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Critical Analysis on Tax Liability of Intellectual Property in Cross-Border Transactions

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The levy and collection of taxes are unhindered problems in domestic and cross-border transactions. Intellectual property taxation presents numerous challenges for tax authorities, particularly issues related to determining taxing jurisdiction, fixing transfer prices, and ensuring compliance with double taxation avoidance agreements. Multinational companies have access to loopholes in the fixation and valuation of intellectual property related to transfer pricing. As stipulated under the Income Tax Act of 1961, the Arm's length principle is used as a principle to value goods and services during transactions held between associated enterprises. Generally, goods and services are valued with some traditional arm's length principle. However, such methods may not be suitable for valuing intellectual property. The main research question this study addresses is: How effectively can the Arm's length principle be applied to the valuation of intellectual property for tax purposes in cross-border transactions? This research aims to analyze the application of the Arm's length principle on intellectual property valuation. Multinational companies appoint tax experts to reduce tax payments and undervalue intellectual property. Such activities may not amount to tax evasion. Still, it causes revenue losses to the source and residence countries. These issues are prevented by applying the best valuation methods, as practised by both developed and developing countries. The Organization for Economic Cooperation and Development has issued guidelines on intellectual property valuation. This paper concludes by highlighting gaps and inconsistencies in current tax legislation and practices. The purpose of this research is to identify the gaps in domestic and international laws and suggest effective measures to address them.

Keywords: Intellectual Property, Valuation, Arm's Length Principles, Transfer Pricing, Method

The wheels of Government can run with the help of revenue collected from the general public. Tax is one of the significant sources of revenue for the Government. There are various sources of revenue collected through the following methods: fees, Fines, Penalties, gifts, grants, taxes, and license fees. It is essential to remember that tax collection is a delicate process. The Government and authorities must collect taxes from taxpayers without causing them harm. Such pinching should not cause more pain to the Taxpayer. Otherwise, taxpayers will not pay tax regularly. It causes negative effects on Government revenue.

The methods of levy and collection of tax policy are not new. The way of tax collection was used by the King who ruled India. Especially evident in ancient documents such as the Arthasastra and Manu Smriti. These manuscripts express the various aspects followed in ancient days, such as levy and collection of tax, diplomatic relations, and sharing of profit with the King. In ancient days, the King was the sole authority to rule their territory with the help of the ministers and Zamindars, etc.[1]

Initially, the King acted as a shield to protect their people from external persons. The King's system was abolished. Nowadays, the role of the King is held by the State or Government. The concept of a protector state changed into a welfare state. The state prioritizes the people's welfare and protection through three major forces: the Army, the Air Force, and the Navy. The welfare state constrains the people's welfare measures in society. The revenue collected is used solely for the creation and improvement of their people's welfare. Tax is divided into two types: direct Tax and indirect Tax. These tax types are divided based on the nature of taxpayers, methods of tax payments, etc.. Generally, tax is collected on the tax base only. According to the Cambridge Dictionary, the tax base means the total value of all the income, property, etc., on which tax is charged.[2] The Direct tax base is much less compared with the indirect tax base. However, the indirect tax base comprises a vast number of consumers who are also taxpayers. These two taxes accumulated more revenue for the Government. The Government replaced the King. As per the Indian Constitution, "No tax shall be levied or collected

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except by authority of law."[3] The authority of law can levy and collect taxes. The term of authority of law consists of the State governments, the Central Government, and the Local authorities. The authorities mentioned above have exclusive power over tax collection. The quantum of tax is fixed based on income, transaction, property, and consumption. This topic is mainly connected with the tax liability of intellectual property in cross-border transactions. The collection of taxes is the biggest issue in India. Unfortunately, tax collection is an unattended issue in both countries.

