THE HIGH COURT OF JUDICATURE AT ALLAHABAD

Court No. 1

SALES/TRADE TAX REVISION No.- 30 OF 2023

COMMISSIONER COMMERCIAL TAX, U.P. AT LUCKNOW

v.

M/S PAN PARAG INDIA LIMITED

For the Revisionist : Sri Bipin Kumar Panday, Additional Chief Standing Counsel
For the Respondent : Sri Shubham Agarwal, Advocate

Last heard on May 13, 2024
Judgment on May 24, 2024

HON'BLE SHEKHAR B. SARAF, J.

1. This is a commercial tax revision petition under Section 58 of the U.P. Value Added Tax Act, 2008 (hereinafter referred to as the 'UPVAT Act'). The following question of law has been admitted by this Court:

> *"Whether on the facts and circumstances of the case the Commercial Tax Tribunal was legally justified in deleting the amount of tax which is taxable under schedule 2 part A at serial No. 3 (All intangible goods like copyright, patent, license etc. transfer of right to use goods)."*

2. In the instant case, first appellate authority had concluded that the dealer/respondent had sold his brand name/title under the franchise agreement, and since it is to be considered as a sale, therefore, Value Added Tax has to be levied on it.

3. Against the order of the first appellate authority, the dealer/respondent had gone into appeal before the Commercial Tax

Tribunal. Relying upon the judgment of Delhi High court in **M/s Mc Donalds India Pvt. Ltd. V. Commissioner of Trade Taxes New Delhi** reported in **2017 (5) GSTL 120**, the Commercial Tax Tribunal held that since the franchise of trademark can be transferred to several persons at the same time, it is merely a license to use the goods and not a transfer of the exclusive right to use the goods, and therefore, no Value Added Tax can be levied on the same. It is this order which is assailed before this Court.

<u>CONTENTIONS OF THE REVISIONIST</u>

4. Mr. Bipin Kumar Panday, learned Standing Counsel appearing on behalf of the revisionist has made the following submissions before this Court:

a. Once the copyright has been transferred and royalty amount has been received in lieu of the same, it becomes taxable under the provisions of the Act because entry at Serial No. 3 in Part A of Schedule- II of the Act makes clear that "All intangible goods like co pyright, patent, rep. license etc; transfer of right to use of goods" are taxable.

b. It is further submitted by him that since franchise or trademark falls within the meaning of transfer of right to use the goods hence Value Added Tax is leviable on it.

c. It is further submitted by him that even if service tax was paid, it does not absolve the liability under the UPVAT Act, as Value Added Tax and Service Tax were separate and distinct taxation regimes before the introduction of the Goods and Services Tax Act, 2017. Further, the term 'sale' as defined under Section 2 (ac) of the UPVAT Act includes a 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.

d. In support of his contentions, he relies upon the judgment of the Supreme Court in case of **Vikas Sales Corporation V. Commissioner of Commercial Tax** reported in (**1996) 4 SCC 433** wherein it was held that REP license/Exim scrips were goods on the sale of which sales tax can be levied.

e. Further reliance has been placed upon the judgment of Madras High Court in the case of **S. P. S. Jayam and Co. v. Registrar, Tamil Nadu Taxation Special Tribunal** reported in **2004 SCC OnLine Mad 1018** and the judgment of Bombay High Court in **Commissioner of Sales Tax v. Duke & Sons Pvt. Ltd.** reported in (**1999) 112 STC 370**.

