

SERVICE TAX vis-à-vis VAT on IPR

Intellectual Property Right ('IPR') refers to legal entitlements, which are attached to certain types of information, ideas, or other intangibles in their expressed form. The holder of this legal entitlement is generally entitled to exercise various exclusive legal rights in relation to the subject matter of the IPR. IPR owner(s) may sell, transfer, assign, licence or permit the right to use of IP to another person for a consideration. IPR laws in India are listed below:

- The Trade Marks Act, 1999
- The Patent Act, 1970
- The Copyright Act, 1957
- The Design Act, 2000
- The Geographical Indication of Goods (Registration and Protection) Act, 1999
- The Protection of Plant Varieties and Farmers Right Act, 2001
- The Semiconductor Integrated Circuits Layout Design Act, 2000
- The Biological Diversity Act, 2002

RELEVANT PROVISIONS OF VARIOUS IPR ACTS

The Trade Marks Act, 1999

The Trade Marks Act, 1999 ('the Trade Mark Act') provides for registration and protection of trade marks for goods and services and prevent use of fraudulent marks.

As per Section 2(zb) of the Trade Marks Act, "trade mark" means a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of others and may include shape of goods, their packaging and combination of colours.

Under section 18 of the Trade Mark Act, any person claiming to be the proprietor of a trade mark, used or proposed to be used by him, may apply for the registration and on registration, under section 28 thereof, registered proprietor of the trade mark acquires exclusive right to use same in relation to the goods in respect of which the trade mark is registered and to obtain relief in respect of the infringement of the trade mark. As per section 38 of the Trade Marks Act, registered trademarks can be assigned and transmitted to another person and on the registration of such assignment and transmission, such person becomes the proprietor of trademarks or registered proprietor.

As per section 27 of the Trade Marks Act, proprietor of unregistered trademark does not get any exclusive right of use and therefore he cannot be considered as IPR holder. Therefore, only the registered proprietor of the registered trademark can be considered as IPR holder.

Further, as per section 48 of the Trade Marks Act, a person other than registered proprietor of a trade mark may be registered as the registered user on the execution of a

written contract between the registered proprietor and proposed registered user and such registered user will be entitled to use and enjoy the benefit of the trade mark.

The Patent Act, 1970

The Patent Act, 1970 ('the Patent Act') provides for registration of patent and protection to the inventors from copying the products or adopting the methods by other persons.

As per section 2(j) of the Patent Act, invention means a new product or process involving an inventive step and capable of industrial application. A patent for the invention can be applied by any person who claims to be the true and first inventor of the invention. Once a patent is granted, under section 48 of the Patent Act, the registered proprietor acquires exclusive right to prevent third parties, who do not have his consent, from making, using, offering for sale, selling or importing patented product in India, and using the patented process, or using, selling or importing product in India obtained directly by patented process. As per section 60 of the Patent Act, a patent can be assigned and transmitted to another person and on the registration of such assignment and transmission, such person becomes the proprietor of patent or registered proprietor. The registered proprietors of the patents are the IPR holders.

Under section 70 of the Patent Act, IPR holders have powers to grant licence to make, use, offer for sale, sell or import patented product or use the patented process in India as per the conditions of the written contract.

The Copyright Act, 1957

Copyright Act, 1957 ('the Copyright Act') grants exclusive rights in a literary, dramatic or musical work, a computer programme, an artistic work, a cinematograph film and a sound recording. Under Section 14 of the Copyright Act "copyright " means the exclusive right,

- (a) in the case of a literary, dramatic or musical work, to do and authorize:
 - (i) to reproduce the work in any material form
 - (ii) to publish the work;
 - (iii) to perform the work in public;
 - (iv) to produce, reproduce, perform or publish any translation of the work;
 - (v) to make any cinematograph film or a record in respect of the work;
 - (vi) to communicate the work by radio broadcast or to communicate to the public by a loudspeaker or any other similar instrument the broadcast of the work;
 - (vii) to make any adaptation of the work;
 - (viii) to do in relation to a translation or an adaptation of the work any of the acts specified in relation to the work in clauses (i) to (vi)
- (b) in the case of an artistic work, to do or authorize
 - (i) to reproduce the work in any material form;
 - (ii) to publish the work;
 - (iii) to include the work in any cinematograph film;

