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FOREWORD

There's a tremendous gap between public opinion and public policy – Noam Chomsky

I am pleased to learn about the 3rd issue of Alexis Journal of Public Policy and Law. My sincere gratitude to the all the researchers and editorial team for achieving this milestone within record time. Furthermore, the editorial team of the journal has been an inspiration for me as they exemplify the values of discipline, dedication, trust, professionalism, humility, and continued innovation in sync with the core organizational goal of innovative and explorative research.

This issue covers diverse range of topics such as Inter-State Water Disputes in India, Legal Education System in India, Tax Considerations for Licensing Technology Transfer in India, Non-Compete Clauses in Employment Contracts in India, and International Transfer Pricing. All the articles presented in this journal provide both detailed and cutting-edge analysis of topics covered, thereby adding new perspective to existing body of knowledge and analysis.

I would thoroughly recommend this journal to all the research scholars and students pursuing studies or research in field of law. Furthermore, I would like to emphasize on experiential learning, continuous personality development, developing emotional quotient, enhancing communication and life-skills to achieve success in today's competitive world.

Once again, I would like to congratulate all the researchers and editorial team for their valiant efforts.

Best Wishes,

Aditya Singh

Founder and Chairman, Alexis Group

Volume 2, Issue1 2015

TABLE OF CONTENTS

ARTICLES

Dr. Gargi Chakrabarti, *Resolving Inter-State Water Dispute in India: The Traditional Approach*
2(1) ALEXIS J. PUB. POL'Y. & L. 1(2015)

RESOLVING INTER-STATE WATER DISPUTE IN INDIA: THE TRADITIONAL APPROACH[**]

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[**] This article was last revised on 1st May, 2016

TABLE OF CONTENTS

I. INTRODUCTION

Water is indispensable for all living creatures.. The very existence of life on earth is because of the presence of water. Thus, water is one of the most precious gifts Mother Nature has given to mankind. A person's survival depends on water to a large extent, more so on fresh water sources used for drinking, cleaning and farming activities. That is the reason why human civilization started near rivers; like the Nile

(Egyptian Civilization), Tigris-Euphrates (Mesopotemian Civilization), Indus (Harappan Civilization), Yellow-Yangzi (Early Chinese Civilization).Rivers shape the development of civilization and influence changes in climate, vegetation, geography and topography. They inspire new technological, economic, institutional and organizational innovations. For example, the watermill was invented to use water flow to run the watermill in order to grind wheat via a mechanical process. The incessant demand of water for various activities has always made water distribution a subject of dispute between states. In this paper the author shall look into the root cause of water disputes prevalent in India. The author will further emphasize on the ways and means of managing ground water instead of solely depending on river water. Thus, besides resolving these disputes in a legal forum the paper will provide an alternative method to resolve such issues by using traditional knowledge in restoring ground water.

II. A BRIEF HISTORY OF WATER DISPUTES

Water dispute is an age old problem,it can be traced as far back as2500 BC. This was the Lagash-Umma Border Dispute - over the "Gu'edena" (edge of paradise) region, where Urlama, King of Lagash[1], diverted water from this region to boundary canals, drying up boundary ditches to deprive Umma of water ;[2] after a successful campaign against the Halidians of Armenia. Around 720-705 BC, Sargon II of Assyria destroys their intricate irrigation network and floods their land.[3] In 1503 Leonardo da Vinci and Machievelli plan to divert the Arno River away from Pisa during conflict between

[1] Hatami and Peter H. Gleick, *Water War and Peace in the Middle East*, Environment Research Library, vol 36:3 (1994) also available at: http://www.atmos.washington.edu/~davidc/ATMS211/articles_optional/Water_War_Middle_East.pdf (hereinafter Hatami and Gleick ,1994)

[2] Peter H. Gleick, 'Water Conflict Chronology' Data from the Pacific Institute for Studies in Development, Environment, and Security database on Water and Conflict (Water Brief) 2008. See also Hatami and Gleick ,1994.

[3] Id

Pisa and Florence ;[4] in 1778 Ferry house on Brooklyn shore of East River burns down. New Yorkers accuse Brooklynites of having set the fire as revenge for unfair East River water rights (Museum of the City of New York, MCNY n.d.);[5] and conflict between Britain and France invoked in 1898 when a French expedition tried to get control over the headwaters of the White Nile, later on the parties ultimately negotiates a settlement of the dispute.[6]

When we take a look at India we find that, there are two types of water conflicts . The first type is related to the impact of large dams on certain sections of the society, specially those who are economically, socially and culturally in a disadvantageous positions; as seen in the case of the Sardar Sarovar Dam on the Narmada in Western India and the Tehri Dam on the Bhagirathi in Northern India;[7] the second type is inter-state water dispute, which challenges the integrity of India as a nation which shall be discussed in the proceeding part of this paper..

