Gift of Brand to corpus of a private irrevocable trust is a non-taxable capital receipt

ACIT vs. M/s Balaji Trust (ITA No. 5139/Mum/2017)

A. FACTS OF THE CASE

- The taxpayer is a private discretionary trust, which was settled for the exclusive benefit of the members of the promoter family.
- The Group Holding Company (**HCo**) was holding the brand including all registered and unregistered trademarks, copyrights, service marks, certification marks, design, trade names relating to the logo and slogans (hereinafter referred to as '**Brand**') since 1996. HCo had contributed the Brand to the corpus of the taxpayer as a voluntary gift without any consideration. As the Brand was settled without any consideration, it was not recognized in the financials of the taxpayer.
- Consequently, the taxpayer had entered into brand licensing agreements with operative group entities. A non-exclusive license to use the Brand was granted to the licensees in consideration of which license fees was earned by the taxpayer (the trust). The license fees earned by the trust was accounted as per the cash system of accounting in accordance with the provisions of Section 145(1) of the Income-tax Act, 1961 (**IT Act**).
- The Tax Officer (**TO**) passed the Assessment Order under Section 143(3) of the IT Act and held that since the definition of 'income' under Section 2(24) of the IT Act is very wide in nature, receipt of Brand contributed by HCo to the taxpayer as a voluntary gift without any consideration, was in the nature of income taxable under the head 'Income from other sources' under section 56(1) of the IT Act.
- Aggrieved by the said order, the taxpayer filed an appeal before the Commissioner of Income-tax (Appeal) (**CIT(A)**). On account of additional evidence submitted by the taxpayer, the CIT(A) remanded the matter back to the TO. TO vide its remand report submitted that the receipt of Brand by the taxpayer was chargeable to tax under Section 28(iv) and 56(2)(vii) of the IT Act. On perusal of the submissions made by TO and the taxpayer, CIT(A) decided the appeal in the favour of taxpayer and held as follows:

  "(B)The receipt of the Brand is on capital account and, therefore, not covered within the definition of "income" in section 2(24) of the Act and, consequently, is not chargeable to tax under section 56(1) of the Act.

  (C) The trademark and copyright are not chargeable to tax under section 56(2)(vii) of the Act as they are not in the nature of "work of art".

  (D) The provisions of section 28(iv) are not applicable as the receipt of the Brand is not arising during the course of carrying on of any business."

- Aggrieved by the order of CIT(A), TO filed an appeal before Income-Tax Appellate Tribunal (**ITAT**), Mumbai raising multiple grounds. Further, TO also filed additional grounds before the ITAT, which were dismissed by the ITAT.

B. JUDGEMENT

As per the TO, receipt of Brand by the taxpayer from HCo is to be regarded as income under Section 2(24) of the IT Act and should be taxable under either of the following provisions of the IT Act:

Sr. No.	Section	Basis of taxation
1.	56(1)	Brand transferred to taxpayer without consideration constitutes income and shall be taxable income under the general provisions of Section 56(1)
2.	56(2)(vii)	Receipt of Brand was taxable by virtue of section 56(2)(vii) of the IT Act as it was in the nature of 'any work of art'
3.	28(iv)	Receipt of Brand by the taxpayer is taxable under Section 28(iv) as any benefit, whether convertible into money or not, arising from the business as taxable under the head 'Profits & gains from business or profession'

The aforementioned points have been detailed out as under:

1. Section 56(1)

- The TO contended that Section 2(24) of the IT Act bestows an inclusive definition of income instead of an exhaustive one. Accordingly, income of every kind which is not expressly exempted under the IT Act shall be chargeable to income tax. If there is no specific provision for such income, then the same shall be chargeable to tax under the head 'Income from other sources' under Section 56(1) of the IT Act.
- The taxpayer contended that the receipt of Brand by the taxpayer was not in the nature of income because:
  - it was in the nature of a gift received from HCo;
  - the receipt was on capital account as it formed part of the profit-making apparatus of the taxpayer, as the asset received was employed to earn brand license fees.
- Therefore, the taxpayer contended that as the receipt was not in the nature of "income", the provisions of Section 56(1) of the IT Act are not applicable, as it covers within its ambit only a receipt which fall within the ordinary meaning of "income".
- The ITAT agreed to the contentions raised by the taxpayer and noted that the Brand, which was a gift by HCo, formed part of taxpayers profit-making apparatus. The taxpayer exploited the Brand by entering into non-exclusive brand licensing agreements with the group entities and, was earning substantial license fees and thus, is in the nature of capital. ITAT had arrived at this view by relying upon various juridical precedents.
- On the interpretation of Section 56(1), ITAT agreed with the TO that if the income does not fall under any specific category mentioned in Section 56(2) of the IT Act, then, such income can be charged under Section 56(1) of the IT Act. However, the ITAT further held that in order to be taxable under Section 56(1), there should be an income under the categories mentioned under Section 2(24) of the IT Act; or it should be such that it has an element of revenue that can be classified as an income.
- With respect to the present facts, the ITAT held that the Brand received by the taxpayer neither carried any element of profit, nor does it fall under any category of income specified under Section 2(24) or Section 56(2) or Section 56(1). Based on this background, ITAT was of the view that the transaction under consideration does not fall under any category of income and upheld the view taken by the CIT(A).
- ITAT rejected the contention of the TO, that the amounts which were originally capital receipts changed their character into revenue receipts, the same shall be taxable as income of the taxpayer in the year in which such amounts changed their character. The ITAT rejected this contention and noted that for the transaction under

consideration, earning any kind of income from the Brand, does not alter its own character and hence it cannot be considered as a revenue receipt. ITAT also rejected TO's argument that as the transaction is of a special kind, it has to be evaluated in a special manner so that it fits in the general residual provision i.e., Section 56(1).

