

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 26.10.2016
Pronounced on: 17.05.2017

+ **ST. APPL.26/2013**

MC DONALDS INDIA PVT. LTD.

.....Appellant

Through: Sh. Arvind. P. Datar, Sr. Advocate with Sh. N. Sai Vinod, Advocate.

Versus

COMMISSIONER OF TRADE AND TAXES, NEW DELHI

.....Respondent

Through: Sh. Sanjoy Ghose, ASC, GNCTD with Sh. Rishabh Jaitley and Ms. Pratishtha Vij, Advocates.

+ **ST. APPL.27/2013**

MC DONALDS INDIA PVT. LTD.

.....Appellant

Through: Sh. Arvind. P. Datar, Sr. Advocate with Sh. N. Sai Vinod, Advocate.

Versus

COMMISSIONER OF TRADE AND TAXES

.....Respondent

Through: Sh. Sanjoy Ghose, ASC, GNCTD with Sh. Rishabh Jaitley and Ms. Pratishtha Vij, Advocates.

+ **W.P.(C) 10726/2006**

GLAXO SMITH KLINE ASIA P. LTD.

....Petitioner

Through: Sh. V. Lakshmikumaran with Ms. Charanya Lakshmikumaran, Sh. Aditya Bhattacharya, Sh. Yogendra Aldak, Sh. Anshul Mathur and Ms. Apeksha Mehta, Advocates.

Versus

ASSESS. AUTH. SPECIAL ZONE TRADE

.....Respondent

Through: Sh. Deepak Anand, Jr. Standing Counsel, for
Sh. Pramod Kumar Rai, Sr. Standing Counsel, for Service
Tax Department.

+ **W.P.(C) 3408/2013, C.M. APPL.6465/2013**
BIKANERWALA FOODS PVT. LTD.Petitioner
Through: Sh. V. Lakshmikumaran with Ms. Charanya
Lakshmikumaran, Sh. Aditya Bhattacharya, Sh.
Yogendra Aldak, Sh. Anshul Mathur and Ms. Apeksha
Mehta, Advocates.

Versus

UNION OF INDIA AND OTHERSRespondents
Through: Sh. Anuj Aggarwal, ASC, GNCTD along with
Ms. Deboshree Mukherjee, Advocate, for Respondent
No.1.
Sh. Amit Bansal, Sr. Standing Counsel, for Respondent
No.2.

+ **W.P.(C) 4453/2013, C.M. APPL.10295/2013**
SAGAR RATNA RESTAURANTS PVT. LTD.Petitioner
Through: Sh. Gagan Kumar, Advocate.

Versus

VTO (WARD 205) & ORS.Respondents
Through: Sh. Harpreet Singh, Sr. Standing Counsel.
Sh. Vikram Jetly, CGSC, for UOI.

+ **W.P.(C) 3404/2015 & C.M. APPL.6089/2015**
SAGAR RATNA RESTAURANTS PVT. LTD.Petitioner
Through: Sh. Gagan Kumar, Advocate.

Versus

VTO (WARD 205) & ORS.Respondents
Through: Sh. Harpreet Singh, Sr. Standing Counsel.

Sh. Rakesh Kumar, CGSC, for UOI.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MS. JUSTICE DEEPA SHARMA

MR. JUSTICE S. RAVINDRA BHAT

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1. The appeal (STA 27/2013) and writ petitions, (W.P.(C)3404/2015, W.P.(C)3408/2013, W.P.(C) 4453/2013 and W.P.(C)10726/2006) all are concerned with the same question of law. Resultantly, they were heard alongwith STA 26/2013. The question of law in STA 26/2013, which is the lead case in this batch, is as follows:

Whether the Tribunal was right in holding that consideration received under the franchise agreement was for transfer of right to use the goods, i.e., the trade mark, under the Delhi Sales Tax on Right to Use Goods Act, 2002 and under the Delhi Value Added Tax Act, 2004?

2. The appellant is a wholly owned subsidiary of McDonald's Corporation, Delaware (a term hereinafter referred to as "McDonald's" or "the Appellant" in respect of the two appeals, i.e. STA 26-27/2013). It entered into joint venture agreements, with Connaught Plaza Restaurants Private Limited, Hardcastle Restaurants Private Limited and Golden Kitchens Private Limited; and held 50% of their capital, during the period under consideration. McDonald's also entered into franchise agreements with various franchisees to allow them to adopt and use the "McDonald's system", for the purpose of operating its restaurants in India. McDonald's receives a fixed amount as location fee from the franchisees, at the time of opening of the restaurants. Further, it collects royalty of approximately 5% of the gross sales, from the restaurants operated by the franchisees. Also,

with the introduction of the taxable category of ‘franchise service’, in the service tax laws, viz. the Finance Act, 1994, the Appellant obtained service tax registration with effect from 01.07.2003 and since then has been regularly filing the service tax return and duly discharging the service tax liability, on the entire service fee, received in connection with the franchise agreement.

3. For the assessment year 2005-2006, the Delhi Value Added Tax authorities (hereafter “revenue” or “DVAT”) stated and took the position that royalty payments were liable to levy on the ground that they constituted consideration for the transfer of rights to use the trade mark “*McDonald’s*”. On 17.03.2006 the Value Added Tax Officer (hereafter “VATO”) issued a letter alleging that McDonald’s had a sale turnover from trade mark and patents, in the form of royalty received from the franchisees, which attracted a levy of sales tax, under the provisions of the Delhi Sales Tax on Right to Use Goods Act, 2002 (hereinafter the “DSTRTUG Act”). Further, McDonald’s was asked to produce the details with regard to the collection of royalty, for the period 15.09.2004 to 31.03.2005, its balance sheet for the AY 2004-05 and the list of franchisees which McDonald’s subsequently submitted on 02.05.2006 and 05.05.2006. Thereafter, on 05.07.2006 it filed its reply resisting levy of tax under the DSTRTUG Act and subsequently submitted a copy of the Master License Agreement (MLA) executed between the Appellant and McDonald’s India.

4. Further to a Show Cause Notice dated 09.10.2006, McDonald’s was asked to show cause why it should not be assessed to tax under Section 23 (6) of the Delhi Sales Tax Act, 1975, read with Section 9 of the DSTRTUG

Act, for the AY 2004-05 and why a penalty should not be imposed upon the appellant for the same. The Value Added Tax Officer, Special Zone ('Assessing Authority I'), vide an order, dated 16.01.2007, treated the "McDonald's system" as goods and invoked a demand of ₹13,44,684/-. Aggrieved, McDonald's appealed to the Joint Commissioner, Trade and Taxes. The Joint Commissioner, by an order dated 01.07.2008 held that the transactions entered into by McDonald's involved the transfer of the right to use "McDonald's system", which constitutes goods in terms of Article 366(29A) of the Constitution and Section (1)(n) of the DSTRUG Act, thereby upholding the order of the Assessing Authority.