A. WATER DISTRIBUTION IN INDIA AND CAUSES OF INTER-STATE WATER DISPUTES

To understand the inter-state water dispute of India; it is important to know the water distribution of Indian rivers. The river system of India can be divided into two parts first, the Himalayan river system includes the Ganges , Indus and the Brahmaputra river system; second, the Peninsular river system consists of the Narmada , Tapi,

[4] Id, see also William Honan, *Scholar sees Leonardo's Influence on Machiavelli*, THE NEW YORK TIMES, Dec 8, 1996, available at http://www.nytimes.com/1996/12/08/us/scholar-sees-leonardo-s-influence-on-machiavelli.html

[5] Id.

[6] ALAN MOOREHEAD, THE WHITE NILE (1960).

[7] Radha D'Souza, *At the confluence of law and geography: contextualizing inter-state water disputes in India Geoforum* 33: 255–269 (2002)

Godavari , Krishna , Kaveri , Mahanadi and the Vaigai river system. Most of these rivers have an inter-state course and thus, are potentially prone to inter-state river water disputes.

Case studies in India reveal that there are several causes of inter-state water disputes some of which are as follows: (i) allocation of waters between different states; (ii) sharing of construction costs and benefits if a project is developed jointly by more than one state; (iii) compensation to the states prejudicially affected by the implementation of a project by another state; (iv) dispute settlement relating to interpretation of agreements and; (v) excess withdrawals by a state.[8] Prevalent views on such disputes see these problems arising primarily from the superimposition of political boundaries of states over the natural boundaries of a river basin.[9] Moreover in India water is managed by State Laws and there exists some differences in the legal provisions in the legal system among all the states in India. The issue of inter-state river dispute will be elaborated with certain case studies in the proceeding part of the chapter.

B. CASE STUDIES OF INTER-STATE RIVER WATER DISPUTES IN INDIA

Some of the case studies to be discussed in this paper include landmark examples such as the Yamuna dispute between Delhi, Haryana & Uttar Pradesh; Kaveri dispute between Karnataka & Tamil Nadu and the Krishna-Godavari dispute between Maharashtra, Karnataka, Andhra Pradesh, Madhya Pradesh & Orissa.

a) Kaveri River Dispute

[8] S.N JAIN ET.AL, INTERSTATE WATER DISPUTES IN INDIA: SUGGESTIONS FOR REFORM IN LAW (1971).
[9] Shah, R.B,*Inter-state River Water Disputes: A Historical Review,* Water Resources Development, (1994).

A serious conflict started between Karnataka and Tamil Nadu regarding the sharing of water from the river Kaveri, both states were of the opinion that sharing of water between the two would not be enough. This dispute dates back to 1807 when the then Presidency of Madras (Now State of Tamil Nadu) complained about excessive upstream use of the water by the then Princely State of Mysore (now Karnataka). [10] This difference of opinion led to the 1892 Agreement which is followed by another agreement in1924. Unfortunately even after signing the agreements Karnataka was of the opinion that these agreements were heavily in favour of Tamil Nadu and demanded the renegotiation of the settlement. On the other hand Tamil Nadu demanded that it had developed almost 3,000,000 acres of agricultural land based on that agreement, so any change in the settlement will lead to an adverse effect on the life of millions of farmers.[11] As those agreements did not worke, the Government of India constituted a Tribunal in 1990. After hearing arguments for a period of 16 years, the tribunal delivered the verdict in February 2007. As per the verdict Tamil Nadu is allotted for annual 419 billion ft^3 (12 km^3) of water, 270 billion ft^3 (7.6 km^3) to Karnataka, 30 billion ft^3 (0.8 km^3) to Kerala and 7 billion ft^3 (0.2 km^3) to Pondicherry.[12] This dispute is yet to be settled, review petition is pending seeking clarification and renegotiations.

b) Krishna Water Dispute

Krishna river basin includes the states of Maharashtra in the upstream, Karnataka in middle riparian and Andhra Pradesh in the furthest downstream. Parts of the basin have hundreds of factories and it is heavily industrialized. The States signed

[10] Report of the Cauvery Water Disputes Tribunal with theDecision (2007).

[11] Id.

[12] *Id* at 201.

agreements for the allocation of water among themselves in 1892, in 1933, 1944 and in 1946.[13] After independence in 1951, a new agreement has been signed but Karnataka State had refused to ratify that, and as a result disputes continued. In 1969 Krishna Water Dispute Tribunal was created, that was the first established tribunal under the Inter-State Water Disputes Act 1969. After clarifications and re-examinations the final award comes in 1976, after 7years. As per Scheme A, the water as available at 75% dependability is to be distributed amongst the three States, as well as the return flows, in the manner details of which are given in the order. Maharashtra and Mysore (Karnataka) have been restrained for using more water than allocated to each of them. The remaining water was permitted to be used by State of Andhra Pradesh but without getting any right in the waters except to the extent of allocation made to it by the Tribunal. There was no provision for sharing of the deficit.[14]

c) Yamuna Water Dispute

Yamuna water dispute was between the states of Himachal Pradesh, Haryana, Uttar Pradesh, Rajasthan and the National Capital Territory of Delhi. In 1994 a Memorandum of Understanding had been signed between these states for proper allocation of water of Yamuna river. [15] Subsequently a different agreement had also been signed later in the same year regarding construction of Hathnikund Barrage on Yamuna river, Kishau Dam on Tons rivers and Renuka Dam on Giri river. The Upper Yamuna River Board (UYRB) and Upper Yamuna Review Committee (UYRC) had been constituted in 1995[16] which is designed to supervise the working of the UYRB to ensure implementation of the MoU regarding allocation of surface flow of

[13] Krishna Tribunal Report (2010) at p.16.
[14] The Report of the Krishna Water Disputes Tribunal with the Decision 50 (2010).

