Consideration for sale of rights in trademarks to be split between primary trademark and associate trademark while computing capital gains

August 2, 2016

In brief

In a recent decision, the Ahmedabad bench of the Income-tax Appellate Tribunal (the Tribunal), in the taxpayer’s case1, held that the associate trademarks were registered as separate trademarks, and accordingly, consideration received on transfer of trademarks (associate and primary trademark as a whole) should be allocated to the respective individual trademarks; and that capital gains had to be computed accordingly.

In detail

Facts

• The taxpayer1, an Indian company, had the right to use certain trademarks under the name and style of Brand ‘A’ and Brand ‘B’.

• In 1981, only detergents were marketed under Brand ‘A’. Subsequently, detergent cakes and soaps were introduced in 1986 and 1989 respectively, and Brand ‘B’ products (soaps and detergents) were introduced in 1997 and 1998.

• During the assessment year (AY) 2001-02, the taxpayer sold its rights in the above trademarks for INR 4.5 billion.

• The taxpayer, relying on the decision of the Supreme Court (SC) in the case of B C Srinivasa Setty2, took the view that no capital gains arose on the above transfer as the trademarks were self-generated assets, and did not have a cost of acquisition.

• This view was not accepted by Revenue. However after the first round of Tribunal appeal, the taxpayer bifurcated the consideration received on sale of rights in trademarks into two parts, viz. consideration for value of ‘trademarks used in 1981’ and ‘other trademarks’ in the ratio of 31.55% and 68.45% respectively, based on a valuation report.

Issue before the Tribunal

Could the consideration be apportioned between brand/trademark developed pre- and post- 1 April 1981?

Key contentions of the taxpayer

• Capital gains, if any, arising on transfer of trademarks and brand names generated post 01 April 1981 was not subject to any tax, since these were self-generated assets not having determinable cost of acquisition, and therefore the taxpayer was not liable to pay tax. (The amendment in section 55(2)(a) of the Income-tax Act, 1961, deeming the cost of acquisition of self-generated trademarks or

1 ITA. No: 1706/AHD/2009
2 B. C. Srinivasa Setty 128 ITR 294 (SC)
brands to be ‘nil’ was introduced in Finance Act, 2001 w.e.f 01 April 2002).

- The taxpayer relied on the SC decision in B C Srinivasa Setty and on the co-ordinate Bench decision in Smt. Shantaben K. Patel (the owner of the pre-1981 Brand)³.

Key contentions of the Revenue

- Brand ‘A’ was the central word in all trademarks. Under section 44 of Trademarks Act 1999, associate trademark could not be transferred separately from the main trademark. Thus, the only asset that was transferred was brand ‘A’ and the others were appended to it. Brand ‘B’ being an associate trademark, could not be separated from the main Brand ‘A’.

- Brand ‘B’ was an associated trademark of Brand ‘A’ and hence could not be transferred on a standalone basis.

Tribunal’s Ruling

- The Tribunal observed that under section 38 of the Trademarks Act 1999, it was always open to the owner of a registered trademark to assign a trademark wholly or in part. The restriction under section 44 of the Trademarks Act, 1999 was that associate trademarks were assignable and transferable only as a whole, and not separately, but subject to those provision, they would, for all other purposes, be deemed be registered as separate trademarks.

- Considering the above and the facts of the case, the Tribunal held that consideration received on sale of rights in trademarks should be apportioned into trademarks existing on 01 April 1981 and trademarks developed subsequently; and capital gains had to be computed accordingly.

- Capital gains on brand ‘A’ (developed before 1 April 1981) would be calculated by considering the proportionate sale consideration, being 31.55% as per valuation report, and the fair market value as on 1 April 1981 would be considered as its cost of acquisition.

- For computing capital gains on Brand ‘B’ (developed after 1 April 1981), the Tribunal relied on the ruling of the co-ordinate Bench in Smt. Shantaben K. Patel³, and concluded that its cost of acquisition could not be determined, and therefore, the proceeds were not subject to capital gains tax.

The takeaways

- This ruling confirms the view that composite consideration for assignment of trademarks associated with a common brand can be divided into/ allocated to individual trademarks, and consequent capital gains should be computed accordingly.

- This may result in computation of period of holding of the respective trademarks and division of capital gains resulting from a composite transaction into long-term gain and short-term gain.

- A point worth noting is that in this case, the contention that, in absence of a cost of acquisition, fair market value as on 1 April 1981 could not be substituted, was not canvassed.

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact:

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³ Smt. Shantaben K. Patel, ITA No. 421/Ahd/2005
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