The intellectual property-related tax issues are very new to developing countries. There is no proper definition for intellectual property under the Income Tax Act of 1961. Intellectual property is different from general property. However, intellectual property is sourced from the creation of the mind, and legal protection is available to the creator or owner of that property. According to Indian Accounting Standard 38, Intellectual property is defined as an identifiable non-monetary asset without physical substance. The creator or owner of intellectual property has the exclusive right over their work.[4] Salmond clearly defined right as "an interest recognized and protected by a rule of legal justice."[5] These intellectual property rights are confined under the Indian Constitution as, "No person shall be deprived of his property saved by authority of law."[6] The owner of intellectual property has the right to claim their property right. The Supreme Court of India confirmed it.[7] This research wants to focus on the tax liability issues of the levy and collection of tax on intellectual property. This intellectual property may be sold for a lump sum consideration. Otherwise, the owner of intellectual property sells the right to use it to another person for a periodic payment as royalty. These two methods are used to determine the real value and tax liability. The imposition of tax becomes a significant issue in the world. This result will suggest appropriate results.

Domestic Law Tax Liability on Intellectual Property

Intellectual property is not like normal property. The identity of intellectual property is fixed based on uniqueness. The source of intellectual property accumulated from human intellectual, mental labour, the skill of human beings, etc. This intellectual property is available in two different media, such as tangible and intangible. For example, computer languages are protected under the Indian Copyright Act, 1967. Software programs are available in packaged software, such as Compact discs and soft copies available on the internet. Soft copies may be downloaded through the internet with appropriate payments. The intellectual property is liable to pay based on the consideration received from the sale or the transfer. These transactions take place among multinational companies. There is a vast difference between the payment of tax by individuals and companies. Individuals shall pay the tax based on their total income, including all expenses. However, Companies have the right to pay tax after deducting all reasonable costs and depreciation. Therefore, multinational companies will not report their actual profits to the income tax department and will show zero profits. Every MNC might have appointed one tax expert. Tax experts are appointed to identify loopholes in taxation and guide the MNC in escaping tax liability. Such tax escapements do not involve illegal activities or evade tax payment. This legal evasion is called tax planning.

Generally, tax is stated as a compulsory payment collected from the people. The absence of discrimination is considered reasonable taxation and applied with reasonable exceptions. The intellectual property may be owned by any person mentioned under the Income Tax Act of 1961.[8] The author or creator of intellectual property has the right to use the deduction and exemptions clause mentioned in our domestic legislation. The creator has exclusive rights over his intellectual property. Ownership is a bunch of rights; it consists of the right to sell, use, and alienate. These rights may be sold either individually or wholly. The creator will assume liability for intellectual property based on the mode of transactions he conducts. These transactions are divided into two types: permanent transfers and temporary transfers. Permanent transfer indicates that the creator may transfer the whole intangible rights to the buyer and get a lump-sum consideration. Temporary transfer means the creator may transfer the right to use to the buyer and charge a royalty. Usually, such a transfer will not be a permanent one. Royalty considerations paid by present or arising in the future are deemed to accrue. The future royalty payment is subject to liability to pay tax under the Income Tax Act, 1961.[9] This deemed income is liable to pay tax based on transactions at the customs frontier or cross-border transactions.

The Income Tax Act, 1961, clearly explains that the Assessee shall pay based on their residential status. At the same time, the Assessee has the right to pay tax after deducting the deduction. The Assessee's residential status is taken into consideration to fix tax liability.[10] The Indian residentshall have the liability to pay tax for income received or accrued inside and outside India. Any non-resident who received any royalty from the source country, such as India. Taxpayers are supposed to calculate their income tax liability under section 44DA of the Income Tax, 1961.[11] In the Denso India Ltd. case, the Appellant company engaged in designing works in Indian markets. The Taxpayer has paid the application cost and royalty payment to Denso Japan for creating, customizing, and modifying products. The Taxpayer has paid royalty payments at a rate of 3 per cent for conventional products and technical assistance provided to new products at a rate of 4 per cent. The Appellant company has claimed the application cost is Nil tax under the Arm's length price. The Income Tax Appellate Tribunal decided in favour of the Taxpayer, and the application cost cannot be considered as royalty. Application cost was paid for extra modification plans to Indian vehicles. Finally, taxpayers easily escape from the payment of tax, resulting in a loss of revenue for the Indian Government.[12]

Domestic Tax Deduction of Intellectual Property

According to section 80 QQB of the Income Tax Act, 1961, the creator of intangibles has the right to claim a deduction for royalty payments. But, taxpayers should comply with the following conditions to avail of this deduction:-

(i) Taxpayers may be individuals or companies. An individual taxpayer's liability is fixed based on residential status. The incorporation in India ascertains the company's residential status. Assesses must be residents of India.