CONTENTIONS OF THE RESPONDENT

5. Mr. Shubham Agrawal, learned counsel appearing on behalf of the respondent has argued as follows:

a. The franchise agreement which the respondent dealer had entered into with various parties, only a mere license was given by the respondent for use of his brand name. The said franchise agreement grants only a representational right and not an exclusive right to the licensees to sell/manufacture goods.

b. The permission granted by the dealer under the agreement was a non-exclusive right given to the licensees, as it was not to the exclusion of others. Thus, the license does not constitute a 'transfer of right to use of goods'.

c. He further relies upon the judgment of the Supreme Court in the case of **BSNL V. Union of India** reported in **2006 (3) SCC 1** wherein the Supreme Court propounded a test for the constitution of a transaction as the transfer of right to use the goods.

d. He further submits that service tax at a rate of 15% has already been paid by the respondent on the amount of royalty received by them from the licensees under the franchise agreement. In view of this fact, no intention to evade tax on the part of the respondent can be inferred.

e. Finally, he argues that Service Tax and VAT are mutually exclusive levies and a single consideration cannot be subjected to both the levies. To buttress his argument, he relies upon the judgment of the Hon'ble Supreme Court in case of **Imagic Creative Pvt. Ltd. v. Commissioner of Commercial Taxes** reported in **(2008) 2 SCC 614**.

ANALYSIS

6. I have heard the learned counsels appearing for the parties and perused the materials on record.

7. The pivotal issue revolves around whether the franchise of a trademark constitutes a transfer of the right to use goods, thereby making it subject to VAT.

8. Section 65(47) of the Finance Act, 1994 which is relevant to the instant issue is extracted herein:

> *"65(47) "franchise" means an agreement by which- (i)Franchisee is granted representational right to sell or manufacture goods or to provide service or undertake any process identified with franchisor, whether or not a trade mark, service mark, trade name or logo or any such symbol, as the case may be, is involved;*
>
> *(ii) The franchisor provides concepts of business operation to franchisee, including know how, method of operation, managerial expertise, marketing technique or training and standards of quality control except passing on the ownership of all know how to franchisee;*
>
> *(iii) The franchisee is required to pay to the franchisor, directly or indirectly, a fee; and*

(iv) The franchisee is under an obligation not to engage in selling or providing similar goods or services or process, identified with any other person;"

9. Reliance has been placed by the revisionist upon the judgement of the Bombay High Court in **Commissioner of Sales Tax v. Duke & Sons Pvt. Ltd. (supra)** wherein the Bombay High Court held that for transfer of the right to use trademark, it is not necessary to hand over the trademark to the transferee or give control or possession of trademark to him. The Bombay High Court further stated that it can be done merely by authorizing the transferee to use the same in the manner required by the law as has been done in the present case. The right to use trademark can be transferred simultaneously to any number of persons. Relevant paragraph is extracted below:

7. "Trade mark" has been defined in Section 2(1)(v) of the Trade and Merchandise Marks Act, 1958 to mean a mark used in relation to goods for the purpose of indicating a connection in the course of trade between the goods and some person having the right, either as a proprietor or as registered user, to use the mark whether with or without any indication of the identity of that person. There is a distinction between transfer of right to use a trade mark and assignment of a trade mark. "Assignment" of trade mark is taken to be a sale or transfer of the trade mark by the owner or proprietor thereof to a third party inter vivos. By assignment, the original owner or proprietor of trade mark is divested of his right, title or interest therein. He is not so divested by transfer of right to use the same. Licence to use a trade mark is thus quite distinct and different from assignment. It is not accompanied by transfer of any right or title in the trade mark. The transfer of right to use a trade mark falls under the purview of the 1985 Act and not the assignment thereof. The manner of transfer of the right to use the goods to the transferee would depend upon the nature of the goods. For transfer of right to use a trade mark, permission in writing as required by law may be enough. In case of tangible property, handing over of the property to the transferee may be essential for the use thereof. All that will depend upon the nature of the goods. Take for instance, transfer of right to use machinery. The right to use the machinery cannot be transferred by transferor to the transferee without transfer of control over it. The case before the Andhra Pradesh High Court in Rashtriya Ispat Nigam Ltd. v. Commercial Tax Officer was a case *of transfer of right to use machinery. It was in that context, the above decision came to be rendered. But the position in case of trade mark is different. For transferring the right to use the trade mark, it is not necessary to hand over the trade mark to the transferee or give control or possession of trade mark to him. It can be done merely by authorising the transferee to use the same in the manner required by the law as has been done in the present case. The right to use the trade mark can be transferred simultaneously to any number of persons. The decision of the Andhra Pradesh High Court in Rashtriya Ispat Nigam Ltd. v. Commercial Tax Officer thus has no application to the transfer of right to use a trade mark."*

