

**Taxation of Gift of Brand 'Essar' – Mumbai Tribunal in Balaji Trust**

- Contributed by CA Sri Harsha

The recent judgment of Honourable Mumbai Tribunal in the matter of Balaji Trust<sup>1</sup> is a quite interesting and special one. In this article, we shall deal with the pivotal issue of the entire matter, the taxation of transfer of brand 'Essar' by Essar Investments Limited (for brevity 'EIL') to the Balaji Trust (for brevity 'trust'). The revenue tried to tax in different ways in different stages in the hands of the trust but ultimately failed, at least at this level. No doubt, considering the stakes involved, an appeal would be preferred by the Revenue before the High Court in due course of time. Though there are multiple issues in this appeal, this article is only about the taxation of the transfer of brand to the trust.

The facts of the matter are that, the trust is a private discretionary trust which was settled on 29<sup>th</sup> March 2012 by the settlor, Shashikanth Ruia with an initial settlement of Rs 10,000. The trust was created for sole and exclusive benefit of the beneficiaries being the members of Ruia family. EIL was holding the brand 'Essar' including all the registered and unregistered trademarks, copyrights, service marks, certification marks, design, trade names relating to the logo and slogans used in relation thereto along with the getups incorporating the logo (for brevity 'brand') from 1996. On 29<sup>th</sup> March 2012, EIL has contributed the brand 'Essar' to the corpus of the trust as voluntary gift and accordingly the 'Essar' brand was settled without consideration. Since no amounts were paid by the trust to EIL for obtaining the brand 'Essar', the trust has not shown the same in the financial statements. Post receipt of such brand, the trust has entered non-exclusive licensing agreements with operative Essar group entities. The said exploitation has resulted in earning of license fees by the trust. The said license fee was offered to tax by the trust by adopting the cash system of accounting in accordance with the provisions of Income Tax Act (for brevity 'ITA')

The Assessing Officer (for brevity 'AO') observed that the license income was not offered by trust in its return of income and accordingly selected the case for conduct of scrutiny assessment under Section 143(2) of ITA. During the course of assessment, the trust was asked to submit the evidence relating to the ownership of brand 'Essar' by EIL. The assessee trust submitted the copy of certificate of trademark registered with EIL along with requisite evidence. Subsequent to this, the AO has passed order under Section 143(3) stating that the definition of 'income' under Section 2(24) is wide in nature, therefore, receipt of trademark and copyright was in the nature of income taxable under the head 'income from other sources' under Section 56(1). The AO adopted the discounted cash flow method and after valuing the trademark and copyright at Rs 1,668 crore raised a demand of Rs 719.14 crores.

The assessee trust has aggrieved by this order has approached the Commissioner of Income Tax (Appeals) [for brevity 'CIT(A)]. The CIT(A) after going through the various documents and other related certificates have come to the conclusion that the brand was owned by EIL and accordingly held that the order of AO needs to be set aside. Aggrieved by this and the other host of issues (which are not being discussed in this piece), the Revenue has appealed before the Tribunal.

The Tribunal was seized with two important questions. One, whether on the facts and circumstances, the action of EIL settling the brand 'Essar' to trust without any consideration, constituted taxable income in the hands of trust in terms of Section 56(1) of ITA, if the said can be categorised as 'income' under Section 2(24) of ITA. Second, whether on facts and circumstances, will the provisions of Section

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<sup>1</sup> TS-1092-ITAT-2021

56(2)(vii) would apply in the hands of trust and accordingly, the receipt of the brand 'Essar' without consideration becomes taxable? We shall examine the views of Tribunal question wise.

**Whether receipt of brand 'Essar' constitutes 'income' and therefore taxable under Section 56(1)?:**

**Arguments by Revenue:**

The stand of revenue is that though the assessee argued that the receipt of brand 'Essar' is not taxable under Section 56(2), the same may not preclude from taxing under Section 56(1). The said stand was adopted by revenue based on the interpretation that the provisions of Section 56(2) starts with a 'without prejudice to the generality of the provisions of Section 56(1)', meaning that the income though does not satisfy the mandate of Section 56(2), can be still taxable under Section 56(1) and the instant case fits such interpretation. The revenue tried to push away the stand taken by the trust that the receipt of brand 'Essar' is a capital receipt and accordingly not an income under Section 2(24) and hence not taxable under Section 56(1) by stating that if it is established that the value of brand falls under the words 'income of every kind' as mentioned in Section 2(24), then there would be a tax under Section 56(1). The revenue has relied on the judgment of Supreme Court in the matter of GR Karthikeyan, where in it was held that prize money received from motor rally as income. The revenue also placed reliance on the judgment of Supreme Court in the matter of Navin Chandra Mafatlal, wherein the imposition of tax on capital gain was held to be in accordance with the law and pleaded before the Tribunal that the value of brand 'Essar' has to be held as 'income' and brought to tax under Section 56(1). The revenue further argued that depending upon the facts of the case, capital receipts have been treated as revenue receipts and reliance was placed on the judgment of Supreme Court in the matter of TV Sundaram Iyengar & Sons<sup>2</sup>, wherein it was held that deposits received from customers in course of business which were originally capital receipts but when transferred to profit and loss account for the reason that they are not claimed by the deposit holders, such receipts would stop being the capital receipts and acquire the nature of revenue receipts.