(ii) The Taxpayer earned a gross total income from royalty payments.

(iii) Fixed slab rate is. Rs. 3,00,000/-

Those mentioned above are compared, and the smaller amount is considered the deduction limit. Specific individuals may hold intangible rights as authors, composers, photographers, or film producers. Their work shall be published in the relevant financial year to claim the deduction above.[13]

Legal Evasion of Tax on Cross-Border Transactions

The levy and collection of taxes are significant issues worldwide. These issues are raised based on the income accrued or deemed to accrue, or non-deduction claimed as a deduction. Domestic tax issues have an impact on international taxation. Multinational companies are evading taxes by invoking loopholes in taxing statutes. Typically, taxpayers can obtain technical advice from tax experts to avoid liability. In that situation, taxpayers won't use any illegal way to evade tax payment. Legal evasion means the Taxpayer may use the deduction and exemption to shrink their tax liability. The evasion of tax is divided into two types: legal evasion and illegal evasion of tax. Illegal evasion is the opposite of legal evasion, and it consists of various actions, including false loss, hiding the original income, black market, using false documents to claim deductions and exemptions, keeping all wealth outside the country, and intentionally failing to file an income tax return. The activities mentioned above may cause illegal evasion. However, legal evasion can be done with the benefits under domestic and international tax laws. Especially, taxpayers access the deductions and exemptions to reduce their tax burden. Legal evasion is also called tax planning.

The Taxpayer has the right to evade tax through legal means. In a pathbreaking judgment, this case shares similar facts with Maruti Suzuki, specifically regarding brand building for intellectual property. The Indian Sony Ericsson company made an advertisement, marketing, and promotion (AMP) expenditure to a foreign company that owns the proprietor of the registered trademark. The Delhi High Court held that the transfer pricing officer shall apply the appropriate methods to value the trademark and AMP expenditure. The court has rejected the bright-line test, which mechanically compared the sales ratio of the Taxpayer with that of comparable companies. The parent company has primary benefits from the AMP expenditure. For that reason, it shall apportion the AMP expenditure between the subsidiary and the parent company.[14]

Practical Issues on Levy of Tax on Intangibles

The levy and collection of taxes are the two parts of tax collection. The authority can impose the action of levy. Such authority is ensured in the hands of legislators. The term " levy applies to the tax and fine. The second part of the tax is collection done with appropriate legislation.[15] Tax authorities want to levy a

tax on transactions. The taxable transaction must be within the ambit of the tax base. Multinational companies appoint tax experts to evade taxes legally. Generally, tax experts invoke the deduction and exemption as a loophole. Taxing legislation provides the appropriate incentives to taxpayers. In another way, tax liability can be relaxed through the interpretation of taxing statutes or by finding loopholes to escape the liability. According to this topic, multinational companies have played a vital role in the fixation of the price of intellectual property. In particular, intellectual properties are handled by associate enterprises. Associate enterprises refer to one company or enterprise that, directly or indirectly, participates in the management, control, or capital of other companies or enterprises through one or more intermediaries.[16] These transactions occur within the customs frontier and across borders. The loopholes mentioned above may be understood with the following examples. There are three different companies situated in three different territories: Company A, Company B, and Company C. Company A holds 55% of shares in Company B. Due to that, Company A has the right to participate in the decision-making process of Company B. These two companies are called associated enterprises and are interrelated with each other. Company B is researching to find drugs for AIDS. This research may achieve either complete or partial success in its objective. B company invested more money in finding drugs, and the total expenditure of research was Rs. 5 crore. Thereafter, Company B sold its patent or uncompleted research to a third company. This third company has no connection with Company A and Company B. The First sale occurs between Company A and Company B. The Second transaction arises between Company B and the third company. The value of the subsequent transaction is Rs. 50 crore. The second transaction will cause revenue losses to the source country. This consumption country may get more revenue.[17]

Generally, tax is levied based on the price or market value of the product. At least, this intellectual property shall be valued at the expenditure incurred during the research and development. Fixation of price is not easy for intellectual property. The following issues may arise at the time of fixation or valuation of intellectual property.