10. Further, a strong reliance has also been placed by counsel for the revisionist on judgment of Madras High Court in **S. P. S. Jayam and Co. v. Registrar, Tamil Nadu Taxation Special Tribunal (supra)**. Relevant paragraphs are extracted herein:

"8. Coming to the facts of the present case, the petitioner/ assessee permitted M/s. Muthu Agencies to use their trademark in the course of trade at the rates specified therein for various items during a particular period. Of course, it retained the liberty to make use of the trademark in the event of the licensor starting to manufacture the products. Equally, it retained the liberty to grant licence to any other individual person or company to use the trademarks. Trademark is the property right and it exclusively belongs to the party who has registered it. Such a right is an intangible or incorporeal goods, which can be merchandised by the registered owners. As pointed out by the Supreme Court, the word "goods" is defined in very wide terms so as to bring in both tangible and intangible objects. General Clauses Act would explain movable property as property of every description except immovable property. Trademark right is intangible goods, which can be subject-matter of transfer. As already pointed out, M/s. Muthu Agencies was granted permission to use the trademark without any restriction whatsoever for a particular period. Consequently, it can only be taken as transfer of a

> *right to use and not a mere right to enjoy. Simply because the assessee retained the right for himself to use the trademark and reserved the right to grant permission to others to use the trademark, it would not take away the character of the transaction as one of transfer of a right to use. That being so, this Court has to only hold that the order of the Tamil Nadu Taxation Special Tribunal, Chennai, confirming the order of the Joint Commissioner-III (SMR), Chepauk, is well in order."*

11. In ***Duke & Sons (supra)***, the Court's interpretation highlighted that the right to use a trademark could be granted without transferring the physical control or possession of the trademark itself. This perspective was further validated in ***S.P.S. Jayam (supra)***, wherein the Madras High Court elaborated on the nature of trademarks as intangible goods, capable of being transferred without relinquishing ownership. The Madras High Court's reasoning underscored that such transfers should be viewed as the transfer of the right to use, rather than a mere license for enjoyment. However, these judgments must be re-evaluated in the context of Finance Act, 1994, which introduced specific provisions for the taxation of franchises. The legislative intent behind this Act was to bring clarity and uniformity to the taxation of service-based transactions, which had become increasingly prevalent with the rise of franchising as a business model. Finance Act, 1994 delineated the boundaries of what constitutes a taxable service in the realm of franchising, thereby superseding earlier judicial interpretations that did not account for this legislative framework.

12. The judgments in ***Duke & Sons (supra)*** and ***S.P.S. Jayam (supra)*** were rendered in a legal landscape where the specific nuances of franchising agreements were not explicitly covered by the prevailing tax laws of the assessment periods that the High Courts in those cases were dealing with. The assessment year under challenge in ***S.P.S. Jayam (supra)*** was 1987-88. The order impugned in ***Duke & Sons (supra)*** dated back to 1989.

13. With the introduction of the Finance Act, 1994, the legal foundation has shifted. The introduction of the said law significantly altered the landscape of how such transactions are to be treated under tax law. The statutory provisions of the Finance Act, 1994 override judicial interpretations that did not consider franchising under a unified tax framework. This means that earlier judgments, such as those in ***Duke & Sons (supra)*** and ***S.P.S. Jayam (supra)*** must now be read in light of the new legislative context. As such, the precedential value of these decisions is diminished.

14. By Finance Act, 1994, the distinction between the transfer of right to use a trademark and its assignment was further nuanced. Licensing agreements, where the franchisee is granted limited rights to use a trademark or business concept, are clearly delineated from outright assignments or sales of trademarks. This distinction is crucial for tax purposes, as it determines the nature and extent of tax liability for the parties involved.

15. In light of the aforesaid, it is pertinent to look at judicial decisions on taxation of franchisees, or licensing agreements, which were rendered after the introduction of the Finance Act, 1994.