**Arguments by Assessee Trust:**

The assessee trust on the other hand argued that the receipt of gift from EIL cannot be treated as 'income' under Section 2(24). They have placed reliance on the judgment of Bombay High Court in the matter of H.H. Maharani Shri Vijaykuverba Saheb of Morvi<sup>3</sup>, wherein it was held that a voluntary payment which is not referable to any binding obligation and depends upon the will of donor is not in the nature of income chargeable to tax under the Act. The assessee also placed reliance on the judgment of Supreme Court in the matter of Parimiseti Seetharamamma<sup>4</sup>, wherein it was held that every receipt is not chargeable to tax and the burden is on the department to prove that an amount which is received voluntarily as a gift is an income chargeable to tax. They have further relied on the judgment of the Bombay High Court in the matter of Dilip Kumar Roy<sup>5</sup>, wherein it was held that amount received from devotees which was not on account of vocation carried on by him but was in nature of gift in recognition of his personal qualities and accordingly the amount received by assessee in that case was not chargeable to tax. Accordingly, it is pleaded that the gift of brand 'Essar' cannot be stated to be income in terms of Section 2(24). Further, it was argued that the brand was received on capital account and been employed for generation of license fee (a profit making apparatus) and

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<sup>2</sup> 88 taxman 429 (SC)

<sup>3</sup> 49 ITR 594

<sup>4</sup> 57 ITR 532

<sup>5</sup> 94 ITR 1

accordingly the said receipt on capital account cannot be said to be 'income'. Finally, it was pleaded that since the brand 'Essar' is on capital account and does not fall under the ambit of 'income', the same cannot be brought to tax under Section 56(1) and placed reliance on Cadell Waving Mill Co (P) Limited<sup>6</sup>, which was further approved by Supreme Court in DP Sandu Bros Chembur (P) Limited<sup>7</sup> to drive home such point. Also, they have placed reliance on the matter of Vodafone Services Private Limited<sup>8</sup> of Bombay High Court, wherein it was held that amount received in excess of fair market value of shares cannot be held as income under Section 56(1). They have also placed reliance on the judgments of KDA Enterprises Limited<sup>9</sup>, Rasi Exports Private Limited<sup>10</sup> and Nerka Chemicals Private Limited, wherein it was held that receipt of gift is not taxable under Section 56(1).

#### **Decision by Tribunal:**

The Tribunal stated that brands along with trademarks and copyrights did not carry any value in the books of accounts for the reason that they were acquired long back and also because they did not have any independent value outside the group since they were inextricably interwoven or in fact intertwined with the group. The tribunal stated if the group entities would have paid 90% lower than the what they have paid to the trust, would the department rework the value of brand? Accordingly it held that the AO does not have any role to play or question the validity of transaction when the shareholders had unanimously passed resolutions and ratified the transaction, unless it is either illegal or against the national interest. The tribunal has held that brand 'Essar' contributed as gift by EIL to trust constituted the profit making apparatus and accordingly forms the fixed capital of the trust and in light of Vazir Sultan and Sons<sup>11</sup> and Bombay High Court in the case of Mahindra & Mahindra<sup>12</sup> has held that the same would constitute a capital receipt. The tribunal proceeded to analyse that once an element of profit is involved, then as argued by Revenue, the same would be taxable under the head 'Income from Other Sources' and may be taxable under Section 56(1). However, there should be an income under the categories of income mentioned under Section 2(24) to proceed to tax under Section 56(1) and the tribunal stated that in the instant case there is no profit element involved in receipt of brand 'Essar' by trust and accordingly the said receipt would not constitute 'income' under Section 2(24). The transaction in question does not involve any exchange of consideration between the parties, and is in the nature of gift of a profit making apparatus which has huge potential to generate royalty income, which is possible only when the group companies are willing to contribute, otherwise, the same has literally no value and accordingly held that receipt of brand 'Essar' would not fall under the income and cannot be taxed under Section 56(1).