Conclusion

- On this issue, the ITAT held that "*In our considered view, the CIT(A) had rightly concluded, that as the contribution of brand as a gift by HCo to the corpus of the assessee trust did neither involve any profit element which could be brought within the meaning of "Income" under Sec. 2(24) of the Act, nor partook the nature of income, therefore, it could not be subjected to tax under the residuary head i.e "Other sources" u/s 56(1) of the Act, thus, uphold his view to the said extent*".

2. Section 56(2)(vii)

- On the applicability of Section 56(2)(vii), TO contended that as per the submissions made by the taxpayer, the registration of Brand was done as an 'artistic work' under the Copyright Act, 1957 (**Copyright Act**). Based on this registration, the Brand falls within the category of 'any work of art' contemplated in the definition of 'property' under Explanation to Section 56(2)(vii) of the IT Act and accordingly the receipt of the Brand was taxable by virtue of Section 56(2)(vii) of the IT Act as it was in the nature of 'any work of art'.
- On perusal of the definition of 'property' under Section 56(2)(vii), ITAT noted that the definition is restrictive in nature and exhaustively refers to the assets which would fall within the ambit of the said definition. Further, as per the definition of 'capital asset' as envisaged in Section 2(14) of the IT Act, 'personal effects' are not included under the said definition with an exception carved out for 'any work of art'. On analyzing the definition of capital asset, ITAT noted that 'any work of art' is a capital asset.
- ITAT further stated that the dictionary meaning of 'work of art' is an object made by an artist of great skill and every ordinary article cannot be treated as 'work of art', as there should be some artistic innovation with respect to the same. On perusal of the definition of 'artistic work' under the Copyright Act, one may note that even if the object has no artistic quality, however, for the purpose of Copyright Act, the said object is to be considered as an artistic work, keeping in mind the purpose of the Copyright Act, which is to protect the rights of an artist who has created artistic work from infringement. ITAT noted that the purpose for which the said term is used under the Copyright Act is different from the purpose with which 'any work of art' is used in Section 56(2)(vii) of the IT Act.
- ITAT was of the view that the Brand is neither an artistic innovation nor possesses any artistic quality for being brought within the meaning of "any work of art" as contemplated in the definition of "property" under Section 56(2)(vii) of the IT Act

Conclusion

- On this issue, ITAT held that *"We, thus, in terms of our aforesaid observations concur with the view taken by the CIT(A) that the brand contributed as a gift by HCo to the corpus of the assessee trust could not have been brought within the meaning of "any work of art" as contemplated in the definition of "property" in 'Explanation (d)" to Sec. 56(2)(vii) of the Act, and thus, on the said count be subjected to tax under the head "Income from other sources""*.

3. Section 28(iv)

- With respect to applicability of Section 28(iv) of the IT Act, the TO contended that the value of the Brand acquired by the taxpayer without making any payment towards its cost of acquisition or sharing its royalty receipts with HCo, results into receipt of benefit free of cost and hence the same should be taxable under Section 28(iv) of the IT Act.
- ITAT observed that the taxpayer was incorporated on the same day when the Brand was gifted to it by HCo. Accordingly, it cannot be stated that the Brand was generated out of the business carried out by the taxpayer.
- ITAT further held that as the Brand has been categorized as a capital asset i.e., a capital transaction, the question of taxing the same as business receipt under the head 'Profits & gains from business & profession' does not arise.

Conclusion

- On this issue, the ITAT held that "*As per section 28(iv) of the Act, the value of any benefit or perquisite arising from business or exercise of a profession shall be chargeable to income-tax under the head Profit & gains of business or profession. However, as in the case before us, the brand was contributed as a gift by HCo to the assessee trust on the same day on which the assessee trust had commenced its operations, therefore, it cannot be considered that the brands are the benefit which arose from the business carried on by the assessee*".

ELP Comments

The ITAT judgement has ruled on various important legal propositions, which will have a far-reaching impact on the industry. One of the important propositions laid down by the ITAT is that, for the applicability of Section 56(1) or Section 56(2), any amount received should fall within the ambit of "income". This signifies that capital receipts in any form are outside the purview of this provision and reiterates the principle that capital receipts are exempt from tax, unless they are specifically made taxable.

Another important aspect which the ITAT has laid down is that a particular transaction will be taxable only if it falls within the charging provision and it is not the mandate of law to mandatorily subject a transaction to tax, irrespective of its nature.

This ruling reinforces the interpretation about the applicability of Section 56(2)(vii) restricted to the term "property", indicating that if the asset does not fall within the meaning of "property" under Section 56(2)(vii), the same cannot be brought to tax. This interpretation curtails the scope of the term "property" and protects the taxpayer from facing genuine hardship, which could arise on account of receipt of any asset without consideration. Though Section 56(2)(vii) is no longer applicable and is replaced by Section 56(2)(x), which has much wider implications, this interpretation will equally hold good while interpreting Section 56(2)(x), as it uses the term "property" having the same meaning as was used for Section 56(2)(vii).

All in all, this is certainly a welcome ruling.

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com or write to our authors:

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