The primary identity of intellectual property is based on the uniqueness of its creation. Unless an intellectual property is invented with novelty, otherwise, such intellectual property rights do not have recognition under legislation. Intellectual property cannot be compared with similar intellectual property. Every intellectual property has its value and depends upon the nature of the property. Consequently, multinational companies have set the intellectual property value below the market price or its original valuation. As per the Income Tax Act, 1961, the Arm's length principle is applied to fix the price or value of the intellectual property. But, traditional goods and services are valued at Arm's length price. Intellectual property is not valued based on conventional methods.[18]

At the same time, income tax is an unresolved dispute in India. Mainly, there are more issues and problems in the levy and collection of taxes on intellectual property. These issues may be eradicated through the pre-arrangement between multinational companies and income tax departments. The primary purpose of this arrangement is to identify the best method of valuation and fixation of the price of intellectual property among the parties. The income tax department may fix the price of intellectual property and impose the tax. It also protects the source country's revenue.

Intellectual property transactions take place within the territory of India. However, there is involvement of a non-resident as a party to the transaction. This scenario arose in the following case. In the Vodafone Tax case, the Indian Vodafone company has been transferred without the transfer of the company's title. In 2007, the Vodafone company acquired the Hutchison Eassar shares at a cost of around 11 billion dollars.[19] Tax authorities argued that the concern transaction involved the indirect transfer of the Indian company's title. However, this transaction takes place between the two offshore entities with the involvement of the Indian Company. In 2010, the Income Tax Appellate Tribunal passed an order in favour of the Vodafone company and observed that Income Tax legislation does not explicitly charge transactions between the two offshore entities. These transactions take place outside the Indian territory. Thereafter, the Income Tax department approached the Supreme Court. Such a transaction would not be liable under the capital gains taxation under the Income Tax Act, 1961. Subsequently, the Indian Government has made an amendment concerning taxation on indirect transfer under the income deemed to be accrued or arisen inside India. This amendment has been applied retrospectively, and a demand notice

has been issued against the Vodafone company. In 2014, the Indian Government and Vodafone entered into a settlement agreement under which Vodafone paid a reduced tax amount. Thereafter, Vodafone agreed to pay 2 billion dollars. As a result of the agreement, the Indian govt. shall not make future claims on payment of tax.[20]

In a precedent-setting judgement, the appellant company was engaged in software development services for its associated enterprises from foreign territory. Associate enterprises have continuously provided cost-plus services, which do not end with intellectual property ownership in India. The Taxpayer contended that the cost-plus arrangements were made for the research and development. Since no profit was generated from the specific services, it is merely a reimbursement of the costs. The tax authorities strongly contended that the Taxpayer developed the software, acquired know-how in India, and the benefits accrued to the associated enterprises. So, the Aztec software company is liable to pay the Tax in India. The Income Tax Appellate Tribunal held that the transfer pricing officer has jurisdiction to value and determine the Arm's length price for international transactions. An Indian company must not shift profits from the Indian authority to a foreign jurisdiction. Cost-sharing agreements shall be within the term of intellectual property creations and valued at Arm's length prices.[21]

Other Tax Challenges with Cross-Border Intellectual Properties

Multinational companies engage in the purchase and sale of intellectual property through cross-border transactions. The tax system is not the same in every country. This company may face different tax legislation, rates of taxation, and definitions of taxable income. It leads to double taxation. Multinational companies pay taxes, which affects the growth of the company. It also extends to the negative impact of economic development. Tax jurisdiction issues affect intellectual property transactions in cross-border transactions. Some countries' jurisdictions may have a positive effect on the payment of taxation, with the lowest tax rates, exemptions, and exceptions on intellectual property transactions.On the other hand, countries levied and collected taxes without considering the taxes paid in other taxable jurisdictions. Due to this issue, Multinational companies have shifted their transactions to jurisdictions with lower tax rates. For example, the European Union's Anti-tax avoidance Directive has been structured with a perfect treaty for the levy and collection of tax on intellectual property.[22]

This activity may cause treaty shopping. There is a vast question about treaty shopping as a result of tax avoidance or tax planning. Treaty shopping may be an advantage for multinational companies and is also considered tax avoidance. Tax evasion is the opposite of tax avoidance.