- (iv) to make any adaptation of the work;
- (v) to do in relation to an adaptation of the work any of the acts specified in relation to the work in clauses (i) to (iii).
- (c) in the case of a cinematograph film, to do or authorize
 - (i) to make a copy of the film ;
 - (ii) to cause the film, in so far as it consists of visual images, to be seen in public and, in so far as it consists of sounds, to be heard in public ;
 - (iii) to make any record embodying the recording in any part of the sound track associated with the film by utilizing such sound track;
 - (iv) to communicate the film by broadcast;
- (d) in the case of a record, to do or authorize
 - (i) to make any other record embodying the same recording;
 - (ii) to cause the recording embodied in the record to be heard in public;
 - (iii) to communicate the recording embodied in the record by broadcast;

In terms of Section 18 and 20 of the Copyright Act, the IPR holder may assign/transmit to any person the copyright either wholly or partially and either generally or subject to limitations and either for the whole term of the copyright or any part thereof. Further, under Chapter VI of the Copyright Act, IPR holder may grant any interest in the copyright to any other person.

The Design Act, 2000

The Design Act, 2000 ('the Design Act') grants copyright to the designer and prevent piracy of the registered designs.

As per section 2(d) of the Design Act, design means only the features of shape, configuration, pattern, ornament or composition of lines or colours applied to any article whether in two dimensional or three dimensional or in both forms, by any industrial process or means, whether manual mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye; but does not include any mode or principle of construction or anything which is in substance a mere mechanical device, and does not include any trade mark or property mark or any artistic work.

As per section 5 of the Design Act, any person claiming to be the proprietor of a design may apply for the registration and on registration, the registered proprietor of the design gets the copyright in the design. As per section 30 of the Design Act, a design can be assigned and transmitted to another person and on the registration of such assignment and transmission, such person becomes the proprietor of design or registered proprietor. The registered proprietors of designs are the IPR holders.

Section 22 of the Design Act prohibits application of a registered design or imitation thereof on any article meant for sale or import of any article for sale to which the registered design or imitation thereof has been applied without the consent of the IPR holder.

Under section 30 of the Design Act, IPR holders have powers to grant licence to use the registered design as per the conditions of the written contract.

The Geographical Indication of Goods (Registration and Protection) Act, 1999

The Geographical Indication of Goods (Registration and Protection) Act, 1999 [‘the GIG Act’] seeks to prevent misuse of well known names traditionally used to indicate and identify some particular produce or articles where a given quality, reputation or other characteristic of such goods is essentially attributable to its geographical origin. Basmati Rice, Kancheevaram Saree, Benaras Saree are some of the geographical indication.

Section 11 of the GIG Act empowers an association of persons to apply for the registration of geographical indication. On the registration of geographical indication, only authorized users are eligible to use geographical indication on their products.

The Protection of Plant Varieties and Farmers Right Act, 2001

The Protection of Plant Varieties and Farmers Right Act, 2001 (‘the Plant Varieties Act’), inter alia, seeks to encourage the development of new varieties of plants and protect plant breeders’ right.

As per section 16 of the Plant Varieties Act, any person claiming to be breeder of that variety of plant may seek registration under section 14 thereof and on registration, the breeder is conferred an exclusive right to produce, sell, market, distribute, import or export that variety of plant or seed.

The Plant Varieties Act recognizes assignment of the right and on such assignment, assignee is recognized as breeder. Breeders recognized under the Plant Varieties Act are the IPR holders.

The Plant Varieties Act also permits appointment of agents and licensees to produce, sell, market, distribute, import or export registered plant or seed.

The Semiconductor Integrated Circuits Layout Design Act, 2000

The Semiconductor Integrated Circuits Layout Design Act, 2000 (‘the IC Design Act’) seeks to protect IPR relating to layout-design (topographies) of the Integrated Circuits (‘IC’) as envisaged under Agreement on Trade Related Aspects of Intellectual Property Rights.