5. Being aggrieved with the above order, McDonald's appealed to the Appellate Tribunal on 01.09.2008. The Tribunal, however, dismissed the appeal, and upheld the orders of the Joint Commissioner- V and Special Commissioner- III. Thus, aggrieved with the impugned order, McDonald's appeals to this court.

6. Similarly, the petitioner Sagar Ratna Restaurants Private Ltd (the first Petitioner in W.P.(C) 4453/2013 and W.P.(C) 3404/2015, hereafter "Sagar Ratna") is aggrieved by the order dated 09.02.2015 passed by the VATO, Delhi, holding that, *inter alia*, the fee received by it-as franchisor, on account of franchise services rendered by it to M/s Queen's Plaza F&B, Bhatinda (the franchisee) pursuant to an agreement- is subject to DVAT levy. Further, Sagar Ratna, on the belief that the franchisee fee derived from the franchisees pursuant to the said franchise agreement was subject to payment of service tax, deposited Service tax @ 12.36 % (the rate of tax during the period in question) on the amount of franchise fee during the relevant

financial year. Thereafter, Sagar Ratna Hotels (the second petitioner) became a franchisor in relation to a business rearrangement in the family of the owners of the Sagar group, wherein the restaurant business (including all trade marks and other intellectual property rights) were sold by Sagar Ratna to Sagar Ratna Hotels. Accordingly, agreements were executed between the first petitioner and second petitioner and the franchisees, pursuant to which Sagar Ratna Hotels became the new franchisor in the franchise agreement in contention.

7. Bikanerwala Foods Pvt. Ltd (hereafter “Bikanerwala”) and GlaxoSmithKline Asia Pvt. Ltd. (hereafter “GSK”) likewise, have filed writ petitions (W.P.(C) 3408/2013 and W.P.(C) 10726/2006) against default assessment notices directing the payment of VAT upon transactions of granting the right to use their respective trade mark and the grant of a non-exclusive license to their respective franchisees. Bikanerwala is engaged in the manufacture and selling of *namkeens*, sweets etc. (packaged snacks) under the brand name of “Bikano” and “Bikanerwala”. GSK was granted a non-exclusive license by Horlicks Limited, a British Company, by an agreement dated 03.02.1997, and thereafter entered into an agreement with SmithKline Beecham Consumer Health Care Limited under which the GSK granted a non-exclusive license to use of the said trade marks to SmithKline Beecham Consumer Health Care Limited, for the sale of the contract products in the whole of India, and also in Nepal and Bhutan. Both Bikanerwala and GSK have entered into franchise agreements similar to that entered into by McDonalds and Sagar Ratna Hotels, earn royalty for rendering such services and accordingly pay service tax on the same. Sagar

Ratna, Sagar Ratna Hotels, Bikanerwala and GSK are hereafter referred to as “the Petitioners”.

8. It is in the light of the above facts, that the court would proceed to examine whether the royalty payable under the franchise agreements signed, is liable to sales tax or VAT under the Delhi Value Added Tax Act, 2004 and under the DSTRTUG Act, 2002.

Prior orders

McDonald's

9. In the case of McDonald's, the assessment order for AY 2004-05 dated 16.01.2007, held that the charge of royalty or franchise relates to the transfer of the right to use of a patent or trade mark, and that McDonald's is liable for registration under Section 4 of the DSTRTUG Act, 2002, at the rate of 4% read with the provisions of the Delhi Sales Tax Act, 1975. The Assessing Officer (AO) adjudged the Appellant to fulfill the conditions assigned to a “dealer” under the DSTRTUG Act, 2002. Further citing the case of *Vikas Sales Corporation v. CCT* (1996) 102 STC 106 SC, the Supreme Court had ruled that trade marks are goods, and that for transferring the right to use, a trade mark, being intangible goods it is not necessary to hand over the trade mark to the transferee or give control or possession to him, but that transfer is achieved or complete by merely authorizing the transferee to use the trade mark in the manner required by law; the AO held that the charging of royalty relates to the transfer of the right to use of a patent or trade mark. It was held, *inter alia*, in *Vikas Sales* (supra) that:

“21.The above material uniformly emphasises the expansive manner in which the expression property" is understood. Learned counsel for the petitioners brought to our, notice the meanings of the term property" set out in Chapter-13, "The Law of Property", in Salmond's Jurisprudence (12th Edition, 1966) In this chapter, several meanings attributed to "property" are discussed in extenso ; to all of which it may not be necessary to refer, Suffice to say that property is defined to include material things and immaterial things (jura in re propria) and leases; servitudes and securities etc (jura in -re aliena). The material things are said to comprise land and chattels while immaterial things include patents, copyrights and trade marks, which along with leases, servitudes and securities are described as incorporeal property The expression "movable property" is stated to include (Page 421) corporeal as well as incorporeal property, Debts, contracts and other chose-in-action are said to be chattels, no less than furniture or stock-in-trade, Similarly, patents, copyrights and other rights in rem which are not rights over land are also included within the meaning of movable property; We are unable to see anything in the said Chapter-13, which militates against the meanings ascribed to the said expression in the judicial dictionaries referred have above., indeed, they are consistent with each other.”

10. The Appellant had cited *Commissioner of Sales Tax v. Duke and Sons Private Limited* (112) STC 370, where the Supreme Court had held that it is not necessary to hand over the trade mark to the transferee for give control or possession to him, and that it can be done by merely authorizing the transferee to use the same in the manner required by law. Thus, going by the above reasoning, the AO held the “McDonald’s system” which includes proprietary rights in valuable trade names, service marks and trade marks etc., to fall within the definition of “goods” under the DSTRTUG Act, 2002. As such, since the goods were thus property having its proprietary rights transferred with a right to use; they were held to fall within the definition of

“sale” under Section 2(n) of the DSTRTUG Act, 2002 and McDonald’s had transferred the goods in the shape of goodwill attached with the use of trade mark and the service portion, if any, is incidental to the transfer of trade mark. The AO framed the assessment demand at ₹ 13,44,684/-. The Joint Commissioner, i.e the appellate authority, rejected McDonald’s plea after undertaking an analysis of the provisions of the DSTRTUG Act, 2002, and the relevant clauses of the Master License Agreement. He concluded that the “McDonald’s system” comprised incorporeal intellectual property. The appellate authority referred to the Supreme Court judgments of *M/s. Vikas Sales Corporation (supra)* and *M/s Sunrise Associates v. Govt. of NCT of Delhi* AIR 2006 SC 1908, to highlight how the franchise agreement has all the attributes of a license and, therefore, transactions covered by the said agreement are taxable under Section 3 of the DSTRTUG Act and, that the nature of the “McDonald’s system” (as examined in the light of Section 2(1)(f) of the DSTRTUG Act) falls under the definition of “goods”.