Treaty shopping refers to the practice where multinational companies select countries to facilitate the transfer of intellectual property to a third country. This practice is done to avail the benefit of a reduced tax rate or exemption in certain countries. There are several factors to consider when evaluating tax avoidance essentials. Multinational companies have plans to access the treaty shopping negatively. The main objective of the treaty was to prevent double taxation and promote genuine economic relations. The multinational company plans to maintain the intermediary company for financial benefits. Such companies do not have actual business practices in the tax jurisdiction. The company has fulfilled the criteria of the shell company.[23]Treaty shopping may decrease the tax revenue for the source country. These issues may be understood through the following example: A company is situated in X country. Country X does not have a double taxation avoidance agreement with Country Y. Consequently, the company in Country X decided to make transactions through Country Z. This decision enables the company to avail of tax benefits and reduce its tax burden. Treaty shopping is divided into various types with its unique structure. Mainly, some structures are relevant to intellectual property cross-border transactions:

(i) Stepping stone conduit
(ii) Triangular structures

InTiger Global International II, III, and IV Holdings are private companies registered in Mauritius. They sold their shares in Flipkart Singapore to Fit Holding. The company shares were acquired between October 2011 and April 2015. The Authority of Advance Ruling has refused to provide a tax exemption. The United States of America controls the entities in Mauritius. The primary purpose of transactions is to avoid paying tax. Thereafter, the Taxpayer approached the Delhi High Court. The Authority of Advance Ruling decision was overruled

on the grounds of the validity of the Tax Residency Certificate. The court ruled against the tax department's transaction, finding no violation of the non-abuse of the Double Taxation Avoidance Agreement. The tax department has preferred an appeal before the Supreme Court of India, and the court passed a stay order against the High Court order. This case is focused on interpreting tax treaties and the importance of a Tax Residence Certificate in claiming treaty benefits.[24]

In a Groundbreaking judgment, the appellant company was engaged in manufacturing and selling cars in India. The parent company was situated in Japan. The Maruti company has spent a considerable amount on advertisement, marketing, and promotion (AMP) inside India. The tax authorities contend that AMP expenditure shall be contributed between the parent and subsidiary companies. However, the Indian company has incurred all the expenses to build a trademark name for both Indian and foreign companies. Generally, brand-building expenses are adjusted with the parent company's contribution. The Delhi High Court has decided in favour of the Income Tax Department. AMP expenditure indirectly enhanced the brand value of the parent company. The transfer pricing officer directed that the Indian company fail to show consideration for the AMP expenditure. Therefore, Maruti Suzuki shall be liable to make transfer pricing adjustments and the Arm's length price.[25]

Different Accounting Practices and Intellectual Property Taxation

Intellectual property taxation is not an issue only with the levy and collection. It is also extended to other ancillary matters. The following methods of accounting may cause issues during the valuation of intellectual property.The term accounting refers to the process of identifying the following: income, expenses incurred, assets, and liabilities of the concerned entities. Tax accounting practices that incorporate laws for taxation that are regulated by the IRS.[26] Another objective of accounting is to determine the profit or loss of a business. Entitle's financial position can be identified through an assessment of the company's accounting. Every entity is required to maintain accounts for legal compliance. The growth of the company shall be assessed based on income and expenditure. The proprietor may easily assess the financial health of the entities and make better decisions to improve their business.[27] The term of accounting has interlinked with recognizing, valuing and amortizing the Assessee's intellectual property. The following concepts are fundamental to the valuation of intellectual property:-

(i) Recognition: Intellectual property may be recognized through acquired entries in the balance sheet. Every important transaction of business shall be entered in the balance sheet. Multinational companies may mention the acquisition cost and royalty payment. Otherwise, Multinational companies are involved in research and development. According to the income tax, research expenditure is eligible for certain deductions. The Taxpayer may claim this deduction in the previous year or preceding years.