As per section 2(h) of the IC Design Act, layout-design means a layout of transistors and other circuitry elements and includes lead wires connecting such elements and expressed in any manner in a semiconductor IC.

As per section 8 of the IC Design Act, any person claiming to be the creator of a layout-design seek registration reproducing the layout-design in an IC or importing and selling

registered layout-design or a IC or an article containing such layout-design will be infringement of the rights of registered proprietor. As per section 20 of the IC Design Act, layout-design rights can be assigned and transmitted and on the registration of such assignment and transmission, such person becomes the proprietor of layout-design. The registered proprietors of layout-designs are the IPR holders.

Under section 25 of the IC Design Act, IPR holders have powers to grant licence to use the registered design as per the conditions of the written contract.

The Biological Diversity Act, 2002

The Biological Diversity Act, 2002 ('the Bio Diversity Act') seeks to provide conservation of biological diversity, sustainable use and equitable sharing of the biological resources, knowledge and connected matters.

SERVICE TAX

Service Tax is imposed by the Parliament under the residuary entry i.e. Entry 97 of List I of the Seventh Schedule of the Constitution of India. Finance Act, 2004 has brought IP service within the ambit of service tax w.e.f. 10 September 2004. In terms of Section 65(105) (zr) of the Finance Act, 1994 service tax is levied on the service provided to any person, by the holder of intellectual property right, in relation to intellectual property service. In terms of Section 65 (55a) of the Finance Act, "Intellectual Property Right" ('IPR') means any right to intangible property, namely, trade marks, designs, patents or any other similar intangible property, under any law for the time being in force, but does not include copyright. As per Section 65 (55b) of the Finance Act, "intellectual property service" means:

- (a) transferring temporarily; or
- (b) permitting the use or enjoyment of any intellectual property right.

Presently, service tax is levied @ 12.36 % including education cess.

Followings are the key ingredients for IPR service to be exigible to Service Tax:

- Service is provided by the holder of IPR
- IPR is recognized under the Indian law
- IPR does not pertain to copyright
- IPR law should be in force at relevant time
- IPR is transferred temporarily or permitted to use without transfer
- Service is provided to a client

IPR holder:

IP reflects the idea that the subject matter is product of the mind or the intellect of a person. Once this fact is recognized by the law, the law protects the right to use and such

person becomes the IPR holder and entitled to exclusive rights to use the idea. Generally, the inventor of the idea is the IPR holder. However, as IPRs are transferable, a person who acquires such rights legally may also be an IPR holder, even though he may not be the inventor of such idea. If a person renders intellectual property service for an IPR, to which he is not legal holder, then such service cannot be taxed.

Recognition under the Indian law:

IPR should be conferred to a person under Indian law. Service rendered by a person whose IPR is not recognized under Indian law cannot be brought within the ambit of service tax. As per Section 24 of the GIG Act, any right to a registered geographical indication cannot be assigned, transmitted or licensed. Therefore, there cannot be any taxable IPR service under the GIG Act. Further, the Bio Diversity Act also does not confer any exclusive rights to any person. Hence, there cannot be any taxable service arising under the Bio Diversity Act.

Law in force

Provisions pertaining to registration under the Plant Varieties Act and the IC Design Act have not been notified. Therefore, at present, there cannot be any taxable service arising under the Plant Varieties Act and the IC Design Act. The Copyright Act has been specifically excluded from the ambit of Service Tax.

A trade secret (which is sometimes either equated with, or a subset of, "confidential information") is secret, non-public information concerning the commercial practices or proprietary knowledge of a business. However, if such trade secret is not covered by the Indian laws, then it will not be covered under taxable service.

VALUE ADDED TAX/SALES TAX

The State Governments are empowered to levy sales tax on the sale or purchase of goods other than newspapers under entry 54 of List II of the Seventh Schedule to the Constitution of India. Further, after 46th amendment under Article 366(29A) to the Constitution, 1950 (the "**Constitution**"), the concept of deemed sale has been introduced empowering the States to impose sales tax on the transfer of the right to use any goods or any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration.