[15] See River Water Disputes, INDIAN GOVERNMENT ARCHIVE, available at http://www.archive.india.gov.in/sectors/water_resources/index.php?id=14
[16] Id.

Yamuna and to review proper development and management of the upper reaches of the Yamuna River Basin.

d) Ravi-Beas Water Dispute

The Ravi-Beas water dispute between the states of Punjab and Haryana , is another example of inter-state water dispute in India. An initial agreement between them had been signed in 1955, but the dispute started in 1966 during reorganizing of Punjab state. [17] Another agreement had come up in 1976, but Punjab protested against it; so, further discussion had to be initiated, including Rajasthan at this time. Further, a new agreement had been signed in 1981 but the dispute continued. Ultimately in 1986 Ravi-Beas Tribunal was constituted and the first report was submitted in 1987. However, the states of Punjab, Haryana and Rajasthan asked for explanation, further report is yet to be received and the dispute is ongoing.[18]

III. LEGAL PROVISIONS

A. HINDU WATER LAW

According to ancient Hindu Law, human action is called *'karma'* and human actions are governed by *'dharma'* (law and order). In the year 200-100 BC Manu provided the water law according to this tradition. Kings are suppose to protect public water and they can collect fees for crossing waters[19] water diversion was not accepted[20]; legal provision of punishment was available for the persons who would pollute the water or

[17] Id.
[18] Alan Richards & Nirvikar Singh, "Inter State Water Disputes in India: Institution and Policies", Department of Environmental Studies & Department of Economics, University of California, 2001.
[19] Manu Smirti,ch. VIII, §§61, 69; ch. IX, §§264–266, 281.
[20] Id at ch. III, §151

try to steal or divert the water[21]. Legal provisions for water management is also depicted in the *Arthashastra*, in which ownership of water bodies, different taxes, prohibition of release of water without a valid reason, prohibition of obstruction or diversion of water course, provision for damages and penalties, treaties to develop joint water works etc had been discussed.[22] It is evident from Manu's Code that water disputes have been a major problem in India since time in memorial.

B. MUSLIM WATER LAW

Additionally, according to the Muslim law of India, water is denoted as a gift from God, and no individual was permitted to own that. No specific legal document has been found regarding water law during the Muslim era, there was a relative lack of concentration towards water regulations during that period.[23]

C. COLONIAL IMPACT ON WATER LAW

Before Indian Independence, British imperialists introduced water regulation and applied common law principles, this was used to lay importance on the rights of landowners on the access to water resource. A series of regulations came up for different activities related to water, like Embankment Regulation 1829 and Bengal Embankment Act 1855[24] for protection and maintenance of embankments; Northern India Canal and Drainage Act 1873 for regulation of irrigation, navigation and drainage; Northern India Ferries Act 1878 for regulation of ferries; and Indian Fisheries Act 1897 for regulation of fisheries etc.

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[21] Id at ch. IV, §§46, 48, 56; ch. XI, §174; ch. VIII, §309; ch. IX, §281, Philippe Cullet & Joyeeta Gupta, "India: Evolution of Water Law and Policy" Chapter 10 of Joseph W. Dellapenna & Joyeeta Gupta eds, The Evolution of the Law and Politics of Water (Dordrecht: Springer Academic Publishers, 2009)

[22] KAUTILYA, ARTHASHASTRA, C.300 BCE

[23] IQBAL AHMED **SIDDIQUI**, HISTORY OFWATER LAWS IN INDIA, 295 (1992).

[24] *Ibid.*

D. CONSTITUTIONAL PROVISIONS ON WATER MANAGEMENT

According to the Indian Constitution; states have the exclusive power for regulation of water law and related matters like, water supply, irrigation, canals, water storage, drainage, embankments, water power and fisheries.[25] There exist some restrictions regarding the inter-state use of the river water.[26] The Union is responsible for the adjudication of inter-state water dispute.[27] Later, the Inter-State Water Disputes Act came up in 1956; which is now responsible for inter-state water dispute resolution by forming tribunals. The Parliament also formed River Boards Act in 1956 according to which Central Government is allowed to advice state governments on development projects in any inter-state rivers and also to help in matters like conservation of water and maximum utilization of it.

E. INTER-STATE WATER DISPUTES ACT 1956

The aim of this Act is to protect the interest of the both upstream and downstream state and to resolve the inter-state water disputes. Further, to improve the consumption of water for irrigation, drinking, industrial purpose, recreation, recharging of ground water, protection from evaporation loss, efficient use of rain water, preventing flood in a river basin, and maintaining the quality of the water.