(ii) Valuation: Multinational companies may assess the intellectual property with the help of the following particulars: purchase Cost of intellectual property rights, legal compliance, and expenditure incurred to use it. Entities engaged in the invention of intellectual property. Research and development costs may give cause for concern.[28]

(iii) Amortization: Owner of tangible property has the right to deduct the depreciation from the original value of the property. However, amortization can be claimed against the intangible assets. This method is also called the straight line method or equal expense method. Some intellectual properties cannot be held for more than the duration mentioned in the legislation. It is also called a limited monopoly right. This expenditure is considered a non-cash expenditure. Entities shall declare the amortization value of intellectual property in the balance sheet. The multinational companies may exploit such value.

(iv) Different accounting principles: Each country has its accounting standards in business and establishment. The United States of America follows the Generally Accepted Accounting Principles. Some countries have followed the International Financial Reporting Standards. India has its system of accounting standards, known as the Indian Accounting Standards. These different standards cause issues at the time of valuation of intellectual property.

(v) Other factors: Intellectual property transactions take place between inter-country transactions. The consideration is paid in foreign currency. The value of currency varies across different

countries. Due to economic factors, the value of currency has not been stable, and changes will apply concerning the market's demand and supply.[29]

Indian Position on Valuation and Fixation of Price of the Intellectual Property

Income tax legislation has a smaller tax base to compare with the Consumption tax, or indirect tax. Tax is levied based on the income of the person, or income accumulated from the transactions, etc. Tax may be imposed on the value declared under transactions. However, multinational companies voluntarily under-value the intellectual property and evade the payment of taxation or reduce their tax liability. Valuation and fixation of price are vital parts of levying and collecting taxes.[30] However, multinational companies often make indirect arrangements to reduce their tax payments. As per the income tax, describe the following traditional methods of valuation of goods and services.

(i) Comparable uncontrolled price method
(ii) Cost plus method
(iii) Income method
(iv) Transaction net margin method
(v) Other methods of valuation of intangible assets

Comparable Uncontrolled Price Method

The act of comparison to identify the original value of goods or services. It is also called a Market price comparison. As per this method, the First transaction may take place between related companies or associated enterprises. This transaction shall be compared with transactions arising between independent persons. The significant difference between the two transactions lies in their control: controlled and uncontrolled transactions. It is not easy to make comparisons of a similar nature of intellectual property at all times. Every intellectual property is unique or a novelty of its creation. Comparison will be a failure in the fixation and valuation of intellectual property. This method is used at the time of transfer pricing transactions. Transfer pricing transactions are held between the associated enterprises or among the multinational companies. Income tax legislation does not specify the conditions for comparison. Transfer pricing price valuation is dealt with under the OECD model.[31] Comparable uncontrolled price methods have their conditions and characteristics to fix the price of intellectual property as follows:-

(i) The comparison shall be done based on the nature or character of goods, property, services, etc.
(ii) Such a comparison must verify the contractual, functional, and assignment of rights.
(iii) Comparison depends upon the economic scenarios of controlled and uncontrolled transactions.
(iv) Uncontrolled transactions shall be verified for the similarity of business strategies and prior arrangements between parties.

The characteristics mentioned above must be similar to uncontrolled transactions. Otherwise, such a nature of comparison is fulfilled by intellectual property. Otherwise, the comparison will be a failure. Any contract and assignment may not be the same in uncontrolled transactions. The economic scenario cannot be the same every year. It depends on various factors, including demand, supply, production, the cost inflation index, and other factors that affect value. Every multinational company has its own strategies or prior arrangements based on the growth of the company. The entity itself can decide it. Such decisions may not be the same, and the absence of standards in their decision-making. Usually, a benchmark study is conducted by a private organization. There is a tremendous amount of tax involved in intellectual property transactions. Such private organizations work to protect the revenue source of the concerned nation. The benchmark study was conducted to identify a reasonable valuation in the comparable uncontrolled price method. There is authentication over the private organization and its result.[32]

In Star India Pvt. Ltd case, the Assessee has acquired the bundle of Sports broadcasting rights from ESPN Star Sports Ltd. These two companies are associated enterprises.Assessee had used the discounted cash flow method to value the broadcasting rights and applied the Comparable Uncontrolled Price method (CUP). The transfer pricing officer vehemently opposed the inflated cash flows by 38%. Simultaneously, CUP methods may not be applied to two dissimilar controlled circumstances. Such issues were brought before the Income Tax Appellate Tribunal. The CUP method was not suitable for comparing with earlier transactions done among comparable transactions. The Tribunal has confirmed that discounted cash flow is an appropriate method for the valuation of

intellectual property concerning benchmark transactions. Generally, the Income Tax Department employs several methods to value the intellectual property. Most of these methods are not defined under Income Tax legislation.[33]