16. The Delhi High Court in the case of **Mc Donalds India Pvt. Ltd. V. Commissioner of Trade Tax** reported in **2017 (5) GSTL 120** espoused that commercial transactions primarily revolve around tangible items, with trademarks serving as valuable assets that contribute to the overall value and demand of the products or services. The Court further stated that since an agreement of franchise of trademark grants only a non-exclusive right, it does not constitute a transfer of right to use the goods. Relevant paragraphs are extracted below:

> *"38**.** Now, hypothetically, even if we are to agree that the McDonald's system as well as trade marks of the petitioners would fall within the definition of "goods", for it to be taxable within the DVAT and DSTRTUG Act, a transfer of the right to use goods needs*

to take place; occasioned from the franchise agreements read concurrently with the relevant law. Section 65(47) of the Finance Act 1994 reads as follows:

> *"(47) 'franchise' means an agreement by which the franchisee is granted representational right to sell or manufacture goods or to provide service or undertake any process identified with franchisor, whether or not a trade mark, service mark, trade name or logo or any such symbol, as the case may be, is involved. Thus, by definition, the franchise agreement grants only a representational right and not an exclusive right to sell/ manufacture goods. Further, the provisions of the franchise agreements are only to the effect of giving the franchisee the non-exclusive right to use, for instance, as was reiterated in clause 11(d) of the MLA (of McDonald's) as below :*
>
> > *"Franchise and joint venture partner shall acquire no right to use, or to license the use of, any name, mark or other intellectual property right granted or to be granted herein, except in connection with the operation of the restaurant."*

***

42. Under trade mark law in India, trade mark use even for advertisement purposes is to be preceded by prior consent of the proprietor and any unauthorized use of the trade mark without such prior permission of the proprietor could lead to an infringement of the trade mark (in India, under section 29 of the Trade Marks Act, 1999). The function of the MLA and other franchise agreements in the case of petitioners and the trade mark licensing agreement (in the case of GSK) was (a) to provide for a strictly limited usage of the marks, i.e., only for advertisement and promotion of the services in the restaurant; (b) to provide for restrictions on usage of such marks, i.e., not for any commercial purposes such as use on merchandise, etc.

43. The grant of a right, in the form of license to use the mark is primarily to be utilized in the licensee's product. In usual cases of licensing, the trade mark owner may not wish to use mark its products or services in an area or region ; it instead would license the mark, to be used by the licensee's products, subject to limitations. The licensee has no right to initiate legal proceedings, in the event of infringement, (i.e., statutory right given to an owner or someone having proprietary *rights over the mark, to seek injunction and damages). This is clear from section 28 of the Trade marks Act :*

> *"28. Rights conferred by registration.—(1) Subject to the other provisions of this Act, the registration of a trade mark shall, if valid, give to the registered proprietor of the trade mark the exclusive right to the use of the trade mark in relation to the goods or service in respect of which the trade mark is registered and to obtain relief in respect of infringement of the trade mark in the manner provided by this Act.*
>
> *(2) The exclusive right to the use of a trade mark given under sub-section (1) shall be subject to any conditions and limitations to which the registration is subject."*
>
> *The property in the mark always vests with the owner. Furthermore, importantly the use of the mark by the licensee inures to the owner, as the latter's continuous use, in terms of section 48 of the Trade marks Act, which is as follows :*
>
> > *48. Registered users.—(1) Subject to the provisions of section 49, a person other than the registered proprietor of a trade mark may be registered as a registered user thereof in respect of any or all of the goods or services in respect of which the trade mark is registered.*
> >
> > *(2) The permitted use of trade mark shall be deemed to be used by the proprietor thereof, and shall be deemed not to be used by a person other than the proprietor, for the purpose of section 47 or for any other purpose for which such use in material under this Act or any other law."*