IV. IMPACT AND ROOT CAUSES OF INTER-STATE WATER DISPUTE

Water, as mentioned earlier, is one of the most important basic resources for mankind as well as the overall development of society. Competition on surface water

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[25] THE CONSTITUTION OF INDIA, (1950),Schdule 7, List 2, Entries 17 & 21.

[26] THE CONSTITUTION OF INDIA (1950),Schdule 7, List 1, Entry 56, *"Regulation and development of inter-state rivers and river valleys to the extent to which such regulation and development under the control of the Union is declared by parliament by law to be expedient in the public interest."*

[27] Article 262, THE CONSTITUTION OF INDIA, 1950.

sometimes become so intense that it may lead to unforeseen circumstances like farmers setting up fire on trains, suicides, police firing on the protecting farmers etc.[28]

A. IMPACT OF INTER-STATE WATER DISPUTE

Inter-state water dispute in bound to happen between the neighboring states, as evident from the case studies above. It invokes the following barriers in the way of development of a country:*First,* it invites provincialism in the mental state of the people of neighboring states,

i) *Second,* it hampers joint venture water work projects for mutual development of both the states,

ii) *Third,* it increase chances of flood or draught in the region,

iii) *Fourth,* it decrease quality of water for drinking and irrigation purposes,

iv) *Fifth,* agricultural activities of one state is hampered by the activities of another,

v) *Finally,* it leads to environmental degradation and imbalance, which may give long term impact on the region.

Another negative impact of such disputes is that it is time consuming and decisions take a long time. For instance in the case of the Krishna Tribunal, hearing started in January 1974, and the final award was given in 1979.. Furthermore, in case of Kavery the dispute started since the 19th Century, tribunal formed in 1990 but the final decision had come after 17 long years, in 2007. Initially the dispute was in between Tamil Nadu and Karnataka, but during the dispute resolution process two more states

[28] As evident in the Kavery river dispute case between Karnataka and Tamil Nadu, See Fakir Chand, *Karnataka farmers try to set train afire*, REDIFF ONLINE, Oct 4, 2002, available at: http://www.rediff.com/news/2002/oct/04cau4.htm & Sadananda R, *Farmer jumps into Kabini reservoir to protest Cauvery water release*, REDIFF ONLINE, Sept 19, 2002, available at: http://www.rediff.com/news/2002/sep/18cau2.htm

had joined, namely Kerala and Pondicherry. The time lag in dispute resolution costs public money.. Long term dispute resolution process significantly affect the water related development and activities like infrastructural projects of dams, irrigation canals and other contributory investments in agriculture for all the states; which in turn affect the utility and productivity of water in the state economy.

B. ANALYSIS OF ROOT CAUSE

River is the natural and flowing source of sweet surface water, thus there exist inter-state river water dispute to meet optimal supply of water for irrigation, industrial usage and for day-to-day life. Basic cause of water problems are include scarcity because of non-availability of surface water in the arid or semi-arid regions,[29] or excess rainfall causing flood and its post effects as manifested in North-Eastern states of India like Assam, Tripura, or states of Ganga Basin like West Bengal, Bihar, Orissa etc. Increasing draught, declining water quality, excess flooding and growing demand among the competitive sectors makes the situation more complex. If ground water storage can be recharged and if rain water can be properly stored and used effectively then, the chances of both draught and flood will be reduced and that can be an efficient solution of long standing inter-state river water dispute.

C. RESOLUTION: THE USE OF TRADITIONAL KNOWLEDGE

We have extensively discussed the cases of inter-state river water disputes and elaborated the negative of the same.. Now we will concentrate on how traditional communities handle the cause of this problem such as the scarcity of water. ; We will also discuss the complexity of the situation due to the increase in demand, less and

[29] Such arid regions include the western states of India like Rajasthan, Gujrat, Delhi, or in the states of Deccan plateau like part of Maharashtra, Madhya Pradesh, Karnataka, and arid regions of Bihar, West Bengal or Jharkhand.

uncertain supply, modern industrialization requiring more water resource and how traditional knowledge can be used to combat this complex situation.

To overcome this uncertainty, traditional people practiced traditional way for water conservation and management. These practices are simple, easy to follow, cheap, technically feasible, compatible with existing farming and other activities, eco-friendly, accommodated well with environmental changes, can serve as a water reservoir during draught, help to recharge ground water, and widely used among the traditional communities throughout India according to the local need as per soil and water quality, climatic conditions, and vegetation type. If the basic cause of water dispute, i.e. water scarcity and uncertainty, can be handled by the effective use of traditional water management systems, then there will be no inter-state river water dispute.

a) Water Management System of Himachal Pradesh

Himachal Pradesh is mountainous land; good water management is part of the culture of traditional people of Himachal. Heavy snowfall in the hilly areas are the important source of water; this water is collected in the small ponds named *kuhls*, these small ponds are digged near the natural slope of the hill and built along the hill gradients and used for irrigation. [30]Walls of the kulhs are cemented with soil, and water stored in the bed. Traditional communities in different parts of Indian Himalaya developed traditional network of *Jal Talais*, to preserve rain water. These appear small trenches of flowing water but actually are the earthen pits of rectangular shape; the digged out soil used as the raised periphery in the earthen mounds; these *jal talais* are built in equal distance and in almost symmetrical rows along the land slopes. Villages which are placed in foot hills or valleys usually harvest the rainwater in the small storage ponds called *Chal*, during rainy season water get stored in those ponds, help in preventing

