

Tax on Intellectual Property Rights

Dr. Meenu Chopra

ABSTRACT

Intellectual property rights (IPR) are the rights being acquired by a person while using his own intellect. These are not the tangible rights but are the intangible rights being utilized by the assessee. Innovation is the base of economic development. In the era of technology, information is being processed at every fraction of second. The technology and knowhow so acquired constitutes IPR. The components of IPR include copyright, design, trademark, patent etc. These rights are also considered as property or asset for the purpose of levy of taxation. In India, taxation depends upon the residential status of a person. Certain benefits are available to the person in taxes, if he is dealing with IPR. Special deductions are provided to reduce the tax burden. In case of transfer of an asset Income tax is leviable for the income computed under the head 'Capital Gain' at the prescribed rate of taxation which depends upon the period of holding. Within Income Tax Act, provision is applicable to claim benefits of cost incurred on acquiring or improving the asset, this will ultimately reduce the tax liability of the person. But in case if intellectual property is acquired in house then the person shall be paying higher tax on capital gains. Benefit of cost inflation index can also be claimed by the person to reduce tax liability. Thus, a person who so ever is the owner of intellectual property is entitled to pay income tax on transfer of the capital asset. The government encourages new innovations and promotes art and culture while providing benefits in taxing laws.

*. Associate Professor, School of Law, Lovely Professional University

Intellectual property rights (IPR) are the rights being acquired by a person while using his own intellect. In other words it is termed as creation of mind. The power and imagination of mind is indefinable and unlimited. What a person can think he can create. Creation has included many aspects; it may include creation of a musical sound, creation of piece of art, creation of a sculptor, innovation of new technology, improvement of the existing technology etc. All these things are termed as creation and hence a part of intellectual property. Thus intellectual property is a property being acquired by a person by using his own skills and intellect. Intellectual property broadly covers two things: 1. Industrial property and 2. Copyright. Industrial property is further a combination of many things such as patent,

trademark, industrial design and geographical indication. Copyright includes right to produce copies of any work may it be the literary and artistic work or creation of musical sound or creation of an algorithm or computer software etc. But where so ever any new thing is created it becomes part of intellectual property rights. As per WIPO, “ IPR is specified under Article 27 of the Universal Declaration of Human Rights provides for the right to benefit from the protection of moral and material interests resulting from authorship of scientific, literary or artistic productions”ⁱ. The importance of protecting IPR was recognised in 1883 in Paris Convention. The objective was of protecting Industrial Property. It was only the year 1886 when in the Berne convention the matter of protecting copyright was fully discussed at a bigger platform. This is an era of commercialisation. Commercialisation basically includes earning profits by using the property so acquired from intellectual property rights. Now the question arises that how a person can earn wealth by using intellectual property. Every holder of intellectual property possesses certain kinds of rights and these rights are the legal rights worth being converted into monetary terms. These rights if utilised in an effective and planned manner may bring fortune to the creator of such property.

Importance of IPR protection

The IPR requires protection because of the obvious reason to protect the interest of IPR creator. It is the result of hard efforts made by owner of the intellectual property creator. The sweat of brow must be acknowledged. Adequate protection of rights and reward encourages creator to create new things and ultimately leads towards the development of human community at large. Innovation is not only creating new things but it includes better and cheaper means to acquire innovative products.

Rights of Intellectual property holders can be compressed into following points:

1. To sell the right
2. To transfer the right on lease or assignment or under the terms of contract and so on.
3. To produce copies of the created work
4. To use the creation as property and can exercise proprietary right over it.

These are not the tangible rights but are the intangible rights being utilized by the assessee. Innovation is the base of economic development. In the era of technology, information is

being processed at every fraction of second. The technology and knowhow so acquired constitutes Intellectual Property Right.

The commercial benefits of intellectual property

The property so created can be transferred to another person and hence the person can maximise his monetary gains also. These days, the world has become a global village. It is a village where we can interact with the persons from one end of the world to another. If taken advantageously the situation will be to fetch benefits from all across the world. It implied that IPR created by one person can be copied from any part of the world. It will ultimately lead to demolition of monetary gains of originator of the work. New products are coming in the market and are being used for the benefit by larger groups of persons. Thus, it is expected to protect the intellectual property. Now what if the originator of the property transfers his rights for monetary gratifications, the possibilities to expand such gratification are also enormous and available throughout the globe. Even the developers of the IPR do spend a lot of money on creation of such right while investing in R & D.