44. Therefore, when a trade vendor, distributor, establishment or anyone else permitted to sell articles or offer services the trade marks (or brand) which belongs to another, it is incorrect to state that the brand or mark, associated with the product, constitutes the sale rather than from sale of the underlying goods or services that are the subject of the trade mark (dishes in a restaurant) themselves. It would be incorrect, therefore, to conclude what is involved is not the sale of the product, but the intangible property or mark connected with the reputation of the mark, though that reputation guarantees a high demand for the product, from which the seller benefits. Likewise, in the case of distribution, a distribution agent is *under an agreement with the manufacturer to sell its goods ; it also possesses the right to advertise the goods and brands of the manufacturer. This implies a licence of the manufacturer's trade mark. In such an event, the distributor need not pay for the right to use the intellectual property under which the goods are sold; he merely pays for obtaining the commercial right to sell the goods he buys from the manufacturer for enabling onward sale.*

***

47. For a transfer of the right to use goods to be effective, such transfer of right should be one that the transferee can exercise in exclusion of others; which is not the case in the present appeals and petitions, as the franchise agreement only grants a non-exclusive right, retaining the franchisor's right to transfer the composite bunch of services to other parties, apart from it retaining ownership to the same. The ownership in the trade mark, logo, service marks, and brand name is solely vested in appellant and the petitioners and has not been transferred; as is clearly manifested in the various clauses of the franchise agreements. The appellant and the petitioners grant a non-exclusive licence to the franchisees, which can be revoked upon non-compliance of the terms and conditions as stipulated in their franchise arrangement. Clearly, this does not amount to a transfer of the right to use goods."

17. Reference at this juncture can also be made to the judgment of the Hon'ble Supreme Court in ***BSNL (supra)*** wherein the Hon'ble Supreme Court laid down the test for a transaction to be constituted as the one for the transfer of right to use the goods:

*"**97.** To constitute a transaction for the transfer of the right to use the goods, the transaction must have the following attributes:*

(a) there must be goods available for delivery;

(b) there must be a consensus ad idem as to the identity of the goods;

(c) the transferee should have a legal right to use the goods—consequently all legal consequences of such use including any permissions or licences required therefor should be available to the transferee;

> *(d) 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;*
>
> *(e) 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."*

18. The Kerala High Court in the case of **Malabar Gold Private Limited v. Commercial Tax Officer, Kozhikode and Others** reported in **(2013) 63 VST 497** wherein the trade mark of the petitioner was transferred to the franchisees for their use and the consideration received was the royalty paid to the petitioner, held that, such a transaction cannot be treated as a "deemed sale". Relevant paragraphs are extracted below:

> *"61**.** The issue therefore can be considered in the light of the dictum laid down in Bharat Sanchar Nigam Ltd.'s case [2006] 3 VST 95 (SC); [2006] 145STC 91 (SC); [2006]282 ITR 273 (SC); (2006) 6 RC 276; (2006) 3 SCC 1. Herein, the term "franchise is included in section 65(105)(zze) of the Finance Act. The same is a taxable service and the taxable event is the service rendered by the company. Thus, any service provided or to be provided to a franchisee will come within the purview of the said provision. The meaning of the terms franchise and franchisor under section 65(47) and (48) are also important. Going by the definition of franchise, it is an agreement by which the franchisee is granted representational right to sell or manufacture goods or to provide service or undertake any process identified with franchisor, whether or not a trade mark, service mark, trade name or logo or any such symbol, as the case may be, is involved. The terms of the agreement herein will show that Clause II of the Preamble has specifically given under items (i) to (v) the activities to be carried out by the franchisee which are as follows :*
>
> > *"(i) Retailing of gold ornaments.*
> >
> > *(ii) Retailing of diamond and other precious stone ornaments.*
> >
> > *(iii) Retailing of premium watches.*

(iv) Retailing of platinum and other premium fashion accessories.

(v) Any other items introduced by MALABAR GOLD in future."