[30] Chaman Lal & L. R. Verma "Indigenous technological Knowledge on Soil and Water Management from Himachal Himalaya" *Indian Journal of Traditional Knowledge* Vol. 7(3) July 2008 pp 485-493

flood, and act as water reservoir for the non-rainy seasons. In up-hill cold desert areas spring water is collected in small ponds, which are made up of concrete stones and walls are cemented with sandy loamy soils so that water can't pass through the walls, water from these ponds are distributed by the diversion channels. Farm ponds are other useful locally used ponds for preservation of rain water and snow melted water; made near the houses, agricultural fields, roadside or forest area; so these can used for household usage, irrigation, as well as drinking water for the livestock. From different types of ponds water is diverted into the irrigation fields, through the diversion channels; channels are made at the toe of the rivers, water collected in the toe and can come easily into the lower terrace, diversion ditches are made along the contour lines and slopes, this is made to interrupt surface waste, this whole system is done according to the guidance of experienced farmers. Walls of the diversion channels are cemented with the clay loamy soil to stop soil erosion. Drip irrigation is also practiced in Simla district using the earthen pitcher which is filled and placed near the field, once filled it continue working for at least two weeks, and serve mainstay of irrigation during summer.

Traditional people of Himachal Pradesh also use other organic or non-organic raw materials for preservation of soil moisture; like 'ashes' of cattle dung, shrubs, bushes are mixed with soil for water preservation into the soil, moreover it also helps in maintaining nutrient availability specially potash, enhance soil fertility and helps in weed control; in Kinnaur district surface of the soil is covered with *pinus*, *chilgoza* needles and grasses from hill top, this technique is called *'mulching'* which helps in conservation of soil water. Hamirpur district suffers from acute shortage of water in the summer season; to combat this local people made water logging structures called *Khatis,* which are digged up concrete hard rock in which water is collected from the subsurface runoff. These rocks are rich in silica which helps in purification of stored water and concrete rock prevents evaporation and seepage of water as well.

Components used for preparation are locally available, easy to get, cheap, and easy to prepare. It helps in maximum use of locally available raw materials and helps in maintenance of water quality during storage.

b) Water Management System of Kumaon HimalayaKumaon Himalaya is practicing terrace cultivation and for irrigation the water is diverted from the rivers through the channels called *guls*; along the lengths of guls smaller se*cond*ary channels are made called hawarr, even small dams are made on these channels called *bans*, and sometimes local water mills are *also* made called *gharats.*[31]

c) Outlet is made at the lower end o*f the f*ields to drain the excess water and sometimes a big rock is placed in the outlet to control the flow of the water downstream. *Naulas* are made to collect the stream wate*r for* drinking and household usage, these are actually tanks closed in three sides, opened on fourth side with steps, animals are not allowed near this, even users are not allowed to contaminate the water, water of *naulas* are treated with amla and neem leav*es and* these are preserved and managed as a community property. Simar or gajar is a marcy land created near the agricultural field, helps charging the ground water and useful for cultivation of basmati rice and some medicinal plants.

d) Water Management System of Rajasthan

In Rajasthan, a large area is arid and part Thar desert region, there exist a long and commendable tradition of water conservation. Some non-governmental organizations are working in Rajasthan to revive the age old system of water harvesting, which is famous as *johad*. Johads are simple barriers built across the slope of the rain water to

[31] Ajay S. Rawat & Reetesh Sah "Traditional Knowledge of Water Management in Kumaon Himalaya" *Indian Journal of Traditional Knowledge* Vol. 8(2) April 2009 pp 249-254

arrest it and it is made up of mud and stone. These are having high banks on three sides and fourth side is kept open for the rain water to entre. It prevents the rain water to flow off and helps the seepage of water into the ground, recharging ground water and improves water balance of soil. The NGO Professional Assistance for Development Action (PRADAN) is helping local people to use this traditional technique using locally available and cheap materials. [32] Ratakhurd village of Alwar district is transformed into a green paradise with the help of *johads*. A series of bunds are made along the hill slopes, preventing rain water from running off, excess of the water arrested by those bunds are spilled through the outlet. A voluntary youth group called Tarun Bharat Singh (TBS) is also working in Rajasthan along with the NGO, they help in making *Johads* (medium sized semi-circular earthen bunds), Weirs (low overflow masonry structure, built in small tributaries), and small dams. They built about 4500 such structures across 1000 villages and helps in recharging ground water.[33] Even surprisingly Aravari river taken a re-birth and that creates improvement in agricultural activities in Banganga basin. Villagers also collected rain water in the covered pits *kund* or in simple pits called *sor* or in stepped wells called *bavdis*.