In the Samsung India Electronics Pvt. Ltd. case, the Assessee was involved in manufacturing and selling electronics products in India using a technology license agreement with Samsung Korea. The Assessee has paid royalty for technical know-how, patents, and trademarks to Samsung Korea. The Transfer Pricing Officer rejected the royalty payment by the Indian company, reasoning that the Assessee was operating under a manufacturing contract at the direction of the parent company. Therefore, the payment did not qualify as royalty. The tax department subsequently disallowed royalty expenses amounting to Rupees 1.99 Crore. The Assessee challenged this before the Income Tax Appellate Tribunal, which decided in favour of the Taxpayer. The Tribunal determined that the Assessee should not be considered as merely a contract manufacturer and maintained its right to claim royalty payments at the Arm's length price. The tax department's authority was found to be limited to determining the Arm's length price, not questioning the business activity of the royalty.[34]

Cost Plus Method

The cost-plus method is also called a transaction-based method and represents traditional methods of valuation and fixation of price. Generally, cost-plus methods are applied to goods, property, and other tangible forms. In this method, expenditure is incurred at the time of manufacturing goods. Sometimes, Intellectual property creators do not specify the actual expenditure done by them, and the profit adds to the concerned subject matter. Multinational companies voluntarily decrease their expenditure and profits. Finally, the Cost of intellectual property may be less than the market price. It fails to identify the actual price of the intellectual property.

Income Method

Any income accrued or deemed to be accrued from the transaction of intellectual property. This income can be ascertained by comparing it to similar transactions involving independent companies. Multinational companies voluntarily show the lowest income. There is elasticity between income and tax. Higher income will result in more taxes. So, intellectual property cannot be evaluated through this method. In other ways, Associated enterprises earn their income indirectly by holding shares of related companies. Tax authorities shall identify the related transaction and impose the tax. The Government shall take necessary measures to evade revenue losses.

Usually, the resale price method is best suited for applications involving goods and services. According to this method, there must be a comparison of two transactions. The primary valuation of intellectual property is compared with the resale method. However, Primary transactions may be arranged between associated enterprises or related company transactions. It is not the same scenario as resale transactions. The resale price method does not apply to first-sale transactions. The resale price of a transaction may not be suitable for primary or first-sale transactions.[35]

Transaction Net Margin Method

Generally, this method is applicable for fixed prices of goods and services. Such comparison shall be made with associated enterprises and uncontrolled parties. The major condition is to maintain similarity between two transactions. The transaction net margin method may not be applied to scientific-related transactions. Patent-related inventions express uniqueness at every level and impossibility in comparison. Such methods are not recommended. Multinational companies claim deductions and exemptions on one side.

On the other hand, they are fixing the lowest price of intellectual property and reducing the tax liability. So, multinational entities absorb both benefits. These loopholes cause revenue losses to the Government. The source country's Government shall take necessary steps to remove the ambiguity on the levy and collection of tax.[36]In a landmark judgement, the Assessee was involved in the manufacture and trade of micro-irrigation systems in India. At the same time, the Taxpayer has paid royalties to their associated enterprises for the use of the technology and know-how. The Transfer Pricing Officer issued a demand notice against the Taxpayer and claimed royalty payment liable to be taxed in India. However, the Taxpayer has applied comparable Uncontrolled Price methods and determined the value of the intellectual property as Nil. This issue was challenged before the Income Tax Appellate Tribunal. The Tribunal has observed that the transfer pricing officer has failed to apply Rule 10B(1)(a) in the valuation of the intangible and tax liability on royalty payments. The Transfer pricing officer fails to bring a reliable source

of the comparable uncontrolled transaction. Therefore, the Tribunal directed the Taxpayer to value the intangible property through the Transactions Net Margin Method (TNMM). Alternatively, the TNMM method may not find the undervalued unique intangibles. This method fails to test the contribution among the associated enterprises and ignores the full contribution of both parties.[37]

