
Consideration on assignment of an indigenously developed patent taxable as capital gains and cost of acquisition of patent taken to be nil

March 14, 2017

In brief

The Mumbai Income-tax Appellate Tribunal (Tribunal) held that the consideration from the assignment of an indigenously developed patent registered for commercial exploitation in India and in the international market, would be taxable under the head, 'capital gains'. The Tribunal observed that the patent provided 'a right to manufacture/ produce/ process some article/ thing' and therefore the cost of such right would be taken as 'nil' under section 55(2)(a) of the Income-tax Act, 1961 (Act).

In detail

Facts

- The taxpayer¹ was engaged in the business of research and development, manufacturing, trading of pharmaceuticals. The taxpayer had an in-house research laboratory, in which, over a period of time it had developed several patented products including a patent by name of "Profofal". During the year under consideration, the taxpayer for a consideration had assigned "Profofal" to a third party for commercial exploitation through a Patent Assignment Agreement (PAA).
- The taxpayer had claimed that no expenditure was incurred for acquiring the patent and consideration

received on transfer of patent was a capital receipt, and thus, contended that the entire receipt on assignment of patent was not taxable under the Act. However, the tax officer (TO) held that developing a process and technology was part of the business of the taxpayer. Further, the TO observed that it was not possible to develop a process/ patent without inputs from specialised/ skilled personnel in a state-of-the-art research facility of the taxpayer. The TO further observed that the taxpayer had claimed all expenses for skilled personnel and research facility in the profit and loss account. Thus, the TO held that the claim of the taxpayer not incurring any cost for developing the

patent was not acceptable, and held that receipt from the sale of patent was a revenue receipt.

- The taxpayer filed an appeal before the first appellate authority (FAA) against the order of the tax officer. The FAA, after perusing the PAA, held that taxpayer had developed an invention which was patented and assigned to the assignee for commercial exploitation. It was observed that the receipt received on assignment of patent was squarely covered under the provisions of section 55(2)(a) of the Act, as the patent assigned was "a right to manufacture/ produce / process any article/ thing," and accordingly, held that the entire receipts were taxable as capital gains with no cost of acquisition being nil.

¹ [TS-72-ITAT-2017(Mumbai-Tribunal)]

Issue before the Tribunal

Whether the consideration received on assignment of an indigenously developed patent would be taxable in the hands of the taxpayer.

Taxpayer's contentions

- The provisions of section 55(2) of the Act do not cover know-how and patents and there was no cost incurred to acquire the patent under consideration being assigned to a third party. Further, the taxpayer contended that the expenditure, even if incurred, on the patent being assigned, was not ascertainable.
- In support of its contentions, the taxpayer placed reliance on a few judicial precedents².

Revenue's contention

The development of a process/technology was part of the business of the taxpayer and the sole object of the taxpayer was to earn profits by transferring such developed patents. The taxpayer had incurred huge expenditure for developing the patent in question, and accordingly, the consideration received for assignment of such patent was a taxable trading receipt.

Tribunal's ruling

The Tribunal held that the entire proceeds from assignment of patent was a taxable capital receipt, the cost of acquisition of indigenously developed patent being nil under the provisions of section 55(2)(a) of the Act.

Further, it was also held that such receipt could not be treated as a revenue receipt, as the taxpayer was not in the business of purchase and sale of patents. The relevant observations of the Tribunal were as follows:

- The Tribunal explained that a "Patent is a legal document that is granted by the Sovereign and gives an inventor an exclusive right to make/ use/ sell an invention for a specified number of years." The Tribunal distinguished between payments made to acquire patented or copyrighted product and payment made to acquire the right to use a patent or a copyright.
- The Tribunal observed that before obtaining a patent for medicine, such as the item under consideration, i.e., "Profosal", the taxpayer had to carry out substantial research, analysis and experimentation, which naturally required expenditure. The tribunal observed that the taxpayer had adopted a tedious and cumbersome process to have a right to manufacture/ produce/ process "Profosal".
- The Tribunal referred to the relevant clauses of the PAA, which clearly stated that "the assignee is desirous of acquiring the patent and has requested the assignor to transfer and assign all its rights, title and interest in the patent to the assignee for the purpose of commercial exploitation of the same" and

held that the consideration received for such assignment of patent would be taxable under the head capital gains and the cost thereof had to be taken to be nil as per the provisions of section 55(2)(a) of the Act."

- Further, it distinguished the case of Kwaliti Biscuits (P) Limited² being relied upon by the taxpayer by holding that the taxpayer in this case continued to carry out the manufacture of and trading in biscuits, and that the case dealt with the transfer of trade mark and brand name. Further, the taxpayer had not transferred the right to manufacture product/ process, whereas in the taxpayer's case, there was an assignment of patent being a right to manufacture/ produce/ process any article/ thing. Further, in another case relied upon by the taxpayer, the issue was deciding the date of applicability of amendments to section 55(2)(a) of the Act.

The takeaways

The decision of the tribunal brings clarity around taxability on the transfer of patents. It also clarifies that receipts on assignment/ transfer of patents would not tantamount to business receipts, the taxpayer not being in the business of purchase and sale of patents.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor.

² Kwaliti Biscuits (P) Limited v. ACIT (135 ITD 35), CIT v. Fernhill

Laboratories and Industrial Establishments (348 ITR 1)

Our Offices

Ahmedabad

1701, 17th Floor, Shapath V,
Opp. Karnavati Club,
S G Highway,
Ahmedabad – 380051
Gujarat
+91-79 3091 7000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th
Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Telangana
+91-40 44246000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City,
Gurgaon – 122002
Haryana
+91-124 330 6000

Bengaluru

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bengaluru – 560 008
Karnataka
+91-80 4079 7000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata – 700 091,
West Bengal
+91-033 2357 9101/
4400 1111

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006
Maharashtra
+91-20 4100 4444

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greaves Road
Chennai – 600 006
Tamil Nadu
+91 44 4228 5000

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road (Station Road),
Bandra (West), Mumbai – 400 050
Maharashtra
+91-22 6689 1000

For more information

Contact us at
pwctrs.knowledgemanagement@in.pwc.com

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 223,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Chennai, Delhi NCR (Gurgaon), Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, visit www.pwc.com/in

PwC refers to the PwC International network and/or one or more of its member firms, each of which is a separate, independent and distinct legal entity. Please see www.pwc.com/structure for further details.

©2017 PwC. All rights reserved

Follow us on:



For private circulation only

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

© 2017 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.