e) Water Management System of Gangetic plains

Gangetic plain is having a practice of utilization of ground water, by using bore wells. In Bihar a famous traditional water utilization system is practiced named *ahar-pyne* system. *Pynes* are canals bringing water into the tanks called *ahars*. The ahars help in recharging the ground water and thus nearby wells get good amount of water throughout the year. This system also helps in diverting rain water falling on the catchment area and thus helps in preventing flood. *Dong* system is practiced among

[32] Saponti Borthakur " Traditional Rain Water Harvesting Techniques and its Applicability" *Indian Journal of Traditional Knowledge* Vol. 8(4) October 2009 pp 525-530

[33] Marcus Moench et al, "The Fluid Mosaic: Water Governance in the Context of Variability, Uncertainty and Change" A Synthesis Paper published by Nepal Water Conservation Foundation, Kathmandu and Institute for Social and Environmental Transition Colorado, 2003

the Bodo people of Assam and West Bengal, which is a system of sustainable use of available water resources. *Dongs* are manmade canals to route the natural water to the paddy cultivating fields; *dongs* are complemented by the *jhampais*, which are the small water distribution channels starting from the dongs and usually digged along the embankments of the paddy fields.[34]

V. TRADITIONAL WAYS OF WATER MANAGEMENT BY LOCAL AUTHORITIES

Participation of traditional and local people in all aspects of use, harvesting and management is important for greater equity and sustainability of local systems. Study of local policy on water harvesting is the decentralized system of water management which helps in planning, implementation, maintenance, sharing, raising resources and resolving conflicts.

A. STUDY OF LOCAL SYSTEM OF WATER MANAGEMENT

a) **Dong Management System** – A body made up of traditional people including the village headmen and the village elders of the adjoining villages of a 'dong' usually responsible for the manufacturing and maintenance of a dong. [35]There is no discrepancy shown in the distribution of water among the different villages and people of all beneficiary villages take part into the process of management.

b) **Arwari River Parliament** – Arwari river basin water management is now on the supervision of the Arwari River Parliament, which is formed in 1998 with participation of people of 70 villages, with a membership of about 2055 people. Tarun Bharat Singh group is working along with this parliament; altogether there is formation of 46 micro watersheds, about 300 water harnessing

[34] "A case study on the traditional water management system of the Bodo people, Dong" available online at http://www.dorabjitatatrust.org/northeast/pdf/Dongs.pdf 13.2.12
[35] "A case study on the traditional water management system of the Bodo people, Dong" available at http://www.dorabjitatatrust.org/northeast/pdf/Dongs.pdf 13.2.12

structure, 2 major streams and Sainthal Sagar Dam. [36] Not only this Parliament helps in sustainable management of natural water resources, control the usage of water, help improving soil fertility and reduce land erosion; but also confirms the active participation of local people of every strata, substantiate the awareness building and empowerment of traditional people.

Involvement of traditional people in this way in the water management system will build up the strong bond of the people with their natural resources, will help in the maximum utilization of water and other resources, will . The focus on water management system requires a holistic approach in consonance with traditional knowledge system and local need and priorities.

VI. CONCLUSION

Every traditional knowledge is already established as time tested and precious for today's need as well. No one can deny that traditional knowledge is effective and potential for modern age also. In spite of the modernization of technology, traditional knowledge can go hand in hand regarding reduction of water scarcity, so it will be complementarily effective for decrease in water dispute. This paper already discussed the various aspects of water dispute and contribution of traditional communities to handle the situation. There is a need of proper awareness and capacity building to revive those useful traditional knowledge for sustainable development of water conservation. Enhancement of traditional knowledge can provide double impact to resolve the critical issue of scarcity of water. The promotion of traditional knowledge is cost effective as easily available resources are related to this; eco-friendly in nature which suits with the environment; moreover easily adaptable and implementable. As a

[36] Saponti Borthakur " Traditional Rain Water Harvesting Techniques and its Applicability" *Indian Journal of Traditional Knowledge* Vol. 8(4) October 2009 pp 525-530

whole, along with modern technology, traditional knowledge would be a boon for mankind to find out a way forward for water dispute.

Aratrika Chakraborty and Anuradha Parihar, *Legal Education System in India*
2(1) ALEXIS J. PUB. POL'Y. & L. 20(2015)

LEGAL EDUCATION SYSTEM IN INDIA[**]

Aratrika Chakraborty and Anuradha Parihar[*]

Legal education as it exists today has come a long way from the traditional framework to a new globalized approach. Today the legal fraternity is not just associated with courtrooms but it is more of a "transnationalized legal service market". What is essential in designing the legal education system today is basically bridging the gap between theory and practicality. A synergism of socio-ethical values with the professional and commercial approach is needed today. There is a necessity to develop an interdisciplinary approach for better appreciation of laws in the context of social, economic, and political concerns. When we look of legal education in our society today it has more of a utilitarian approach which is desirable from the economic point of view. But the question is can legal education be separated from the study of spiritual and moral consciousness. The education system demands today a combination of modernity and trans-nationality with ample research and scholarship imbibition and at the same time knowing the indigenous philosophies and jurisprudence of our country.

