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Right to use of Trade Mark – Goods or Services – Whether VAT or Service Tax applicable

We are sharing with you analysis of an important recent judgment of the Hon'ble Kerala High Court in the case of **Malabar Gold Pvt Ltd** (hereinafter referred to as "the Petitioner") **Vs. Commercial Tax Officer [2012-TIOL-1032-HC-KERALA-VAT]** on the following issues:-

Issue:

- Whether Trademark is "Goods"? Whether right to use of Trademark taxable under State VAT Acts as sale of goods?
- Whether VAT or Service Tax applicable on right to use of Trademark?

Facts:

The Petitioner Company had entered into Franchisee Agreements with several companies, situated inside and outside Kerala and also abroad, as per which, on mutually agreed terms and conditions, these companies were allowed to use the Trademark owned by the petitioner. In return, it is receiving royalty, the rate of which is also specified in the agreement. Franchisee Services, being an activity attracting Service Tax under the Finance Act, 1994, the petitioner obtained registration under Section 69 of the Finance Act and is paying service tax.

They were issued notice by the Kerala State VAT authorities stating that transfer of right to use any goods is taxable under Section 6(1) of under the Kerala Value Added Tax Act (hereinafter referred to as the "Act") and that, Royalty received by the petitioner from its franchisees for use of its Trade Mark would attract VAT under entry 68 of the third schedule to the Act.

Then, the Petitioner Company has filed Writ Petitions against the demand of VAT on Royalty received for use of its trademark and for sharing business know-how.

Held:

The Kerala High Court ***upheld the demand of VAT by holding that Trade Mark is goods and Royalty received from franchisees for use of its trademark and for sharing business know-how is leviable to VAT.***

The Court held that as per Article 366 (29A) of the Constitution of India, ***"tax on the sale or purchase of goods" includes 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*** and "Goods" under Section 2(xx) of the Act means that all kinds of movable property (other than newspapers, actionable claims, electricity, stocks and shares

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and securities) and includes livestock, all materials, commodities and articles and every kind of property (whether as goods or in some other form) involved in the execution of a works contract, and all growing crops, grass or things attached to, or forming part of the land which are agreed to be severed before sale or under the contract of sale. The expression would mean all kinds of movable property, including livestock, all materials, commodities and articles other than what are excluded in the section itself.

Decision of the Court on whether VAT or Service Tax applicable: The Petitioner contended that the transaction in question attracted service tax and that in view of the principles laid down in the "*Imagic Creative (P) Ltd. v. Commissioner of Commercial Taxes and others* {(2008) 2 SCC 614}", payments of service tax and VAT are mutually exclusive and hence VAT is not payable since the petitioner is paying service tax on royalty received, the impugned demand for VAT and penalty are illegal. The Court held that this Court is not called upon to decide the legality of the levy of service tax on the royalty received by the petitioner. Therefore, *if the petitioner has a case that levy of service tax is illegal for any reason, it is up to them to challenge the levy in appropriate proceedings.*

Paradigm Shift in Taxation of Service w.e.f 1st July, 2012:

Whether simultaneous inclusion of Declared Service and then exclusion of Deemed Sale under Article 366 (29A) from the definition of Service is not leading to anomaly & confusion for Trade?

As you are aware of that "temporary transfer or permitting the use or enjoyment of any intellectual property right", is a one of declared service under Section 66E(c) of the Finance Act and Service tax is applicable?

The term Service is defined under Section 65B (44) of the Finance Act, which is reproduced here in below:

"Service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include—

(a) an activity which constitutes merely,-

(i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or

(ii) such transfer, delivery or supply of any goods which is deemed to be sale within the meaning of clause (29A) of article 366 of the Constitution; or

(iii) a transaction in money or actionable claim;.."

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Conclusion: Can't be have simplicity in our tax systems as they broadly reflect the philosophy of the existing tax rules. These principles can be summarized as follows:

- **Neutrality:** Taxation should seek to be neutral and equitable between forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation;
- **Efficiency:** Compliance costs for businesses and administrative costs for the tax authorities should be minimized as far as possible;
- **Certainty and simplicity:** The tax rules should be clear and simple to understand so that businesses can anticipate the tax consequences of a transaction, including knowing when, where and how the tax is to be accounted;
- **Effectiveness and fairness:** Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimized while keeping counter-acting.
- **Flexibility:** The systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.

Food for Thought:

Goods and Services Tax (GST) is the need of the hour, which is India's most ambitious indirect tax reform that would replace existing State and Central taxes such as excise duty, service tax and value-added tax and purchase tax, etc. It is a consumption based tax that will create a seamless pan-India market and also bring down the total incidence of taxes on goods and services by eliminating double taxation/ cascading of taxes, etc.

By lowering business costs, it will boost economic growth and increase exports and bring India in line with practices followed in many developed countries.

Thanks & Best Regards.

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