62. Clause 2 under the heading "products" will show that the franchisee cannot stock, exhibit or sell any products in the authorised showroom during the period of the agreement except the products authorised by Malabar Gold, which may include products manufactured or sourced by Malabar Gold. Therefore, the same will definitely satisfy the meaning of "franchise" as contained in section 65(47) of the Finance Act, 1994. The learned Special Government Pleader for Taxes referred to the agreement herein and said that no service is referred to in the clauses therein. We do not agree, in the light of clauses 3, 4 and 5 of the model agreement as already noticed. Since what is termed as "taxable service" is any service to be provided to a franchisee by a franchisor in relation to a franchise, the terms of the agreement will have to be understood in that context.

63. In the light of the principles stated in para 98 of the judgment in Bharat Sanchar Nigam Ltd.s case [2006] 3 VST 95 (SC); [2006] 145 STC 91 (SC); [2006] 282 ITR 273(SC); (2006) 6 RC 276; (2006) 3 SCC 1, the provisions of the agreement, especially clauses (3) and (5) will show that the franchisor retains the right, effective control and possession and it is not a case of transfer of possession to the exclusion of the transferor. We notice that under clause(12) the franchisee has no right to sub-let or sub-lease or in any way sell, transfer, discharge or distribute or delegate or assign the rights under the agreement in favour of any third party, which is also significant. On termination of the agreement also, going by clause 25.3, the franchisee shall forfeit all rights and privileges conferred on them by the agreement and the franchisee will not be entitled to use the trade name or materials of "Malabar Gold". Merely because, going by clause 18, the franchisee is not an agent, it will not get any other exclusive right.

*****

67. Therefore, we are unable to agree with the view taken by the learned single judge. The view taken in para 14 of the judgment is that the transaction in question is a deemed sale

> *as defined under section 2(x)(iii) of the KVAT Act. The above view was taken by concluding that the trade mark of the appellant is transferred to the franchisees for their use and the consideration received is the royalty paid to the appellant. In para 17, the principles stated in Bharat Sanchar Nigam Ltd.s case [2006] 3 VST 95 (SC); [2006]145 STC 91 (SC); [2006] 282 ITR 273 (SC); (2006) 6 RC276; (2006) 3 SCC 1 were distinguished on the facts of the said case and it was held that in the said case the court was not dealing with a case involving transfer of intellectual property rights such as trade mark. It was held that there is total transfer of trade mark on payment of royalty which alone will attract the provisions of the KVAT Act. With great respect, we are unable to agree with the same.*
>
> *68. Accordingly, we allow the appeals reversing the judgment of the learned single judge* and hold that the franchise agreement will not attract the provisions of the KVAT Act. No costs."*

19. Commercial transactions primarily revolve around tangible items, with trademarks serving as valuable assets that contribute to the overall value and demand of products or services. However, as highlighted by the Delhi High Court in ***McDonald's (supra)***, since, a franchise agreement grants only a non-exclusive right, it does not constitute a transfer of the right to use goods. As defined by the Finance Act, 1994 "franchise agreements" grant representational rights, not exclusive rights to sell or manufacture goods. The judgment of Kerala High Court in ***Malabar Gold (supra)*** also bears relevance. The Kerala High Court noted that the terms of agreement made it clear that the franchisor retained effective control and possession, preventing a transfer of possession to the franchisee. The Division Bench of Kerala High Court disagreed with the earlier view that the transaction constituted a deemed sale and held that the franchise agreement did not attract provisions of the Kerala Value Added Tax Act, as it involved non-exclusive rights and control retained by the franchiser.

20. Franchise agreements typically grant non-exclusive rights to use trademarks and business systems. Such agreements do not constitute a

transfer of the right to use goods in a manner that excludes others, which is a critical criterion for considering a transaction as a deemed sale. The non-exclusive nature of these rights ensures that the franchisor retains control and can license the same rights to multiple franchisees, reinforcing the licensing framework rather than a full transfer.

21. When trademarks are licensed, the licensee's use of the mark is considered the owner's use, maintaining the continuity of the trademarks' reputation and legal protections. This distinction between ownership and licensed use is crucial for determining the scope of rights and the corresponding tax liabilities. For instance, in typical licensing arrangements, the licensee does not acquire the right to initiate infringement proceedings, which remains with the trademark owner. This legal nuance affects the control dynamics and the nature of the transaction, influencing whether the arrangement is taxed as a service (licensing) or as a transfer of goods (sale). The retention of ownership and control by the franchisor or licensor ensures that the transaction remains within the purview of service tax rather than sales tax.