In terms of Article 366(12) of the Constitution, "goods" includes all materials, commodities, and articles. Further, the word "goods" has been defined in Section 2(7) of the Sales of Goods Act, 1930 as meaning "every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

The term "goods" has also been defined in the respective state Sales Tax/VAT laws. For example, in terms of Section 2(12) of the Maharashtra Value Added Tax Act, 2002 (the

“MVAT Act”) "goods" means every kind of moveable property not being newspapers, actionable claims, money, stocks, shares, securities or lottery tickets. In the case of *Tata Consultancy Services v State of Andhra Pradesh*, the Apex court held that 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. IPR have utility, capability of being bought and sold and capability of being transferred and possessed. Therefore, most of the state has levied Sales Tax/VAT on intangibles like copyright, patent, designs, trademarks, technical know how and brand name. Sale of IPR or giving right to use IPR is considered as sale. Generally, Sales Tax/VAT is levied @ 4% by the States.

It may be noted that for being goods, there is no requirement that IPR should be recognized under the Indian law or that the relevant IPR law should be in force at relevant time. Therefore, even those IPRs, which are not covered within the ambit of Service Tax, are exigible to VAT.

From the foregoing, it is clear that sale or transfer of the right to use IPR is taxable under VAT by the State governments as sale of goods whereas temporary transferor or permitting the use or enjoyment of IPR is exigible to service tax. On plain reading of the aforesaid provisions, *ex-facie*, it appears that some transactions may be taxable under VAT as well as Service Tax.

SERVICE TAX AND SALES TAX/VAT ARE MUTUALLY EXCLUSIVE

Under article 248 of the Constitution, Parliament has exclusive powers to make any law in respect of any matter not enumerated in the Concurrent List or the State List and such power includes the power to make any law imposing taxes, which are not mentioned in either of those Lists. Tax on the sale or purchase of goods is covered under the State list. Therefore, the Central Government does not have power to impose tax on transactions exigible to tax on sale or purchase.

In the case of ***Bharat Sanchar Nigam Ltd v. Union of India [2006 (002) STR 0161 (SC)]***, the Apex Court held that States are not allowed to entrench upon the Union List and tax services by including the cost of such service in the value of the goods. For the same reason, the Centre cannot include the value of the goods in the cost of the service as was held in ***Gujarat Ambuja Cements Ltd. v. UOI [(2005) 4 SCC 214]***. The Court further held that mutual exclusivity which has been reflected in Article 246(1) of the Constitution means that taxing entries must be construed so as to maintain exclusivity. In the case of ***Imagic Creative Pvt. Ltd. v Commissioner of Commercial Taxes in Appeal (civil) No. 252 of 2008***, the Apex Court again reiterated that payments of service tax as also the VAT are mutually exclusive.

Therefore, what constitute sale of goods has to be understood to distinguish whether a particular transaction is exigible to VAT or Service Tax.

Sale of Goods

In the case of **State of Madras v. Gannon Dunkerley & Co. Ltd.** [AIR 1958 SC 560], the Supreme Court has held that there had to be three essential components to constitute a transaction of sale - namely,

- (i) an agreement to transfer title,
- (ii) supported by consideration, and
- (iii) an actual transfer of title in the goods.

In the absence of any one of these elements, there cannot be a sale. A permanent transfer of IPR does not fall within the ambit of Service Tax as it is considered a sale of goods and there is no ambiguity in this regard either in VAT or Service Tax.

Transfer of the right to use the goods

Article 366(29A)(d) of the Constitution empowers state to levy VAT on the transfer of the right to use the goods. In the case of BSNL, the Apex Court held that the transaction must have the following attributes:

- (i) There must be goods available for delivery;
- (ii) There must be a consensus ad idem as to the identity of the goods;
- (iii) 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;
- (iv) 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;
- (v) 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.