11. As such, in concurrence with the AO’s assessment and reasoning, the Joint Commissioner upheld the AO’s assessment order and directed the Appellant to deposit 50% of the amount in dispute as condition precedent for entertaining the appeal for hearing on merit, to which the Appellant complied, however, this appeal was dismissed and the Appellant preferred an appeal to the Appellate Tribunal Value Added Tax (ATVAT).

12. The Tribunal, from a perusal of the relevant clauses of the MLA held that the McDonald’s Systems in pith and substance comprises of the trade mark “McDonald” and “McDonald Hamburgers”, as well as the working manuals and hard/soft forms of instructions/guidelines for operation of the

overall system known as the McDonald's system, and held them to be intellectual property within the legal/proprietary rights of the franchisor. The Tribunal also held that the McDonald's systems fulfills the criteria to qualify as "goods", as laid down in *Bharat Sanchar Nigam Ltd v. Union of India* (2006) 3 SCC 1 (hereafter "*BSNL*"). Highlighting *SPS Jayam and Co. v. Registrar* (2004) 137 STC 117 (Mad.) it was further noted that merely because the assessee retained the right for himself to use the trade mark and reserves the right to grant permission to others to use the trade mark, the character of the transaction as one of transfer of a right to use could not be denied. The Tribunal rejected the appellant's contention that a composite contract of service cannot be split up to tax transfer of the right to use goods, and that the permission to use the trade mark is merely incidental to the bunch of services being provided under the MLA; thereby, there being no transfer of any right to use under any enactment. It held that the appellant is providing service to self with the sole aim of protecting its own interests, and that the service component arising from the MLA is merely incidental to the main activity of transfer of right to use the McDonald's system, as was similarly held in *Nutrine Confectionery Co. (P) Ltd v. State of Andhra Pradesh* (2011) 11 VST B-386 (AP).

The Petitioners (Sagar Ratna, Sagar Ratna Hotels, Bikanerwala and GSK)

13. The petitioners urge that the VAT authorities claim that tax can be levied on the royalty and franchise fees charged by them (i.e the Petitioners) based on the franchise agreements entered into by them. This is largely based on the considerations that weighed with the revenue when it demanded

payments in respect of transactions that McDonalds entered into with its franchisees. The petitioners submit that this interpretation is in disregard of the dominant intention that arose from the franchise agreements, and that the service tax that was already being paid by the Petitioners, and further, that the non- exclusive transfer of the right to use goods (according to the provisions of the franchise agreements) was not tantamount to a transfer that is leviable under the DSTRUG Act, 2002.

Arguments advanced

14. At the outset, learned senior counsel for McDonald's submits that the assessing authorities and the Tribunal misconstrued the terms of the franchise agreement. The franchise agreement only confers the right to use the McDonald's systems in a restaurant, and royalty is paid as a percentage of gross sales. The exclusive purpose for which the McDonald's system can be utilized is highlighted in the clause 11 (d) of the franchise agreement that reads as follows:

“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.”

Similarly, the franchisee agreements signed between the Petitioners and their respective franchisee parties do not give the exclusive right to use the respective trade marks and only permit such usage to the limited purposes provided in the franchise agreements. Relevant clauses from the franchise agreement between Bikanerwala and Sagar Ratna and their franchisees are relied on to say that there was no intention to transfer the right to use the

goods (i.e the trade marks or intellectual property).

15. Mr. Arvind Datar, learned senior counsel and Mr. Lakshmikumaran (appearing for the appellants and petitioners) submit that the franchise agreement and the payment of royalty are subject to service tax under the Finance Act, 1994. Sections 65 (47) and 65 (48) of the said Act read 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;

(48) "franchisor" means any person who enters into franchise with a franchisee and includes any associate of franchisor or a person designated by franchisor to enter into franchise on his behalf and the term "franchisee" shall be construed accordingly.”

16. Thus - submits McDonald's - the franchise agreement only gives rise to a *“representational right to sell or manufacture goods or to provide service or undertake any process identified with franchisor...”*, and as such, the royalty received by the Appellant is consideration for use of the McDonald's system, and not for transfer of the right to use any goods; exclusively or otherwise. Relying on *BSNL v. Union of India (supra)* McDonald's contended that there can be no overlapping of service tax and sales tax/VAT levy. Counsel also highlighted the basic attributes that constitute the transfer of the right to use goods. In the concurring decision of *Dr. A.R. Lakshmanan, J (in BSNL)* it was held as follows:

“96. 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 licenses required therefore 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.”

Thus, it was contended how the franchise agreement only permits the use of “McDonald’s system” but there is no transfer of any right to use the trade mark.

17. Likewise, learned counsel highlighted the decision of *Malabar Gold Private Ltd. v. CTO* (2013) 63 VST 496 wherein the Kerala High Court in consideration of nature of the franchise, as well as the scope of the expression “transfer of right to use goods” and the scope of Article 366(29A), Entry 54 of List II, concluded that the tests laid down in *BSNL* (*supra*) were squarely applicable, and that there were no goods which were

deliverable at any stage and there was no transfer of right to use any trade mark. It was thus, contended that the levy of sales tax/VAT was without jurisdiction and contrary to the relevant statutory provisions.

18. A further reference was made to *Subway Systems India Pvt. Ltd and Ors v. State of Maharashtra and Ors* 2016 (95) VST 499 (Bom) of the Bombay High Court, where the petitioner was engaged in establishing and operating franchise sandwich shops in India under the brand name “Subway”, and the Maharashtra VAT authorities demanded VAT on the amount of franchise fees and royalty received from the franchisees for use of trade mark. The Bombay High Court allowed the Writ Petition filed by Subway and held as follows:-

“(i) "The agreement between Subway and its franchisees is not a sale, but is in fact a bare permission to use and therefore subject only to service tax. [Page No.80]

(iii) In Subway's case, there are set terms provided by the agreement which have to be followed. A breach of these would result in termination of the agreement. We believe there is no passage of any kind of control or exclusivity to the franchisees. In fact, this agreement is a classic example of permissive use. [Page No.80 &81]

(v) "The mere inclusion of "franchises" under the MVAT Act would not automatically make all franchise agreements liable to sales tax.