From the perspective of taxation law, every income is supposed to be taxed. Even the income earned from transferring the IPR is also an income and is supposed to be taxed. The income from transferring IPR shall be taxed under the head “Capital Gains”.

As per Indian Taxation system the income of the previous year is taxed in the Assessment yearⁱⁱ. In India tax year ranges from 1st April to 31st March. Any income earned during this duration is taxable in the assessment year. For instance, if Mr. Radhey Sham earned income on 21st March, 2017 he is supposed to pay tax and file return of income in the Assessment year 2017-18. Here 2016-17 shall be considered as the previous year.

Residential Status

There is difference between Citizenship and residential status for analysing tax liability. A person may be citizen as per the provisions of Citizenship Act, 1956 but he may not be a resident for calculating tax liability. The resident may be divided into two categories in case of individuals.

1. Resident
 - i) Ordinarily resident

- ii) Non Ordinarily resident
- 2. Non Resident

The tax liability is highest in case of ordinary residents. Their global income is taxable in India. But in case of Non ordinarily residents and non-residents only that income which accrued or arised in India OR is received or deemed to be received in India is taxable in India.

Accrued or deemed to accrue or arise in India

The Concept of accrual of income is very important for the purposes of taxation. It implies that any income that accrue or arise within India shall be table in India. The taxability shall remain same irrespective of the residential status of the person. For all kinds of persons whether ordinarily resident, not ordinarily resident or even non resident if the income generated from connection in India the income shall be taxable in India. The accrual must be actual and not hypotheticalⁱⁱⁱ. *“Income ‘accrues’ to the taxpayer at the time when it becomes due only when there is reasonable expectancy that the right will be converted into money or its equivalent”*.^{iv}

The same is the fact if the income is received in India to whom so ever, it shall be taxed in India. *“Income is said to be received in India when it reaches the assessee; when the right to receive the income becomes vested in the assessee it is said to accrue or arise in India”*^v.

The income from IPR can be generated in following manner:

- A. Permission to use Intellectual Property Right
- B. Transfer of Intellectual Property Right

A. Permission to use Intellectual Property Right

The owner of Intellectual property may allow the other person to use the Intellectual Property Right so created by him. In lieu of such permission it is also possible that he shall be charging royalty from the user of such right. The royalty may be payable in India or outside India. The royalty may be payable by government of India or any other person (except for business carried on outside India) or royalty received from a non-resident in

India. The definition of royalty is given under section 9(1)(vi) is wide enough to cover industrial and copyright royalties.

“Royalty means consideration for-

- a. The transfer of all or any rights(including granting of licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;*
- b. The imparting of any information concerning the working of, or the use of patent, invention, model, design, secret formula or process or trade mark or similar property;*
- c. The use of patent, invention, model, design, secret formula or process or trade mark or similar property;*
- d. The imparting of information concerning technical, industrial, commercial or scientific knowledge, experience or skill;*
- e. The use or right to use, any industrial, commercial or scientific equipment but not being amount referred to section 44BB;*
- f. The transfer of all or any rights (including granting of licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with radio broadcasting, but not including consideration for sale, distribution or exhibition of cinematographic films; or*
- g. The rendering of any services in connection with the aforesaid activities”.*^{vi}

Thus, the royalty is a consideration for transferring rights concerning any kind of intellectual property starting from basic patent, copyrights, design etc. but is extendable upto all possible inclusions such as secret process and formula. The original IPR is protectable and process to make it functional is also protectable. So any royalty received in relation to same is also an income for the purposes of taxation. Any information which is technical in nature and can be exploited at commercial level is part of it. It also includes right to grant licence regarding all the rights falling under the category of copyrights. The section is wider enough to cover any kind of income in association with such activities. As a general principle in taxation, any expenditure incurred to earn an income is also deductible from the income and only the balance income is taxable. In relation to IPR the expenses which can be claimed as deductible expenses are:

1. Depreciation: This is the cost of wear and tear of an asset^{vii}. Even the depreciation on, “know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of a similar nature, being intangible assets acquired on or after the 1st day of April 1998”^{viii} is a deductible expenditure.
2. In case if the IPR is acquired by a person while paying a lump sum amount, it is also deductible in six equivalent instalments spreading across six assessment years^{ix}. It implies that onetime payment cannot be taken as expenditure in a single year.
3. In addition to this, deductions also exist for expenditure sustained on scientific research but it does not include capital expenditure.
4. Certain deductions are available under Chapter VI of Income Tax Act. The objective of these deductions is to encourage spending on such expenses and the benefit would be given to assessee while reducing his total taxable income. It means the expenditure incurred, as per the limits of the Act shall be deductible from Gross total income and tax shall be paid on the balance income only. The said deductions in relation to IPR are as follows:
 - i. Section 80 GGA "deduction in respect of certain donation for scientific research or rural development"
 - ii. Section 80 QQA "Deduction in respect of professional income of authors of text books in Indian languages"
 - iii. Section QQB “Deduction in respect of royalty income etc. of authors of certain books other than text books”
 - iv. Section 88 RRB “Deductions on payment of royalties for patents”
 - v. Section 115BBF “Tax on Income from patents”
5. Added benefits to Start ups: The endeavour of the government is to promote start ups. Thus, it is providing additional benefits to it. Basically a start up is an industry where it has come into existence for less than 7 years. Its total turnover is also less than Rs. 25 crores per annum. It involves innovative ideas which may be based on advancements in IPR. Specifically section 80IAC provides about the special benefits.

B. Transfer of Intellectual Property Right In case if the Intellectual Property Right is transferred by the owner of the right in favour of some other person than the Income tax is chargeable under the head ‘Capital Gains’. Under this

particular head of Income, gain arising on transfer of capital asset is taxable. The term 'capital asset' means, "property of any kind held by the Assessee, whether or not connected with the business or profession but it shall not include any stock in trade, consumable stores or raw material held for the purpose of business or profession. It does not include personal effects i.e. immovable property held for the personal use by the Assessee and any family member dependent on him."^x Even the jewellery is also exempted from its preview. The third exception to the general rule is agricultural land in India. If any agricultural land in India which is not covered within the municipality or cantonment board where population is less than 10,000 shall not come under the preview of capital gain tax.^{xi}

Further the capital asset can be divided into two categories: Long term and Short term. Asset held for not more than 36 months immediately preceding the date of its transfer is short term capital asset and in reverse scenario it would be long term capital asset. Accordingly the gain shall be short term (STCG) or long term capital gain (LTCG). The purpose of such differentiation is the variation in the terms of applicability of tax rate. LTCG is taxable at the flat rate of 20%. However, STCG is taxable as part of business income and is taxed as per the applicable slab rates.

However while computing taxable gains certain deductions are also made out of the sales consideration received on the transfer of Intellectual property. In case if the IPR is created internally, the cost of acquisition shall be NIL. The cost of improvement shall also be deducted. The benefit of indexation is also given to the assessee/ owner. In other words, for computing LTCG, the balance of full value of consideration and indexed cost of acquisition plus improvement is taken. This balance amount is termed as capital gain. For indexation the year beginning on 1st day of April, 1981(substituted by April 1, 2001, w.e.f. 01.04.2018)^{xii} is taken as base year.

In the Act, the rules for taxation of Intellectual Property Right are not adequately provided for. The authorities are giving directions as per the facts and circumstances of each case. The matters are generally disputes for the want of jurisdiction. The situation becomes complicated whenever the involvement of non-residents is there. In a case^{xiii} it was explained by the Delhi High Court, "*in relation to IPR and in absence of specific information the place where intangible property is situated shall deem to be the place where owner is located and*

thus, if the owner is outside India, gains arising from the transfer of such intangible assets are not taxable in India, despite the IP rights concerned being registered in India". It was analysed that the situs of an intangible asset such as IP rights is difficult since such assets do not have any physical form. The Indian legislature could have provided for a provision for deeming the location of an intangible asset to be in India for taxation purposes.