22. The differentiation between licensing and transfer also extends to the method and scope of use. In licensing, the licensor often imposes stringent conditions on the use of the trademark to ensure that the brand's reputation and quality are maintained. These conditions might include guidelines on marketing, product quality, and even operational standards. Failure to comply with these conditions can result in the revocation of the license. This level of control is indicative of a licensing arrangement rather than a transfer, where the new owner would have the autonomy to use the trademark without such restrictions. In contrast, a transfer or assignment of a trademark involves transferring all rights associated with the trademark to the transferee. This includes the right to use, license, and enforce the trademark. Once transferred, the original owner relinquishes all control and ownership rights over the trademark. This kind of transaction is more straightforward in terms of taxation as it involves a clear transfer of an

asset, typically subject to sales tax or capital gains tax depending on the jurisdiction and the specifics of the transaction.

23. Enter the protagonists, the franchisors, and franchisees, each adorned with their roles and responsibilities. The franchisor, akin to the playwright, holds the script of the brand, trademarks, and business model, while the franchisee, like the eager actor, steps onto the stage with dreams of entrepreneurial success. Together, they form a dynamic duo, ready to bring their shared vision to life. As the plot thickens, the script of franchise agreements unfolds, revealing the terms and conditions that will govern the partnership between franchisors and franchisees. Like the lines of a well-crafted drama, these agreements detail the rights and obligations of each party, setting the stage for a performance of mutual benefit and cooperation. Tax authorities, like astute critics, scrutinize each scene, seeking to unravel the true nature of franchise agreements. Yet, amidst the confusion, one question looms large: can franchise agreements be taxed as sales of goods?

24. Franchise agreements have become a ubiquitous feature of modern commerce, facilitating the expansion of businesses across diverse industries and geographies. However, the tax treatment of franchise agreements poses intricate challenges, with implications for both franchisors and franchisees. Transfer of the right to use a trademark does not necessitate the physical handover or control of the trademark. Instead, it can be affected by authorizing the transferee to use the trademark in accordance with the law. This underscores the intangible nature of trademark rights and their transferability without the need for physical possession. Franchise agreements primarily grant a representational right rather than an exclusive right to sell or manufacture goods, thereby categorizing such transactions as services rather than sales of goods. Franchise agreements are fundamentally licensing agreements rather than sales of goods. Licensing involves granting permission to use intellectual property rights, whereas sales of goods involve the transfer of ownership of tangible items. Understanding this distinction is

crucial for determining the appropriate tax treatment for franchise agreements.

25. At first glance, franchise agreements may appear analogous to sales of goods, as they involve the transfer of rights and benefits from one party to another in exchange for monetary consideration. However, a deeper examination reveals crucial distinctions that warrant disparate tax treatment. Unlike conventional sales transactions, which involve the transfer of tangible property, franchise agreements primarily entail the licensing of intangible assets, such as trademarks, trade secrets, and proprietary know-how. One of the central aspects of franchise agreements is the grant of intellectual property rights from the franchisor to the franchisee. These rights include trademarks, trade names, logos, and proprietary business methods. Unlike tangible goods, which can be bought and sold outright, intellectual property rights are licensed for use under specific terms and conditions. Another key factor that distinguishes franchise agreements from sales transactions is their non-exclusive nature. Franchise agreements typically grant franchisees the right to operate a business using the franchisor's brand and system within a defined territory. However, this right is not exclusive, as the franchisor may grant similar rights to other franchisees within the same or overlapping territories. Franchise agreements also entail an ongoing relationship between the franchisor and franchisee, characterized by training, support, and ongoing assistance. Unlike a one-time sale of goods, which concludes once the transaction is complete, franchise agreements involve continuous interaction and collaboration between the parties. The financial aspects of franchise agreements further underscore their distinction from sales transactions. Franchise fees and royalties are payments made by the franchisee to the franchisor in exchange for the right to use the franchisor's brand and system. These payments are not for the purchase of goods but rather for the ongoing support and benefits provided by the franchiser.

