The penetration of digitalization in every sector of the economy is a challenge from taxation perspective. Given the global nature of operations, it is possible for multi-national enterprises (MNEs) fragment their production and supply chain across various low tax jurisdictions. They park and manage the Intellectual Property (‘IP’) in one tax jurisdiction, to carry out production and delivery systems from multiple tax jurisdictions. In a digital era determining the ‘situs’ of an IP embedded in a product sold internationally is the biggest challenge. The final products pass through many tax jurisdictions and may not be taxed either due to the arrangement of activities and business models in line with the treaty provisions and domestic law of each jurisdiction.

The benefits that MNEs get are

(a) reduction in tax burden and
(b) low risk by creating multiple tax presence.

In the above illustration, US Company (US Co) designed, developed, manufactured and marketed the digital wireless communication products which work on CDMA technology. The CDMA circuits, systems software along with license to manufacture the wireless products was granted to Original Equipment Manufacturers (OEMs) who also situate outside India. The US Co. charged fees for the license granted and also charged a royalty fee for the products sold using the patented property. It received royalty from manufacturers of OEMs who sold handsets in India. The Indian tax authorities disputed that the royalty income received against sales made in India is liable to tax in India.
A similar cross-border dispute had come up for adjudication before the Delhi Tribunal in the case of *Qualcomm*¹

Similar challenges would be faced by all such cross-border MNEs when countries exercise their right to tax on the embedded portion of the IP, especially when the domestic tax law permits to tax such income².

**Right to tax is linked with Situs**

Before exercising right to tax, it is always essential to ascertain, what is the situs of an IP? Whether the right to tax is vested with tax jurisdiction in which the products are manufactured, i.e. the situs of manufacture of products, or in the tax jurisdiction where the products are used, i.e., the situs of use of products?

The Madras High Court in *Anglo French Textiles*³ laid a preposition that the right to tax is with the country where the manufacturing activity takes place. Though not in the similar context but in different context, in *Lufthansa*, *Havells*, *Metro & Metro* & *Titan*, the Courts accepted the above principle. This principle is effective when the underlying property is a tangible asset. But when the underlying property is an IP, this principle may not hold good.

IP have no physical existence, occupy no space and therefore can have no actual location. In order to confer jurisdiction over IP, courts have to ascertain the real and actual situs of IP.

In *Qualcomm* case, the Delhi Tribunal mentioned that royalties for use of a technology is taxable in the place where the technology is used. Accordingly, when the royalty is for use of a technology in manufacturing, it is to be taxed at the situs of manufacturing the product, and when the royalty is for use of technology in functioning of the product so manufactured, it is to be taxed at the situs of use.

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¹ 56 taxmann.com 179 (Delhi - Trib.)
² Section 9(1)(vi)(c) provides for such chargeability
³ [1993] 199 ITR 785 (Mad.)
⁴ [2015] 278 CTR 1 (Delhi)
⁵ [2012] 253 CTR 271 (Delhi)
⁶ [2013] 158 TTJ 308 (Agra - Trib.)
⁷ [2007] 11 SOT 206 (Bangalore)
Before applying above preposition, courts must first have to ascertain the real and actual situs of IP and exercise the taxing right.

**Guidance on finding out the real and actual situs of IP**

IP is a peculiar form of intangible property. A trademark affixed to a tangible product is present wherever the product is shipped, offered for sale, and consumed. A copyright is an intangible, yet has a presence wherever a tangible copy of the copyrighted work is transported and used. A trade secret or a patent is embodied in the tangible, movable, and physical machinery, process, product, or method.

Where is the situs of a trademark, copyright, trade secret, or patent? According to US trade secret law, trade secrets have a fictional situs where the trade secret owner resides. Indeed, numerous US courts have held that IP protected under state law, the holder’s state residence is the situs of the IP. Federal trademarks, copyrights, and patents, on the other hand, are not protected under state law; they are protected under federal law. Trademarks, copyrights, and patents, therefore, do not have situs in their state of origin; they instead have no real situs, apart from the domicile of the holder. In other words, the state in which the owner of intellectual property resides is the situs of the IP.

The US Supreme Court in *Quill* held that a taxing state must establish the physical presence of out-of-state companies within its jurisdiction in order to exercise taxing statute to pass constitutional muster.

*To conclude*

As IP assets continue to be valuable corporate assets, holders of such assets will seek ways to legitimately minimize tax burdens in their quest to maximize overall corporate revenue and profit. States that want to extend their taxing power on IP holding companies should first have some understanding of the nature of IP rights. Sound tax policies should take into account the interest of IP rights holders and then balance those interests with domestic taxation rules.

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8 *Quill Corp. v. North Dakota* 504 U.S. 298 (1992)