Other Methods of Valuation of Intellectual Property Law

The intangible asset may be valued through profit and loss accounts maintained by business entities. These accounts track the expenditures made for research and development. For example, Company A purchased intellectual property in the previous year. The value of intellectual property can be ascertained through acquisition, and its value may be declared at the time of merger and demerger of companies or upon the grant of any government scheme. On the other hand, the company may value the intellectual property based on the money spent on research and development. The expenditure may provide insight into setting the price of intellectual property. Entities may declare an under-value for expenditure incurred and claim a lesser deduction from the income tax legislation. This activity may lead to tax evasion and reduce the revenue source of the source country. In a landmark judgement, the Assessee agreed with its associated enterprises, under which it was bound to pay royalty of 3 per cent on the net sale price of domestic and cross-border transactions in exchange for technical know-how. The Assessee used the Transaction Net Margin Method and the Comparable Uncontrolled Price method for valuation. The Transfer Pricing Officer rejected the valuation, stating that the benchmark data used belonged to the United States of America, and not Indian company transactions. The officer has applied the benefit test to assess benefits from the royalty, and tax authorities reduced royalty payments to 2 per cent. The Assessee challenged this before the Income Tax Appellate Tribunal, which decided in favour of the Taxpayer and noted that the Assessing Officer failed to apply Rule 10B(1)(a) of the Comparable Uncontrolled Price method. The Tribunal ruled that the benefit test was not part of the statutory methodology and deleted it from consideration, valuing the intellectual property at the Arm's length price.[38]

In a pioneering judgement, the appellant company entered into a technical collaboration agreement with Honda Motor Company Ltd., located in Japan. As per the agreement, the Indian company received the technical know-how and the right to access patents, while the trademark concern was with the Japanese company. The consideration for the contract was paid as a royalty and lump-sum fees. The Supreme Court of India decided issues in favour of the tax authorities. The payment was made between the Indian company and the Japanese company. Such payment falls under tax base within the territory of India. Therefore, Appellant company is liable to pay tax in India.[39]

Conclusion

In light of the point discussed, this research examines the tax liability of intellectual property in cross-border transactions. It reveals the increasing complexity of balancing innovation incentives with taxation policy. Income tax legislation indicates that traditional valuation methods are insufficient in determining value and setting prices. Traditional valuation methods may be helpful for valuing goods and services. The Arm's length principle may provide the foundational framework. However, valuation methods may lead to disputes and a lack of reliable benchmark studies. Practical inefficiencies in application accompany every valuation method. The Government shall make appropriate changes in legislation to add specific valuation methods and levy Tax on cross-border transactions. A solution is available in international law. The OECD advocates valuing intellectual property using the Hard-to-value-intangible approach, along with suitable valuation methodologies. India had not recognized the relevant approach to resolving the disputes. As a result, the Government faces revenue losses at all times. This analysis reflects the practical application of the OECD's guidelines and a precise mechanism for resolving disputes.

In Conclusion, income tax legislation required a balanced approach towards transparent valuation methods, harmonized application of transfer pricing standards, and global cooperation. Ultimately, this research points to the critical need for international standardization to promote equitable and predictable taxation. These issues shall be attested to with appropriate suggestions:-

(i) The Government shall identify the non-traditional valuation methods for levying and collecting tax on intellectual property. Income tax authorities shall adopt the best methods followed by developing nations.

(ii) India shall implement the hard-to-value-intangible approach. This approach may prevent

revenue loss for the source government. Income tax authorities shall prepare the manual for the levy and collection of tax on intellectual property.

(iii) Tax authorities shall assign specific tasks to verify the application of the safe harbour principle and treaty shopping.

(iv) The Indian Government shall authorize any specialized agencies to make prior arrangements with multinational companies. Such an arrangement shall deal with the valuation and fixation of the price of intellectual property.

(v) The income tax authorities shall maintain the benchmark principle. This benchmark study consists of details of controlled and uncontrolled transactions held between multinational companies. Tax authorities may verify this benchmark principle to fix the price of intellectual property on cross-border transactions.

(vi) Contacting states shall maintain transparency in sharing information about international taxation. Income tax authorities cross-check this price and the valuation of intellectual property.

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