However, no such provision has ever been enacted. "In case of an intangible asset, the principle of '*mobilia sequuntur personam*' (which means movable property held by a person is governed by the same law that governs that person) will be applicable unless altered by legislation. Thus, it was held in this case that since the owner of trademarks and the Brand Intellectual Property Rights, ie Foster's was situated in Australia, the trade mark and the Brand Intellectual Property Rights were regarded as being situated in Australia. Therefore, any gains arising on the transfer of the trade mark and the Brand Intellectual Property Rights would not be taxable in India"^{xiv, xv},

Taxation of capital gains on Intellectual Property Right and Double Taxation Avoidance Agreement (DTAA)

From the perspective of taxation if a person is earning income he is entitled to pay tax to the government of the country to which he belongs and has earned income. There might be many instances when the country in which he is actually residing and the country in which he is visiting and earning profit may be different. Under normal circumstances he is expected to pay tax to both the countries. But this will ultimately lead to taxation on the same income at multiple stages. If this happens then the person is adversely affected and is demotivated to carry on business operations and pay tax honestly. Thus to promote international trade many countries have undergone tax treaties to facilitate international taxation. The basic purpose is to reduce the tax burden of the person and encourage trade.

Section 90, 90A and 91 of Income Tax Act, 1961 incorporates special provisions for the inclusion of double taxation avoidance agreements and special treatment for Assessee in the stated situations. These agreements are made with major nations of the world. Basic aspect that has been considered is the number of Indian citizens residing in the country. Taxation is a matter which is not confined to boundaries but its impact can be seen across boundaries. For example, if a businessman is exporting goods outside the country he is

entitled to pay income tax to Indian Government viz a viz he is to oblige the taxation authorities of the other country also in which he has supplied goods. The endeavour of the government is to promote exports and this export further fetches foreign currency and these aspects have become important part of National Income and effect the growth rate of the country. Somewhere these things are also affecting rate of inflation. In case a person is resident in India his global income is taxable. It means if he earns income in any part of the world that income shall be taxed in India. But on the other hand this person must have paid tax in the country in which the income is originated. Hence on the same income; Income tax is being levied by both the governments. To avoid such kind of incidents the nations have developed a tendency of entering into Double Taxation Avoidance Treaties. The objective of these treaties is to avoid the instances of double taxation on person. The objective of the treaty is to encourage trade between two countries and provide relief to the Assessee.

Interpretation of tax treaties

Interpretation of statute is one of the essentials in implementing and enforcing treaties. The treaties are entered into by the commuters of different countries. The general meaning of a term may not be same for all the contracting parties. In this situation it is difficult to interpret and apply the provisions. Interpretation must be such as satisfying the intentions and expectations of both the parties.

Conclusion

Thus it can be concluded that Income from the Intellectual property Rights can be earned both as a regular income like royalty and can also be a capital gain is earned on transfer of IPR as a capital asset. Under Indian Income Tax Act, 1961 the provisions for the taxation of gains earned from Intellectual Property Right is not given adequately. The authorities are interpreting law in each and every case and are trying to make it effective in the era of expanding technology and innovation. An effective taxation system and royalty policy encourages authors and artists to produce better work and thus helps in expansion and promotion of technology.

Bibliography

ⁱ http://www.wipo.int/edocs/pubdocs/en/intproperty/450/wipo_pub_450.pdf

ⁱⁱ Section 3, Income Tax Act, 1961

ⁱⁱⁱ CIT v. Excel Industries Ltd. [2013] 219 Taxman 379 (SC)

^{iv} Franklin County Distilling Co. v. CIR CCA 6, 125 F. 2d 800,804,805

^v CIT v. Ashokbhai Chimanbhai [1965] 56 ITR 42 (SC)

^{vi} Dr. Vinod K. Singhanian and Dr. Kapil Singhanian, Taxmann's direct taxes law & practice with special reference to tax planning, Page no. 82-83, 58th edition, 2017

^{vii} Section 32(1)(ii) of Income Tax Act, 1961

^{viii} Section 32(1) (ii)

^{ix} Section 35AB

^x Section 2(14) of the Income Tax Act, 1961

^{xi} Dr. Kailash Rai, Taxation Laws, P. No. 183 Allahabad Law Agency, Allahabad, Eighth edition 2006

^{xii} Inserted by Finance Act, 2017, w.e.f. 01.04.2018

^{xiii} CUB PTY Limited (Formerly known as Foster's Australia LTD) v UOI & ORS WP (C) 6902/2008

^{xiv} Vinita Krishnan and Shabnam Sheikh, Jnl. Intellectual Property Law and Practice Advance, Journal of Intellectual Property Law & Practice, 2016, Vol. 00, No. 0 Access published December 29, 2016

^{xv} https://www.pwc.in/assets/pdfs/news-alert-tax/2016/pwc_news_alert_28_july_2016_income_arising_to_non-resident_from_transfer_of_intangible_property.pdf