Once the right to use goods has been transferred by the IPR holder to the transferee, IPR holder, during such time loses his rights over the IPR although such transfer may be subject to certain restrictions. The IPR holder cannot use, transfer, assign or licence such IPR during such time. If all the ingredients as aforesaid are satisfied, it will amount to transfer of the right to use the goods and shall be exigible to VAT.

Now, let us see what constitute temporary transferor of IPR. Temporary transferor of IPR is not defined under the Finance Act.

Temporary transfer of IPR

A person acquires a legal right over the IP when he is recognized as the proprietor under the IP laws. On assignment, transmission or sale, the assignee or the person to whom the

rights are transmitted is recognized as the proprietor of the IPR. The service tax is levied when the holder of the IPR provides some service. Hence, consideration received by the original holder on assignment or transmission is not taxable as the IPR is transferred permanently and permanent transfer is not covered within the scope as it amounts to sale and person selling the rights no longer remains a holder of intellectual property rights.

On temporary transfer of IPR, the transferee acquires the legal right to use the IPR in exclusion of to the transferor. A temporary transfer of IPR is nothing but transfer of right to use IPR and tax on such transactions are covered within the powers of the State Government. On the other hand, the Finance Act also levy Service Tax on considerations received towards temporary transfer of IPR. Hence, **there is conflict within the powers of State Governments and Central Government. Both cannot tax same transaction.**

Permitting the use or enjoyment of IPR

Permitting the use or enjoyment of IPR without transfer, either permanent or temporarily, is within the ambit of service tax. Under Section As per section 48 of the Trade Marks Act, Section 70 of the Patent Act, Section 30 of the Design Act, IPR holders have powers to grant licence to use the registered trademarks, patents and design.

There may be two types of licensing arrangement: (i) Exclusive Licence, and (ii) Non-exclusive Licence. In the case of Exclusive Licenses, the IPR holder divest his rights to use IPR for a certain period in favour of the transferee. The transferee uses the IPR in exclusion to the transferor and the transferor cannot again transfer the same rights to others. Therefore, an exclusive licence is akin to transfer of right to use goods and exigible to VAT. On the other hand, the Finance Act also levy Service Tax on considerations received towards grant of Exclusive Licence for the use of IPR. Hence, **there is conflict within the powers of State Governments and Central Government. Both cannot tax same transaction.**

In the case of Non-exclusive Licence, the IPR holder can give similar licences to others and also to use the trademark itself. In these cases, the IPR holder always has the effective control over the IPR. As the IPR holder merely licenses the other person to use the IPR, it is not considered as transfer of the right to use in exclusion of others and therefore cannot be exigible to VAT as held by the Apex court in the case of BSNL.

Permitting the use or enjoyment of IPR on non-exclusive license is a transaction not considered as sale of goods. The Finance Act levy Service Tax on considerations received towards grant of Non-exclusive Licence for the use of IPR. Hence, **there is no conflict within the powers of State Governments and Central Government.**

CONCLUSION

Transaction involving assignment or transmission of IPR, whether temporary or permanent, will be exigible to VAT. Grant of licence on exclusive basis also appears to be exigible to VAT. Imposition of VAT is governed by the statute of the respective

states. Some states do not levy VAT on sale of intangible goods or goods involving incorporeal nature. Some may be taxing some specific transactions while some other may tax sale or transfer of right to use the IPR of all kinds, whether registered or nor, and whether recognised under the law or not.

On the other hand, transaction involving temporary transfer of IPR and grant of licence to use IPR, whether on exclusive or non-exclusive basis, is exigible to Service Tax. Service Tax is not levied on IPRs under the Plant Varieties Act, the IC Design Act, the GIG Act, the Bio Diversity Act and the Copyright Act. Further, Service Tax is also not levied on the IPR not recognised under the Indian law.

Transfer of right to use the IPR either by temporary transfer or licence on exclusive basis is presently taxable by the both, State Governments and Central Government. Power of the State Government and the Central Government to levy tax is mutually exclusive. Therefore, levy of VAT and Service Tax on the same transaction involving temporary transfer or licence on exclusive basis is not sustainable legally.