

# Franchise Business & TAXES

Franchise retail, the new business mantra of the jewellery industry, has thrown into focus taxation issues. **Narendra Soni** sheds light on some legal aspects.



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Over the last few decades, the Indian retail market has seen a significant increase in franchise-based businesses, with leading brands across industries leveraging their goodwill to increase market reach. One of the major sectors to favourably use this model has been the gems and jewellery industry and today, there are several leading brands and jewellers who have expanded both in the country and overseas through a combination of 'own' and 'franchisee' stores.

Franchising is a contractual bond between the franchisor — one who develops a brand and a business format through long years of selling a product or a service — and a franchisee, who is ready to assist the franchisor in establishing the business for his brand or product or service in a specified area. The franchisee usually provides capital and entrepreneurship at the retail outlet level and is obliged to follow the franchisor's concept of business operations, managerial expertise and market techniques.

The franchisor grants representational rights to the franchisee to sell or manufacture goods or provide services or undertake any process identified with the franchisor by symbols such as trademark, service mark, trade name (brand name) or logo in lieu of which the franchisee is obliged not to engage in selling, producing or providing similar goods or services identified with any other person in the defined territory.

The deemed sale concept under Article 366 (29A) of the Constitution of India covers a

transfer of right to use any goods for any purpose for levy of Sales Tax on sale or purchase. In the case of *Tata Consultancy Services vs. State of Andhra Pradesh 2004 (11) TMI 11*, the Supreme Court of India had held that Indian laws do not make a distinction between tangible goods and intangible goods that are capable of abstraction, consumption and use and that can be transmitted, transferred, delivered, stored, possessed and so on. Thus, various states levy VAT on granting of representational rights under the franchise-based business model.

Apart from VAT, the Government of India treats temporary transfer or permitting the use or enjoyment of any intellectual property right or transfer of goods by way of licensing without transfer of right to use such goods as *deemed service* for levy of Service Tax by incorporating them under Declared Service as defined under 66E of the Finance Act, 1994.

'Deemed sale' and 'deemed service' thus lead to dual tax implications at the assessment stage and throw up the moot question: when can transfer of right to use goods be considered either sales or services? In the case of *Imagic Creative Pvt. Ltd. vs. CCT & Ors. 2008 (1) TMI 2*, the apex court had held that payment of Service Tax and VAT are mutually exclusive and may consist of different elements, providing for attracting different natures of levy.

Courts have analysed agreements in numerous cases to determine which tax should



be made applicable, depending on the terms and conditions of the franchise agreements. The Kerala High Court in the case of *Malabar Gold Private Limited vs. CTO, Kozhikode & Ors. 2013 (7) TMI 101* had held that Service Tax should be levied in franchise agreements since the appellant company had entered into similar contracts with other franchisees and, thus, the transfer was not on an exclusive basis.

Going by the judgement, franchise agreement would be a deemed service when there is a temporary transfer of intellectual property right by the franchisor. Intellectual property may emerge from application of intellect, which may be in the form of an invention, design, product, process technology, etc. Also, the right transferred should be conditional and non-exclusive in nature and should be for a limited period. However, in the said limited period, control and responsibility of property must be retained by the franchisor. Therefore, according to the present law, Service Tax would be applicable on granting of temporary transfer or use of enjoyment of the intellectual property.

In the case of *Vitan Departmental Stores and Industries vs. The State of Tamil Nadu (2013) 12 TMI 743*, the Madras High Court had held that since

the assessee had transferred rights exclusively in favour of the transferee in respect of a specified outlet for a definite period of time, it was not a mere licence or transfer of right to enjoy but transfer of right to use intangible goods and hence Sales Tax could be levied on the received amount.

The concept of exclusivity is, thus, one of the essential criteria to be checked to understand the applicability of VAT or Service Tax on the transaction. So, the need of the hour is the proposed Goods and Services Tax (GST), which is expected to replace existing State and Central taxes and bring down incidences of double taxation/cascading of taxes on goods and services.

Until then, it is advisable to look twice before taking a leap. ■