Also, if a franchise agreement is effectively nothing more than a mere permissive use, it cannot be made liable to VAT". [Page No.84]

(vi) "What must be looked at is the real nature of the transaction and the actual intention of the parties. The agreement should be considered holistically and effect must

be given to the contracting parties' intentions. The label or description of the document is irrelevant. [Page No.84]"

19. It was highlighted by the counsel for the appellant as such the nature of transaction merely relates to provisions of certain specific services under the franchise agreement and the permission to use the trade mark is only incidental to those services; and under no circumstances is there any transfer of right to use the trade mark. The franchise agreement is a composite contract, wherein, the trade mark and other services like knowhow, recipe, training, trade secrets, policies, etc. are provided to the franchisee. But, there are no goods, and no transfer of property. Thus, the provisions of Article 366(29A) and the corresponding definition of “goods” and “sale” in the MVAT Act are not applicable at all. Concurrently, in the present appeal, the object of the franchise agreement between McDonald’s and its franchisee(s) is to operate a comprehensive restaurant system (consisting of manuals, instructions etc., to run McDonald’s’ restaurants) at the location(s) specified in the agreement. The agreement is not even remotely connected with sale or “deemed sale” of goods and the ownership in the McDonald’s trade mark, logo, service marks, and brand name is solely vested in McDonald’s Corporation, U.S and is never transferred. This is clearly manifested in the various clauses of the franchise agreement.

20. It was argued that levy of VAT in the present case is impermissible. The counsel for appellants relied on the judgment reported as *Godfrey Phillips Ltd. v. Union of India* (2005) 2 SCC 515 to argue that the Constitution does not permit overlapping of taxes as held. Once an activity is taxable as a service, it cannot be taxed as sale/deemed sale of goods. As there is no “transfer of right to use of goods”, or indeed any transfer at all,

Article 366(29A) is not applicable. There is no “deemed sale” and no levy under the Delhi VAT is permissible. Counsel also relied on *Imagic Creative (P) Ltd. v. Commissioner of Commercial Taxes & Others* (2008) 2 SCC 614 and *BSNL (supra)*. In this context, it was pointed out that the sales tax and service tax are mutually exclusive levies and the same consideration cannot be subjected to both levies, in the instant case, there being only one taxable event, viz., provision of franchise service as arising from the franchise agreement.

21. Even in a composite contract, the dominant nature test has to be applied as held by *BSNL (supra)* in the context of “deemed sale” as are made taxable by the legal fiction created by the 46th Amendment. When the Finance Act, 1994 (as amended) excludes sale of goods/deemed sale from the purview of service tax, it is equally necessary that Delhi VAT is not interpreted so as to levy VAT on a pure service.

22. It was similarly contended by the Petitioners, how the franchise agreements entered into by them were devoid of any provision of transferring the exclusive right to use the goods to the respective franchisees, (this, apart from the fact that what was being transferred was more than just the trade mark, and constituted composite services; thereby not falling within the definition of “goods”) and thus, how the applicability of VAT under the Delhi Sales Tax Act, and the DSTRUG Act, 2002 would be incorrect. Mr. Datar, learned senior counsel lastly relied on Section 48 of the Trade and Merchandise Marks Act, 1958 (“the Trade Marks Act” hereafter) and argued that use of the mark by a permitted user is not considered to be grant of any property right and in fact, such use inures to the benefit of the Intellectual

Property proprietor. Therefore, the use by licensee or franchisee cannot be considered as a transfer in law, because the property and all incidents in relation to it, always belong and vest with the trade mark owner.

23. Counsel for the revenue, Mr. Sanjoy Ghose and Mr. Satyakam, rely on *Tata Consultancy Services v. State of Andhra Pradesh* AIR 2005 SC 371 for the proposition that incorporeal rights can also be considered as goods for the purpose of sales tax or VAT levy. Therefore, the revenue's position is that there can be no exemption for these levies merely because the agreement involves incorporeal rights. The revenue disputes the assessee's arguments regarding exclusivity and submit that it is irrelevant that the appellant or the petitioners can enter into several such agreements by giving franchises to multiple users. There is no such exception carved out in law, especially when the subject is a bundle of rights.

24. Learned counsel points out that in *Subway Systems* (supra) the Bombay High Court had not completely agreed with the assessee, but in one of the cases, held in favour of the revenue. The following passage of the judgment was cited:

"We do not think that in BSNL the Supreme Court intended to prescribe a test of global or universal application without regard to individual circumstances. The judgment of the Supreme Court (in paragraph 90) notes the factual aspects. There, the entire infrastructure, instruments, appliances and exchange remained in the physical control and possession of the petitioner at all times and there was neither any physical transfer of such goods nor any transfer of the right to use such equipment or apparatuses. One of the issues that arose for consideration was whether there was any transfer of the right to use goods by providing access or a telephone connection by

the telephone service provider to a subscriber. This BSNL test, was, therefore, set out in these circumstances. The Court had no occasion to consider its applicability to intangible property like intellectual property. This is how BSNL has been interpreted by us in Tata Sons. We think that this interpretation is correct. In any case, it binds us. The Kerala High Court in Malabar Gold, in paragraph 35, took a contrary view. It took the BSNL twin test to be applicable as a general proposition, i.e., one that admits of no variance. As discussed above, we do not think this can ever be a correct reading of BSNL.”

It is argued that *BSNL (supra)* itself made exceptions as to what did not constitute sale.

25. Mr. Ghose argued that the permission to use the Mc Donalds’ system under the Master License Agreement (MLA) between the franchisee and the proprietor is nothing but a transfer of the right to use the goods. Emphasizing that the intangible nature of the property should not cloud the court’s consideration of what was permitted, counsel submitted that as franchisee, the entity became entitled to claim that the goods sold by it, i.e eatables and snacks were from the McDonald’s world. The representational nature of the arrangement, whereby the franchisee’s existence depended upon its marketing the mark, through the permission granted under the MLA is the real nature of the transaction with the owner of the mark.