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TABLE OF CONTENTS

I. INTRODUCTION

Legal education as it exists today has come a long way from the traditional framework to a new globalized and transnational approach. Today the legal fraternity is not just associated with courtrooms but it is more of a "transnationalized legal service market".[1]

Lord Denning in his address to the society of Public Teachers of Law expressed three purposes of legal education:[2]

(1) to show how legal rules have developed, the reasons underlying them and the nexus between legal and social history,

(2) To extract the principles underlying the existing legal rules, and

(3) To point the right road for future development.

Legal education has been a topic of planning and deliberations for many decades. There are several government bodies including Law commission of India, University Grants commission and Bar Council of India who have taken several initiative steps for the improvement of legal education in our country. The National Knowledge Commission has also given its own set of recommendations

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[1] B. C. Nirmal, *Legal Education In India: Problems And Challenges*, IIUM LAW JOURNAL VOL. 20 NO. 1, 2012
Student, NLU Jodhpur

[2] Priya Ravi, *Legal Education and its Aims,* Available at http://www.legalservicesindia.com/article/article/legal-education-&-its-aims-126-1.html , (last visited, 29th January 2016)

Legal education in India has its roots right from the Vedic times but the Britishers introduced the first formal kind of legal education system on the lines of which our modern education system stands. Though now US legal education system also has its influence globally and the National Law schools are influenced by the US legal education system to a large extent.

The Vision Statement 2010-2017 of the Chairman of the Bar Council of India of June 2, 2010 made a promise to the Nation, of 'ensuring equality before the law and the supremacy of the rule of law in the Indian democracy.' The Vision Statement identified inadequate quality of legal education and infrastructure and lack of relevant skills training to meet the ever-changing demands of the modern world, as two of the issues affecting the image of the legal profession in India and identified as one of the steps towards resolving these issues as 'creating clear quality standards for legal education and a common entry standard for entering law schools across the country.' What is most interesting in the Vision Statement is its understanding that Indian legal education should be 'value creating' not only for "top of the pyramid" law graduates but must also have 'stringent minimum standards' so that 'it is transformational for all students,' irrespective of the law school that they choose to graduate from.[3]

What is essential in designing the legal education system today is basically bridging the gap between theory and practicality. And a synergism of socio-ethical values with the professional and commercial approach is needed today. There is a necessity to develop an interdisciplinary approach for better appreciation of laws in the context of social ,economic, and political concerns.

Under clause (h) of sub-sec (1) of Sec.7 of the Advocates Act, 1961 the Bar Council of India has power to fix a minimum academic standard as a pre-condition

[3] Bar Council of India, *Reform of Legal Education in India , Note on Proposed Directions for Reform* ,available at http://www.barcouncilofindia.org/wp-content/uploads/2010/07/LegalEducationReformRecommendations.pdf (Last visited on 30th January, 2016)

for commencement of a studies in law . Under clause (i) of sub-sec (1) of Sec. 7, the Bar Council of India is also empowered "to recognize Universities whose degree in law shall be taken as a qualification for enrolment as an advocate and for that purpose to visit and inspect Universities". The Act thus confers on the Bar Council power to prescribe standards of legal education and recognition of law degrees for enrolment of persons as Advocates. However, for promoting legal education and for laying down standards of legal education, the Universities and State Bar Councils must be effectively consulted. The University Grants Commission has in the course of time evinced interest in improving legal education and has taken various steps towards at end, through adequate funding, creating of senior posts and other means.[4]

Before the coming of BCI and UGC the need for upgrading legal education has been felt for long. Numerous committees were set up periodically to consider and propose reforms in legal education such as Calcutta University Commission [1917-1919], University Education Commission, was set up in 1948-49, In the year 1949 the Bombay Legal Education Committee was set up to promote legal education. The All India Bar Committee made certain recommendations in 1951.

In 1954, XIVth [14th] Report the Law Commission (Setalvad Commission) of India discussed the status of legal education and recognized the need for reform in the system of legal education and made certain major recommendations.

The National Knowledge Commission (herein after NKC) was constituted on 13th June 2005. The NKC was established to make an intensive study on the issues like building an excellent education system to meet the challenges of education in the 21st century. In its report NKC recommended not only an increase in the number of institutes in higher education but also emphasise be given on improving the quality of education.

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[4]Adv. Devadas T.M., *History of Legal Education in India*, available at, http://strippedlaw.blogspot.in/2010/11/history-of-legal-education-in-india.html (Last visited on 30th January,2016)

Based on the recommendations of the Working Group and further consultations with stakeholders, NKC has proposed ten key recommendations with special reference to legal education given below:[5]

- Regulatory Reform: A New Standing Committee for Legal Education;
- Prioritize Quality and develop a Rating System;
- Curriculum Development;
- Examination System;
- Measures to attract and retain talented faculty;
- Developing a Research Tradition in Law Schools and Universities;
- Centers for Advanced Legal Studies and Research (CALSAR),
- Financing of legal education; Dimensions of Internationalization;
- Technology for dissemination of Legal Knowledge.

