

Legal Implications of Goods and Service Tax on Brand Usage within Group Companies

by Mr. Srinivas Kotni, Managing Partner, Lexport

Introduction

A new wave of debate has emerged in the business world following the issuance of a GST notice to Mahindra & Mahindra concerning the tax liabilities associated with the use of its iconic brand name by group companies. This development has sparked widespread discussion among industry stakeholders regarding the potential implications of GST on brand usage within corporate groups, raising critical questions about whether similar practices might also attract GST scrutiny.

This notice reflects an emerging trend where GST authorities are increasingly scrutinizing transactions between related entities, particularly in relation to brand usage and intellectual property. Covering the period from 2017 to 2023, the notice forms part of a broader investigation into the taxation of brand usage, echoing similar actions previously taken against real estate developers for brand name utilization by subsidiaries and joint ventures.

Position of Law on Supply between Related and Distinct Parties

The notice concerns the usage of the 'Mahindra' brand name by group companies that are related parties, even though they are separately registered. Ordinarily, such transactions might seem to fall outside the purview of GST as they occur without any consideration or royalty to the brand. However, GST is applicable on supplies between related or distinct parties even when done without consideration, provided these transactions are in the course or furtherance of business.

This underscores the importance of understanding how GST regulations apply to internal transactions involving intellectual property and brand usage. Under the GST regime, "Scope of Supply" includes the transactions between related and distinct parties, including companies and their subsidiaries, even if the supply is done without any consideration. This is subject to the fulfilment of condition that such transactions are done "in the course of furtherance of business."

The same is envisaged in the provisions of Schedule I, Section 7 of the CGST Act, which treats certain activities as supply even when made without consideration. Relevant provisions of Section 7 and Schedule II of the CGST Act have been produced below: —

Section 7 Scope of Supply: — For the purposes of this Act, the expression supply includes—

(c) the activities specified in Schedule I, made or agreed to be made without a consideration;

...

Schedule I

Clause 2:

Supply of goods or services or both between related persons or distinct persons as specified in Section 25, when made in the course or furtherance of business:

Provided that gifts not exceeding fifty thousand rupees in value in a financial year by an employer to an employee shall not be treated as supply of goods or services or both.

Here Related Persons are referred to the individuals or entities connected through various forms of control or influence. This includes those who hold a position of control in each other's businesses, partners in a business venture, employers and their employees, or those who share significant stock ownership in each other's enterprises. It also encompasses individuals or entities with direct or indirect control over one another, those controlled by a third party, or those who jointly control a third party. Additionally, family members involved in each other's business activities are considered related persons.

Distinct Persons as per Section 25 are the establishments with separate registrations within or across states are considered distinct persons. Hence, even if a business entity operates under different registrations in various states, these are treated as distinct for GST purposes.

Classification as Supply of Goods or Services

The key issue arising from the above controversy is whether to classify the usage of the brand name as a "supply of goods" or a "supply of services." The usage of the "Mahindra" brand name by its group companies is considered a temporary transfer of an intellectual property right. As such, this transaction is categorized as a supply of services, as outlined in Section 7(1)(A), Schedule II of the CGST Act. Consequently, the applicable tax liability for such supplies of services is 18%, calculated based on the royalty paid.

Challenges

It is evident that brand usage by related parties, even without consideration, constitutes a supply as it occurs in the course or furtherance of business. Furthermore, such a transaction is classified as a supply of services, given that the transfer is temporary. However, a significant challenge lies in determining the value of this supply. Since no direct consideration is involved, establishing a base for calculating GST becomes complex. The primary issue is how to assess the value of such brand usage for GST purposes and what metrics or standards should be applied to ensure accurate taxation.

This classification implies that companies permitting the use of their brand names or logos by subsidiaries or other related entities must assess the open market value of such intellectual property. Subsequently, GST should be levied on this value.

A significant challenge for companies lies in determining the open market value of the intellectual property. Unlike straightforward corporate guarantees, there are no clear guidelines for valuing brand usage fees, which may lead to disputes and potential financial liabilities.

Additionally, there is a considerable challenge regarding the Input Tax Credit (ITC) on the tax paid for such brand usage. Given the potentially substantial amount of tax involved, companies must navigate the complexities of claiming ITC. The question remains whether the tax paid can be claimed as ITC or if the transaction will be deemed as consumption on the part of the supplier. This issue adds another layer of complexity to the GST framework, necessitating careful consideration and strategic planning.

Key Takeaways

The GST notice served to Mahindra & Mahindra exemplifies a broader trend wherein GST authorities are increasingly scrutinizing brand usage among related parties. This action could set a significant precedent, compelling other diversified business groups to re-evaluate their internal transactions and face similar regulatory challenges.

To ensure compliance, companies must meticulously assess and document the value of brand usage and intellectual property. Transparent transactions between related entities are crucial for mitigating potential tax liabilities.

In summary, the Mahindra & Mahindra case highlights the necessity for businesses to remain vigilant and strategically prepared regarding internal transactions and brand usage within corporate groups. Navigating the complexities of GST regulations, including the valuation of intellectual property and related-party transactions, is essential for avoiding unexpected tax liabilities and staying aligned with evolving regulatory expectations.