26. It was argued that the material conditions in the MLA are clauses A-D and 8-9. The revenue highlighted that what is the basis of these conditions, in essence or as was observed by the tribunal “in pith and substance” was the trade mark “McDonalds” or “McDonalds’ hamburger”. Those other services such as the standards for use, the supply of instructions and manuals, etc. were incidental to the use of the mark. Furthermore, that the trade mark

owner retained the right to terminate the arrangement, did not in any manner deflect from the nature of the transaction, which was to grant a reasonably stable right to use of the goods (i.e the marks) for a finite point of time. As long as such right was not fleeting, but real and lasting in time, it did amount to a “transfer”.

27. Learned counsel elaborated the arguments, by relying on the revenue model. It was submitted that the percentage of gross turnover or receipt as the basis of royalty showed that the licensor trade mark owner, really intended that the proportion of the value of the mark was to be the basis for calculating its royalty (or franchise fee/license) in relation to the entire turnover. The observations of the tribunal in this regard, which were commended for consideration and endorsement of this court, are as follows:

“the service that the appellant is providing to the franchisee is with a view to get the gross sales of the franchisee augmented so that it may get more royalty which means that the provision of sales under the MLA is designed in a manner to ensure continual enhancement of sales of the franchisee meaning thereby that provisions incorporated in the MLA are just for the purpose of the gross sales enhanced. In our considered view provision of service under the MLA is incidental to the main activity of transfer of the right to use the trade mark “McDonald”.”

28. Learned counsel relied on Section 2(1)(v) of the Trade and Merchandise Marks Act, to say that the purpose of a trade mark is its use 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. It was submitted, in this context that

the term “sale” is widely phrased, in relation to the “right to use” goods, so as to be capable of assimilating franchise agreements as in the present case.

29. Counsel relied on the judgment of the Bombay High Court reported as *Commissioner of Sales Tax v Duke and Sons P. Ltd* 1999 (112) STC 320, where it was held that:

*“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.”

30. The definition of “goods” in Section 2(1)(m)(ii) of the DVAT Act was relied by counsel for the revenue, who said that it included “*property in goods (whether as goods or in some other form)*” as the incident of taxation, was relied upon together with the expression “sale” in Section 2 (zc) of the said Act, which *inter alia*, expansively states that the term (i.e. “sale”) includes “(vi) *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;*” As there is elasticity to the *form* (i.e tangibility) of the subject matter (property) as well as to the term (“*whether or not for a specified period*”) the grant of a right to use the mark, as part of an arrangement, cannot but be a transfer of the right to use it. In this regard, particular emphasis was placed on the franchise agreement in respect of Bikanerwala, which stated in one of the recital that the franchisee could, at the “*FRANCHISER's sole and absolute discretion utilize its trade marks, Trade name / artistic works (hereinafter collectively referred to as "Rights")*”. It was argued that such recitals and conditions clearly established that the purpose of the arrangement (which might have included other matters) clearly contemplated the use of the mark, albeit for a limited time, for the benefit of the franchisee, for which consideration was payable on agreed terms. This was nothing but a transfer of the right to use the goods.

31. It was argued that in the case of GSK the arrangement is a trade mark licensing agreement. Though the agreement contained restrictive conditions

with reference to trade mark use, within the scope of the permission, what the trade mark proprietor permitted was undoubtedly a transfer, sufficient to attract liability to VAT levy. Just like in the case of McDonald's, under the terms of this agreement, GSK CH was to pay GSK AP (the licensor/owner) a royalty of 5% of the net sales value of the specific products on which the Trade Mark was to be applied. The use of the term "non-exclusive" in this case, too, only indicates that the agreement does not intend to exclude others. But, to the extent the trade mark was transferred to the petitioner, there was transfer of the right to use intangible goods i. e., the trade mark. To the extent it was transferred, there was no restriction on its use.

32. Mr. Ghose also argued that in *BSNL (supra)*, the Supreme Court had visualized the eventuality where there could conceivably be an overlap of a taxation incident by speaking about the "aspect" principle (of a legislative head) and for this purpose, relied on the observation that " *..the same transaction may involve two or more taxable events in its different aspects. But the fact that there is overlapping does not detract from the distinctiveness of the aspects.*" It was, therefore, urged that no one denies the legislative competence of States to levy sales-tax on sales provided that the necessary concomitant of a sale are present in the transaction and the sale is distinctively discernable in the transaction. It was thus urged that the fact that the licensor/owners also paid service tax, did not preclude the court's analysis or a conclusion with respect to DVAT incident and levy.

Analysis and Findings:

33. To analyse the soundness of the rival contentions and examine if consideration received under the franchise agreements was for transfer of right to use the goods, i.e., the trade mark, under the DSTRTUG Act, 2002 and under the Delhi Value Added Tax Act, 2004, the court needs to first examine what is intended to be transferred in the franchise and trade mark licensing agreements.

34. From a plain reading of the MLA, in (in the McDonald's cases) it is apparent that the arrangement is a composite contract wherein, the trade mark and other services like knowhow, recipe, training, trade secrets, policies, etc. are provided to the franchisee. The object of the franchise agreement between McDonald's and its franchisee(s) is to operate a comprehensive restaurant system (consisting of manuals, instructions etc., to run McDonald's' restaurants) at the locations specified in the agreement, albeit, without an exclusive transfer of right to use the same. Similarly, the agreements signed by the Petitioners (Sagar Ratna, Bikanerwala in whose cases the arrangement is a franchise contract) give the respective franchisees limited rights to operate services within the agreement, and are non-exclusive in nature; the franchisors remaining entitled to transfer rights to any third party to use their trade mark. In the case of GSK, the foreign, trade mark owner permitted use of the trade mark, subject to strict conditions with respect to the production and sale of the articles in question.

