Advance Ruling on taxation transfer of Intangible Property

I. Background
This Alert summarizes the decision of the Indian Authority of Advance Ruling (AAR), in the case of a company incorporated in Australia on the taxation of income earned from transfer of intangible property licensed to its Indian subsidiary.

II. Facts of the case

- The Applicant is a non-resident foreign company incorporated in Australia and forms part of the global multi-beverage group dealing in beer, wine etc. and also non-alcohol beverages. The business of the Applicant, interalia, includes brewing, processing, packaging, marketing, promoting and selling of beer products in Australia and abroad.

- The Applicant owns various brands including Foster’s brand in relation to beer products which comprises of trade marks, logos, devices, brand guidelines, advertising material, technology and know how including recipes and brewing specifications. The Applicant entered into a Brand License Agreement (‘BL Agreement’) with Fosters India Limited (‘Fosters India’) granting Fosters India an exclusive license to brew, package, label and sell Foster’s Lager (beer) and an exclusive right of user of the trade-marks within the territory of India.

- The Applicant has been paying taxes on the income received under the BL Agreement, treating it as Royalty.

- Subsequently, the Applicant entered into a composite Sale & Purchase Agreement (‘SP Agreement’) with SAB Miller UK for sale of shares and sale by the Applicant of (a) trademark, (b) Fosters Brand intangible Property and (c) the grant of exclusive and perpetual license in relation to Foster’s Brewing intangible Property, confined to the territory of India for a total consideration of USD 120 million.

- As per the SP Agreement, SAB Miller UK made a deed of assignment in favor of its Indian subsidiary, SKOL Breweries Ltd (‘SKOL’), nominating it as the transferee in terms of the SP Agreement. Vide this assignment deed, the Applicant granted to SKOL an exclusive, perpetual and irrevocable license relating to the Foster’s Brewing IP (which was transferred on a media).

- Also, the BL Agreement entered into between the Applicant and Fosters India was to be terminated. Subsequent to this, the intangible property would revert to the Applicant, who would then transfer it to SKOL. These events would happen simultaneously.
III. Ruling Sought by the Applicant

The Applicant sought a ruling on the following questions:

- Whether the receipt arising to the Applicant, from the transfer of the intangible property is taxable in India, having regard to the provisions of the Income Tax Act, 1961 ("Act") and the Double Taxation Avoidance Agreement between India and Australia ("Treaty").
- If the receipt is held taxable in India, then whether the applicant is justified in contending that tax should be computed based on the consideration as per the independent valuation obtained by the Applicant?

It may be noted that the taxability on transfer of shares was not in issue before the AAR.

IV. The Ruling

Income accrue or arise under the Act

- Income arising from the transfer of a capital asset situated in India is chargeable to tax under the Act. Even under the specific Treaty no benefit can be claimed by the Applicant, as taxation of such transactions would be in accordance with domestic tax law provisions.

Capital Asset

- The term 'capital asset' has been defined under the Act to mean property of any kind held by an assessee whether or not connected with his business or profession, which is a wide definition.
- The AAR observed that the term 'property of any kind' as used in the section would include intangible property.
- Hence the AAR observed that, items falling broadly under the description of intangible property which are subject matter of transfer under the SP Agreement are to be treated as capital asset.

“Situate in India”

- The AAR observed that the crucial question to be addressed was whether the capital assets transferred are “situate in India”.
- The Applicant’s contention that the intangible assets transferred were not located in India (as it had reverted to the Applicant in Australia) on the relevant date of transfer was rejected. So also the contention that they have no particular geographical location and no situs apart from the domicile of the owner was rejected.
- It was held that the intangible property comprising of Fosters trade-marks and brand IP can be said to be located in India where the business of Fosters India was being carried on.
- The intangible property belonging to the applicant had its ‘tangible presence’ in India at the point of time of the transfer of the intangible. The location had never shifted. The shifting of situs cannot be established by mere symbolic delivery of counterparts of trademarks outside India.
- The AAR observed that though the registration of the Applicant’s trade-mark in India has no bearing on the ownership, yet, it is one of the relevant factors pointing to the roots it had taken and the recognition it had gained in India.
- The AAR held that the intangible property can be said to be situated in India. The situs of the intangible property should not be traced and confined only to places where the contract was entered into and acted upon by the parties. On the relevant date of the transfer, they were very much present in India and the transfer of such assets took place concurrent with the transfer of controlling interest in Fosters India to SAB Miller UK.

Apportionment of Profit

- Regarding the transfer of intangible property relating to brewing information, the AAR observed that, though the brewing manual in one sense is a trade intangible, it is also in the nature of goods. Following its decision in case of Pfizer Corporation In Re (271 ITR 101) - in case of technical information in a dossier -, the AAR held that the ownership of the brewing intangible property was vested with the Applicant in Australia and hence the same was not situated in India and accordingly not taxable in India.
- The AAR held that only income arising from the transfer of capital assets comprising of trademarks and other brand intangible property situated in India, can be subjected to tax in India.
- However, once income is deemed to accrue or arise in India on account of transfer of capital assets situated in India, the entirety of consideration received in respect of such transfer shall be taxed in India. This is irrespective of the fact that the property could be notionally treated to be existing also at the place where the owner resides.
Additional Contention

• The tax authorities further contended that the AAR should give effect to the “substance of the transaction”. The tax authorities contended that the intermediary companies in the structure lacked substance and were created to perform the role of conduit in the transactions. However, the AAR held that based on the material placed before them, it was not possible to come to a definitive conclusion on this aspect. These are larger issues in view of the Supreme Court ruling in the case of Union of India v Azadi Bachao Andolan (263 ITR 706) and hence do not call for an answer where the AAR has already decided that the situs of the capital asset is in India.

V. Implications

• A ruling by the AAR is binding only on the Applicant, in respect of the transaction in relation to which the ruling is sought and on the Revenue, in respect of the Applicant and the said transaction. However, it does have persuasive value and the Indian Courts, Revenue Authorities and the Appellate Authorities do recognize the principles and ratio laid down by the AAR while deciding other cases.

• In the absence of specific rules in the Act and inadequate Indian jurisprudence on the issue of determining the situs of intangible property for tax purpose, the AAR appears to have relied on international decisions of the US and UK Courts on ‘goodwill’ in determining that the situs of the trademark is in India.

• In the context of tax treaties, the difficulties arising in properly classifying payments from transfer of geographically-limited intangible property rights has been recognized by the OECD in its draft contents of 2008 update to the Model Tax Convention.

• Taxpayers may need to assess impact of the ruling on cross-border acquisition transactions which involve transfer of intangible property used in India by their Indian affiliates.
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