26. In conclusion, the taxation of franchise agreements and sales of goods represents a complex and multifaceted issue that defies easy categorization.

While both involve commercial transactions, they embody distinct economic realities and legal considerations that necessitate differential tax treatment. By recognizing the unique characteristics of franchise agreements, including the prevalence of intangible assets and the importance of intellectual property, tax authorities can develop nuanced tax policies that promote fairness, efficiency, and compliance. Ultimately, a balanced approach that takes into account the economic substance of franchise transactions and the need to prevent tax arbitrage and avoidance will ensure the integrity and effectiveness of the tax system.

27. In light of the above, I am of the view that the franchise agreement in present case grants a non-exclusive license rather than a transfer of the right to use goods. As such, the transaction does not attract Value Added Tax under the UPVAT Act.

28. The Supreme Court in the case of **Godfrey Phillips India Limited v. State of Uttar Pradesh** reported in **(2005) 2 SCC 515** held that the Constitution of India does not permit overlapping of taxes. Once an activity is taxable as a service, it cannot be taxed as sale/deemed sale of goods. Relevant paragraphs of the are extracted below:

> "*44. The Indian Constitution is unique in that it contains an exhaustive enumeration and division of legislative powers of taxation between the Centre and the States. This mutual exclusivity is reflected in Article 246(1) and has been noted in H.M. Seervai's Constitutional Law of India, 4th Edn., Vol. 1 at p. 166 in para 1A.25 where, after commenting on the problems created by the overlapping powers of taxation provided for in other countries with federal structures such as the United States, Canada and Australia, the learned author opined:*
>
> > *"The lists contained in Schedule VII to the Government of India Act, 1935, provided for distinct and separate fields of taxation, and it is not without significance that the concurrent legislative list contains no entry relating to taxation but provides only for 'fees' in respect of matters contained in the list but not including fees taken in any court. List I and List II of Schedule VII thus avoid overlapping powers of taxation*

and proceed on the basis of allocating adequate sources of taxation for the federation and the provinces, with the result that few problems of conflicting or competing taxing powers have arisen under the Government of India Act, 1935. This scheme of the legislative lists as regards taxation has been taken over by the Constitution of India with like beneficial results."

***

46. Therefore, taxing entries must be construed with clarity and precision so as to maintain such exclusivity, and a construction of a taxation entry which may lead to overlapping must be eschewed. If the taxing power is within a particular legislative field, it would follow that other fields in the legislative lists must be construed to exclude this field so that there is no possibility of legislative trespass."

29. It is clear from the factual matrix of the instant case that the respondent herein had received royalty amount from various dealers under the franchise agreement and service tax has been duly paid by it on the same. If these payments have been subjected to service tax, they cannot be recharacterized as the sale of goods to levy VAT or sales tax. The prevention of double taxation is a fundamental principle of tax law. Double taxation occurs when the same income or transaction is taxed more than once by different tax authorities or under different tax regimes. An activity once taxed as a service cannot be taxed again as a sale of goods. This principle is crucial for ensuring fairness in the tax system and avoiding undue tax burdens on taxpayers.

30. I would like to put on record my gratitude for the assistance rendered by Sri Bipin Kumar Pandey, learned Additional Chief Standing Counsel appearing for the revisionist and Sri Shubham Agarwal, learned counsel appearing for the respondent. Furthermore, I would also like to put on record my appreciation for painstaking research and assistance in drafting this judgment by my Research Associate Mr. Aman Deep Sharma and Law Intern Mr. Jaspreet Singh.

31. In light of the aforesaid, I found no reason to interfere with the view taken by the Commercial Tax Tribunal, and accordingly, the instant revision application is dismissed.

32. There shall be no order as to the costs.

24.05.2024
Kuldeep

(Shekhar B. Saraf, J.)