35. The fundamental premise behind enlargement of the definition of the term "sale" under Article 366 (29A) of the Constitution of India is the introduction of transactions which, although, do not qualify the definition of the term "sale" but would still be deemed to be considered as "sale" under

the enlarged definition for the taxability purposes. Hence, it was submitted that deeming fiction which introduces the concept of “deemed” or “mutant” sales needs to be interpreted in a strict manner and the scope of such deeming fiction should only be to the extent of what is actually envisaged/intended by introduction of “deemed sales”. Article 366 (29A)(d) of the Constitution reads as follows:

“(29A) tax on the sale or purchase of goods includes

(a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;

(b) a tax on the transfer of property in goods (whether as goods or in some other form) invoked in the execution of a works contract;

(c) a tax on the delivery of goods on hire purchase or any system of payment by instalments;

(d) a tax on the 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;”

Thus, for a tax to be levied on the sale or purchase of goods, there has to be a transfer of the right to use the goods; what thus needs to be assessed is whether the franchise agreements give rise to such a transfer of the right to use the goods; in addition to adjudging whether the nature of the content of the franchise agreements (for instance, that which comprises the “McDonald’s system”) is one of goods or services.³⁶ Firstly, the franchise agreement needs to be read in its entirety to understand the intention of the contract, it would be incorrect to cull out only a section of the agreement to make it leviable to VAT. The franchise agreement

evidently intends to make a non-exclusive transfer of the composite system of services that is not limited to the trade mark, but is inclusive of a bunch of services, and hence, cannot be treated as goods and be subject to VAT. By virtue of this observation alone, the levy under the DVAT is incorrect. In *Commissioner VAT, Trade and Taxes Department v. International Travel House Ltd.* [2009] (25) VST 653, a Division Bench of this court held that composite contracts cannot be split up by taking from it the value of the goods for the purposes of taxing the same under DVAT Act. The relevant part of the judgement reads as follows:

*“1. The conclusion, therefore, which emerges with respect to the facts of the present case on applying the ratio of the BSNL's case is that, since the contract in question is a composite contract of sale of goods and services, clearly, it is not permissible for the State Legislature by applying DVAT Act to tax composite contracts comprising of both goods and services. Not only the contracts cannot be artificially split up so as to enable the sale element to be taxed, further, the States cannot treat the contract as only a contract of sale of goods and tax the whole value of the transaction as a sale of goods. Since the parties have not intended the contract to be mutilated/severable inasmuch as no different values are specified in the subject contract towards goods value separately and the value of services separately, it is not permissible by the DVAT Act to impose sales tax on the whole transaction value because that would amount to the State to entrench upon the Union List and tax services by including the cost of such services in the value of the goods. Thus, the contract in question being a composite contract is to be treated as a contract for services and no sales tax can be imposed on the contracts in question. It has also been held by the Constitution Bench of the Supreme Court in its judgment reported as *Godfrey Phillips India Ltd. and Anr. v. State of U.P. and Ors.* (2005) 2 SCC 515 that taxing entries must be*

*construed with clarity and precision so as to maintain exclusivity and a construction of a taxation entry which may lead to overlapping must be eschewed. Reference in that case was also made to the judgment in Kesoram Industries Ltd.'s case that in our Constitution a conflict of the taxing power of the Union and States cannot arise. Since the contract in question is taxed as services by the Central Government defining the same as services under the Finance Act, 1994, we would have to thus eschew an interpretation which will lead to overlapping in the taxation entries otherwise the same transaction will be taxed both as services as also goods. **To avoid that overlapping, and more particularly in view of the legislative history behind the provision of Article 366(29A) it becomes clear that a composite contract of both services and goods should be treated as a contract of services assessable to tax under the Finance Act, 1994 as the same has been defined and included therein.** Our aforesaid discussion negates therefore the two pleas of the senior counsel for the appellant on the basis of the judgments reported as *State of West Bengal v. Kesoram Industries Ltd. and Ors.* (2004) 10 SCC 201 and *Ralla Ram v. Province of East Punjab* AIR 1949 FC 81, that the measure of taxation being the whole value of the contract cannot mean that the tax is still not a tax on goods and that subject matter of the taxation being the goods, DVAT Act can impose tax on composite contracts on the entire value of the transaction.”*

37. McDonald’s and the petitioners (Sagar Ratna, and Bikanerwala) are solely engaged in providing franchise services to its franchisees and the same would thus not be liable to VAT under the provisions of the DVAT Act, as the franchise service is expressly a taxable service and cannot be treated as goods. From a perusal of the facts of the cases, as well as the provisions of the franchise agreements, it can be concluded that what was intended to be transferred was not the trade mark, but an entire gamut of services, which includes, *inter alia*, a guide that educates the franchisees on

various aspects of business and conduct to market the business. To segregate the terms of the agreement to levy VAT on only specific aspects of it would be inexact. Moreover, the Appellant and the Petitioners are already paying service tax levied on the franchise agreements, and there can be no overlapping of taxes. The subject matters in List I and List II of the Seventh Schedule to the Constitution are distinct and once a particular service is subject to service tax, it cannot be treated as a sale of goods and subject to VAT. Thus, the definition of “intellectual property” and levy of sales tax on transfer of right to use trade marks, patents and copyrights etc. will not apply in the case of a franchise agreement. This was highlighted in paragraphs 88 and 89 of *BSNL (supra)*.

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 DSTRUG 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.”

39. In the Franchise agreement, which involves, Sagar Ratna, the following conditions are relevant:

“2.2 In consideration of regular payment of 15.00% (Fifteen Percent) of total turnover of the Restaurant & Banquet Hall from sale of foods and services and in further consideration of the observance and performance of the undertakings on the part of the Franchisee, the Franchiser grants to the Franchisee the right to establish and operate the South and North Indian vegetarian specialty restaurant at the location for the term as aforementioned.

3.6 NOT TO TAMPER WITH FOOD ITEMS AND THEIR PREPARATIONS

The Franchisee undertakes not to tamper with the process of preparation of food items and their recipes and strictly adhere to the process and knowledge provided by the Franchiser. The Franchisee shall- not be entitled to change the menu, the name of food items, and their recipes. In case of any food items supplied to the Franchisee in packaged form the Franchisee undertakes not to temper with such packed food items except putting such notices as are required by the packaging laws prevalent in the state and shall inform the Franchiser of any such laws and the alterations made for the compliance thereto.

3.7 MAXIMUM PRICES

The Franchisee undertakes not to charge customers prices in excess of the prices specified by the Franchiser in writing from

time to time

3.18 ASSIGNMENT

It is agreed that this agreement is non- assignable, transferable and no right direct or indirect in favour of any other party can be created without written consent of the Franchiser. The Franchiser shall have absolute discretion either to accept with such terms and conditions as may be deemed fit, or refuse the same. The Franchisee undertakes not to assign, charge or otherwise deal with the right granted to the Franchisee under this agreement and arrangement in any way without the prior written consent of the Franchiser. The restriction herein above will be applicable for takeover of company/firm of the franchisee, amalgamation and merger or any other process of law by which status of ownership or constitution of the Franchisee organization will amount to change.

