Vodafone* to conclude why the transaction is not attracted by section 9(1)(i) of the IT Act. The Court has made it ample clear that registration of trademarks or the utilization or exploitation of trademarks in India may play an important role in establishing a nexus between the asset and the territory, but that by itself does not establish *situs* of the asset.

The Court's concurrence with internationally accepted principles on situs of intangibles will have far reaching effect on tax incidence of intangibles. It is difficult to disagree with the Court's reasoning that in the absence of explicit provisions relating to situs of intangibles, unlike tangibles in Explanation 5 to section 9 of the IT Act, any attempt to levy tax on sale of intangibles owned by non-resident will be reading something not provided in law. Shifting of situs can only be done by an express legislation and section 9(1)(i) of the IT Act cannot by a process of interpretation be extended to cover intangibles situated outside India. Doing so will render the express statutory requirement of section 9(1)(i) nugatory (as explained in *Vodafone*).

Having said that, what needs to be seen is whether the Delhi High Court's reasoning will be affirmed by the Supreme Court, that is, if and when an appeal is preferred by the tax authority. Even otherwise, the Parliament may, if it thinks fit, introduce a deeming fiction for location of intangibles in section 9(1)(i) of the IT Act, either retrospectively or prospectively. We will have to wait and see.

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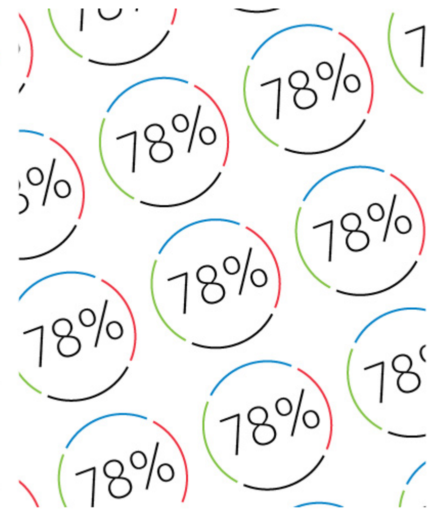

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