#### **Whether the provisions of Section 56(2)(vii) would not apply in the hands of Trust:**

##### **Arguments by Revenue:**

The revenue argued that the since the brand 'Essar' was 'artistic work' under the Copyrights Act, 1957, and therefore falls under the category of 'any work of art' mentioned under Section 56(2)(vii), the receipt of brand 'Essar' without any consideration is taxable in the hands of trust. The revenue further

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<sup>6</sup> 249 ITR 265

<sup>7</sup> 273 ITR 1

<sup>8</sup> 368 ITR 1

<sup>9</sup> 68 SOT 349

<sup>10</sup> 12 TTJ 239

<sup>11</sup> [1959] 36 ITR 175 (SC)

<sup>12</sup> [1973] 191 ITR 130 (Bom)

argued that as per Rule 11UA(1)(b) of IT Rules<sup>13</sup>, the property which is received by trust is amounting to Rs 1668.1 crore, the same would be subjected to tax.

#### **Arguments by Assessee Trust:**

The assessee trust stated that definition of 'property' in the explanation to Section 56(2)(vii) is restrictive in nature in as much as it is defined exhaustively as opposed to the definition of 'capital asset' in Section 2(14). In light of the restrictive definition of 'property' under Section 56(2)(vii), the brand cannot be called as 'property'. Further, the assessee argued that 'brand' and 'work of art' are different type of capital assets and the definition of 'capital asset' include the personal effects in its ambit subject to exclusion of 'work of art'. Hence, it can be inferred that 'work of art' is something related to personal property that was covered under the ambit of 'capital asset' (for the reason that it is excluded from the ambit of 'personal property') and brand being related to business would not fall under the ambit of personal asset and though it is assumed that the definition of property has to be read in extensive for the purposes of Section 56(2)(vii). Since the brand does not qualify as 'property', there would not be any tax liability under Section 56(2)(vii).

#### **Decision by Tribunal:**

The tribunal stated that the genesis of controversy hinges around the claim by the revenue that as 'Essar' brand was registered by EIL as 'artistic work' under the Copyrights Act, 1957, therefore it would fall within the definition of 'property' as contemplated under Section 56(2)(vii). The question before the tribunal was that 'whether or not the 'Essar' brand registered as an 'artistic work' under the Copyrights Act would ipso fact bring the same within the meaning of 'any work of art' as contemplated in definition of 'property' under Section 56(2)(vii)?

The Tribunal has agreed with the contention of the assessee that the definition of 'property' in Section 56(2)(vii) is restrictive in nature and exhaustively refers to the assets which would fall within the domain of said definition. However, on the other hand, the definition of 'capital asset' as envisaged under Section 2(14), the same provides that it would not include personal effects with an exception for 'work of art'. The Tribunal stated that exclusion of 'work of art' from the ambit of personal effects to be called as 'capital asset', signifies only such work of arts which are personal effects are covered under the definition of 'capital asset'. Since, in the instant case, brand 'Essar' which is related to business and not a personal effect, would not fall under the definition of 'property' as per Section 56(2)(vii). The tribunal further referred to Corpus Juris Secundum, various dictionaries and the decision of M.A Chidambaram<sup>14</sup>, since the said expression has not been defined either under Section 56(2)(vii) or Section 2(14), to hold that a simplicitor registration of logo 'Essar' under the Copyrights Act, 1957 as 'an artistic work' would not ipso fact mean that it is in the nature of 'work of art' and agreed with the assessee's argument that 'though all works of art are artistic works but however, all artistic works are not works of art'. Accordingly, the Tribunal held that brand 'Essar' is neither an artistic innovation nor possesses any artistic quality for being brought within the meaning of 'any work of art' as contemplated in Section 56(2)(vii).

Alternatively, assuming that brand 'Essar' falls under 'any work of art', the tribunal stated that there are only three methods prescribed by Rule 11UA(1)(b) and DCF is not one among them, the valuation adopted by the revenue is erroneous and hence held in favour of the assessee trust.

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<sup>13</sup> Income Tax Rules, 1962

<sup>14</sup> [1999] 239 ITR 371 (Mad)

**Concluding Remarks:**

As stated in the opening paras, the Revenue would undoubtedly challenge the order of Tribunal before the High Court in due course of time. However, in our view, the analysis of the Tribunal is in accordance with the law and hope the High Court upholds the order. The stand of revenue right from the beginning shows the attitude of taxing the transaction in any manner, be it under Section 69A or Section 56(1) or Section 28, which would require a serious reconsideration. The settlement of brand 'Essar' to trust by way of voluntary gift was finally held to be not taxable under any of the sections of ITA. One should wait for the verdict of High Court to see, if it unsettles this proposition.