3.18.2 The Franchisee shall not be entitled to grant any sub-franchise or enter into any arrangement with any other person, firm or company, with a view to creating/delegating the rights and duties of the Franchisee granted under this agreement. In the event of there being any breach of this term by the Franchisee this agreement shall automatically stand cancelled but subject to the discretion of the Franchiser either to condone such breach or to treat this agreement as cancelled and right to recover damages from the franchisee in accordance with the damage clause contained in this agreement without prejudice to his right to take such other actions as permissible under law.

5. OWNERSHIP OF INTELLECTUAL PROPERTY RIGHTS

5.1 The Franchisee acknowledges and recognises the exclusive right of the Franchiser to the Intellectual Property rights including without limitation Trademarks as well as the insignia,

logo, holograms, designs and other Intellectual Property-Rights associated with the Franchiser.

5.2 The Franchisee will observe the following requirements in the use of the Trademarks:

(i) Use them in a proper trademark sense in the manner as prescribed by the Franchiser from time to time;

(ii) Not encumber, sub-license, assign, transfer or otherwise deal with the Trademark;

(iii) Under no circumstances on any occasion will the Franchisee register any business, trade or corporate name or style associated with the Franchiser either under the Trademarks Act, Copyright Act, Companies Act, Society Registration Act or any other Act for time being in force or any new Act that may be put into force provided that in case of requirement of any law for registration of any business, trade or corporate name or style, such registration shall be done with the written consent of the Franchiser, which registration shall be withdrawn or revoked after expiry of the term of this agreement.

5.3 The Franchisee shall forthwith notify the Franchiser of any infringement of such Intellectual Property Rights of which the Franchiser becomes aware provided' however that the prosecution of any claim with respect to any Intellectual Property Rights shall be the sole responsibility and undertaken at the absolute discretion of the Franchiser.

5.4 The franchisee undertakes that notwithstanding anything contain contrary to in this agreement, after the termination of this agreement the franchisee shall not use the trademark SAGAR RATNA or any other deceptively similar trademark at any time thereafter in respect of any restaurant or allied business including food items.”

40. Likewise, in Bikanerwala’s case, the franchise agreement relied on, states, *inter alia* that:

“9. Protection of Rights of FRANCHISER:

...

(b) The FRANCHISEE acknowledges and agrees that all rights in and to the trade names/artistic works “BIKANO” & “BIKANERVALA” including all of the goodwill of the business associated therewith, are and shall hereafter continue to be the exclusive property of the FRANCHISER, and that for all use of the said trade names/artistic works by the FRANCHISER, the FRANCHISEE, acknowledges and agrees that it does not have and shall not hereafter claim acquire or assert any ownership.

(c) The FRANCHISEE shall execute, acknowledge and deliver all documents and do all things which may be requested by the FRANCHISER to assist the FRANCHISER to establish, maintain and safeguard all rights or ownership in and to the said trade names/artistic works, both during the term of this Agreement and after the expiration or termination thereof.

(d) The FRANCHISEE shall not, either during the term of this Agreement or after the expiration or termination thereof for any reason object to, or interfere in any way with the ownership, registration or use of the trade names “BIKANO” & “BIKANERVALA” by the FRANCHISER or its other FRANCHISEEs, as a trade name or for any other purpose whatsoever, either in India or in any other country or region of the world.

...

INFRINGEMENTS

The FRANCHISEE shall not be entitled to be given any notice of infringement and/or Passing Off or take any other legal remedy relating to the infringement/passing off by others in respect of the trade names “BIKANO” & “BIKANERVALA” or any other trade names/artistic works, or other industrial property rights of the FRANCHISER without obtaining the prior written authorization of the

FRANCHISER in respect of the same.

...

12. Rights and Obligations of the parties Upon Expiration or Earlier Termination of this Agreement.

a) Upon the date this Agreement terminates, whether through expiration or earlier cancellation FRANCHISEE shall:

(i) not use trade names, symbols, recipes of the FRANCHISER which shall always remain the exclusive property of FRANCHISER;

...

16. Assignment

a) FRANCHISER shall be entitled to assign all or part of its rights and obligations under this Agreement to any other subsidiary or sister concern of FRANCHISER or its directors without the consent of FRANCHISEE.

b) FRANCHISEE shall be entitled to assign its rights and obligations under this Agreement only with the prior written consent of FRANCHISER.

21. Miscellaneous

(a) This Franchise Agreement between FRANCHISEE and FRANCHISER is on nonexclusive basis in the sense that FRANCHISER shall be free to enter into franchise or any other arrangement with any party anywhere on similar or any other terms."

...

41. In the case of GSK, the following conditions contained in the Trade mark licensing agreement with the foreign company/proprietor were relied upon:

“LICENSOR hereby grants to LICENSEE a non exclusive rights to use and/or authorise the use of the Trade Marks by such parties as LICENSOR may approve upon or in relation to the Contract Products for sale in India, Nepal and Bhutan (and in such other countries as may be agreed upon in writing between the parties from time to time) subject to the further terms of this Agreement.

2 LICENSEE shall use and/or authorise the use of the Trade Marks upon or in relation only to the Contract Products manufactured and packed in strict accordance with the Quality standards, specifications (including standards and specifications as to quality control, method of processing, packaging) and directions of LICENSOR. The Trade Marks shall not be used upon or in relation to any goods other than the Contract Products.

3 LICENSEE shall not use and/or authorise the use of the Trade Marks or any of them in close proximity or in conjunction with any other trade mark or trade name, whether owned by LICENSEE or any other third party. The manner in which the Trade Marks or any of them may be used upon or in relation to the Contract Products and on labels, packaging, printed or other material or wheresoever, shall be approved in writing by LICENSOR.

4 LICENSEE shall, when using and/or authorising the use of the Trade Marks upon or in relation to the Contract Products, indicate clearly that LICENSOR is the owner of the Trade Marks and that the Trade Marks are being used are being used only by way of permitted use.

5(a) LICENSEE shall, at all time, during the continuance of this Agreement, permit or cause to permit the authorised representative of LICENSOR to enter any part or parts of any factory or premises where manufacturing, processing labelling or packaging of the Contract Products is carried on for the purpose of inspecting the Contract Products and/or the method of manufacturing, processing, labelling or packaging thereof. On request by LICENSOR, LICENSEE agrees to supply

LICENSOR samples of the Contract Products processed and/or offered for sale in accordance with this Agreement.”

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.”

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 good; it also possesses the right to advertise the goods and brands of the manufacturer. This implies a license 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.

44. For a transaction to constitute a transfer of the right to use goods, there should mandatorily be a transfer of the exclusive right to use the goods being transferred. This was also highlighted in the dominant nature test as laid down in *BSNL (supra)* as follows:

“96. 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 licenses required therefore 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.”

It was similarly held in 20th Century Finance Corporation Ltd. v. State of Maharashtra (2000) 119 STC 182 that a right to use goods accrues only on transfer of right. The Supreme Court in this case held that the taxable event under Article 366(29A)(d) of the Constitution was the transfer of the right to use goods, and a distinction was set out between a transfer of a right to use goods and a mere permissive use of goods. Paragraphs 26 and 27 of the judgment read:

“26. Next question that arises for consideration is, where is the taxable event on the transfer of the right to use any goods. Article 366(29A)(d) empowers the State legislature to enact law imposing sales tax on the transfer of the right to use goods. The various sub-clauses of Clause (29A) of Article 366 permit the imposition of tax thus: Sub-clause (a) on transfer of property in goods; Sub-clause (b) on transfer of property in goods; Sub-clause (c) on delivery of goods; Sub-clause (d) on transfer of the right to use goods; Sub-clause (e) on supply of goods; and Sub-clause (f) on supply of services. The words “and such transfer, delivery or supply...” in the latter portion of Clause (29A), therefore, refer to the words transfer, delivery and supply, as applicable, used in the various sub-clauses. Thus, the transfer of goods will be a deemed sale in the cases of sub-clauses (a) and (b), the delivery of goods will be a deemed sale in case of Subclause (c), the supply of goods and services respectively will be deemed sales in the cases of sub-clauses (e) and (f) and the transfer of the right to use any goods will be a deemed sale in the case of Sub-clause (d). Clause (29A) cannot, in our view, be read as implying that the tax under Sub-clause (d) is to be imposed not on the transfer of the right to use goods but on the delivery of the goods for use. Nor, in our view, can a transfer of the right to use goods in Subclause (d) of Clause (29A) be equated with the third sort of bailment referred to in

"Bailment" by Palmer, 1979 edition, page 88. The third sort referred to there is when goods are left with the bailee to be used by him for hire, which implies the transfer of the goods to the bailee. In the case of Sub-clause (d), the goods are not required to be left with the transferee. All that is required is that there is a transfer of the right to use the goods. In our view, therefore, on a plain construction of Sub-clause (d) of Clause (29A), the taxable event is the transfer of the right to use the goods regardless of when or whether the goods are delivered for use. What is required is that the goods should be in existence so that they may be used. And further contract in respect thereof is also required to be executed. Given that, the locus of the deemed sale is the place where the right to use the goods is transferred. Where the goods are when the right to use them is transferred is of no relevance to the locus of the deemed sale. Also of no relevance to the deemed sale is where the goods are delivered for use pursuant to the transfer of the right to use them, though it may be that in the case of an oral or implied transfer of the right to use goods, it is effected by the delivery of the goods.

27. Article 366(29A)(d) further shows that levy of tax is not on use of goods but on the transfer of the right to use goods. The right to use goods accrues only on account of the transfer of right. In other words, right to use arises only on the transfer of such a right and unless there is transfer of right, the right to use does not arise. Therefore, it is the transfer which is sine qua non for the right to use any goods."

45. Likewise, the Supreme Court in *State of Andhra Pradesh and Anr. v. Rashtriya Ispat Nigam Ltd.*[2002] 126 STC 114(SC) upheld the Andhra Pradesh High Court's decision that the essence of transfer is *passage of control over the economic benefits of property which results in terminating rights and other relations in one entity and creating them in another*. A similar decision was made in *Malabar Gold Private Ltd. v CTO* (2013) 63 VST 496, where a Division Bench of the Kerala High Court considered the

nature of the franchise agreement as well as the scope of the expression “*transfer of right to use the goods...*”. The High Court concluded that the tests laid down in the *BSNL (supra)* case were squarely applicable, that there were no goods which were deliverable at any stage and there was no transfer of right to use any trade mark.

46. 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 license 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.

47. The peculiarity of intangibles or incorporeal property, of the kind this court has to deal with, i.e. intellectual property, is that unlike real property, its boundaries are unset. These rights are only real and effective to the extent they enable the owner or transferee to “keep out” from use those who are not permitted to do so. In other words, the nature of intellectual property and the remedies provided for their enforcement, hinge upon the *right to exclude* others from using it. The distinctiveness of a mark, earned through dint of

continuous use and brand building, results in the trade mark which is classically known as “a badge of origin” that assures the user of the products the constancy of the quality associated with it. Only ensuring that others who do not own it are prevented from using or appropriating it ensures its enforcement. In the case of the franchise agreements involved in the present case, none of the franchisees or in the case of the trade mark licensee (or in GSK’s petition the trade mark licensee), are empowered to safeguard violation of the mark, through enforcement mechanisms, such as filing suits for injunction or damages. This underlines that the most important attribute of ownership or transfer (even in the most evanescent sense) is absent. Furthermore, by reason of Section 48 of the Trade Marks Act, the utilization of the mark by the franchisee/licensee would accrue to the trade mark owner. Therefore, the reputation or brand building which accrues on account of increased volume of business because of the franchise/licensing arrangement, continues to be with the owner. No brand building or brand benefit accrues or arises to the franchisee/licensee.

48. From the above analysis, what irrefutably follows is that the franchise agreements in the three cases (and trade mark licensing agreement in GSK’s petition) permit a limited right to use the composite system of the respective businesses of the Appellant and the Petitioners to the franchisors/licensee, *and the dominant intention, as well as the specific provisions arising from the franchise agreements are not of a transfer of the right to use goods.*

49. In view of the above discussion, it is held that the Tribunal erred in holding that consideration received under the franchise agreement (in McDonald’s case) was for transfer of right to use the goods, i.e., the trade

mark, under the Delhi Sales Tax on Right to use Goods Act, 2002 and under the Delhi Value Added Tax Act, 2004; its findings are set aside. For the same reasons, it is held that the franchise agreements in the case of Bikanerwala and Sagar Ratna are not subject to DVAT levy; in the case of GSK, it is held that the trade mark licensing agreement cannot result in fastening DVAT liability upon such transaction. The assessment orders and notices impugned in all the cases, and the orders of the DVAT Tribunal are hereby quashed. The appeals and writ petitions are, therefore, allowed in these terms. There shall be no order on costs.

S. RAVINDRA BHAT
(JUDGE)

DEEPA SHARMA
(JUDGE)

MAY 17, 2017