Thus, it also recommended the establishment of the National Universities in higher education so that the quantity and quality both of the education system would be taken care of simultaneously.

II. IMBIBING THE CONCEPT OF DHARMA

When we talk of legal education it should not be limited to the aspects of professional skills only. Law serves as a tool for social engineering. It is not only confined to courtrooms and litigants but it forms part of the society as a whole. Law was considered inherently linked to the concept of Dharma in ancient India. Concept of Dharma is essentially righteousness.

[5] *See,* http://shodhganga.inflibnet.ac.in/bitstream/10603/12649/7/07_chapter%203.pdf,(Last visited on 30th January,2016)

In his speech to the Constituent Assembly, Dr. S. Radhakrishnan said: "We have held that the ultimate sovereignty rests with the moral law, with the conscience of humanity."

Dharma, thus is synonymous with 'the rule of law', the basic foundation of our Constitution. In ancient India, the Vedas and the Dharmashastras were the supreme foundations of law and its ultimate source. The Dharmasastra was taken by early British colonial administrators to be the law of the land for Hindus in India. A separation of religion and law within Dhamasastra has been called into question .The British however saw the Dharmasastras as codes of law and the basic jurisprudence, behind framing the laws. So we need to delve into the question that when we are talking about these being just religious codes are we correct or there needs to be an essential role of the study of the philosophies and jurisprudence from which the basic concepts are still equally relevant even in today's Indian society.

Law and legal education can never be isolated from ethics, moral and philosophical consciousness if it has to form a framework for societal structure. When we look of legal education in our society today it has more of a utilitarian approach which is desirable from the economic point of view. But the question is can legal education be separated from the study of spiritual and moral consciousness. We study jurisprudence as a part of our legal curriculum but synergism of jurisprudence and the laws are lacking in the true sense. When we are talking about the proper legal education and imbibing jurisprudential concepts one needs to understand the higher moral law over and above the positive law embodying certain values of universal validity. Establishing a harmonious social order should be the aim of legal research and education and that can be achieved only through this synergism.

The curriculum covers the laws but we should realise the code and philosophies behind any legislative framework. And this pertains to not only the legal academia but also the legislative community as a whole. Whenever a law is framed ,studied

and further reformed there are historical, socio-cultural, economic and several dimensions linked to it and unless we derive the knowledge from our understanding of the society and the ethical and moral undertones relating to the code we will not be really able to appreciate and work towards it.

III. THE CHALLENGES OF GLOBALIZATION

One of the important aspects which legal education system needs to take care today is the existence of a global market and the increasing globalization. The earlier insularity with which curriculum were framed pertaining to mainly study of domestic laws is no longer desirable. The study of domestic laws today has to be also done on a comparative perspective. Time and again be it in the realm of human rights, environment law, international laws and conventions have played a major role in Indian legislation, so there cannot be a limited impetus to international and comparative law anymore in the curriculum. In the present day, an innovative programme of integrated interdisciplinary legal learning and in the new areas such as Comparative Law, information technology, intellectual property, corporate governance, human rights, environment, and international trade law, investment, and commerce, transfer of technology, alternative dispute resolution and space is important. There should be an international component necessarily even when the domestic laws and jurisprudence is studied and analysed.

Some observations of David Gerber are apposite in this context. For instance, Gerber calls for greater attention to theory in the broad sense of conceptual structure, because theories are the mechanisms for structuring information and knowledge effectively. Analogous to this viewpoint is the model suggested by Ugo Mattei. He argues for a classification of legal systems, which he refers to as taxonomy of legal systems for the purpose of learning from each other by rethinking the traditional boundaries drawn in the context of changing nature of

global politics. This situation necessitates revisiting the classic categorisation of legal systems as civil, common and socialist.[6]

Roscoe pound also pointed out that how legal education is transcending the boundaries because of the gradual economic unification and so lawyer's role has several new aspects in the society.

There are four important factors of legal education: global curriculum, global faculty, global degrees, and global interaction. These deserve public attention.

There is also need to present Indian universities more in the global forum with more and more exposure of global faculties. There are several foreign universities who arrange for lecture from foreign luminaries by video conferencing. Today technology has made possible for us to shorten the distances and make the academic forum well connected to a much larger extent than it was even 2 decades ago. More and more stress should be given to exchange and collaboration programmes in law schools.

IV. NATIONAL LAW UNIVERSITIES- A TURNING POINT IN THE LEGAL EDUCATION SYSTEM

The most creative step taken by the Bar Council of India to pave the way in reforming the legal education system was the establishment of the National Law School of India University Bangalore in 1987. This system aimed and in fact changed the historical system of imparting legal education in departments of law in the universities. These departments being within the universities suffered with a lot of complications in the form of lack of institutional autonomy and independence and therefore these departments did not receive appropriate priority in these universities. It was only by the keen interest of students that the universities could still provide the society with some of the best lawyers and legal academicians.

[6] *Supra Note* 3

With the establishment of NLSIU a lot of students were attracted to join legal education as these law schools introduced a new system of integrated five-year program for the high school leavers and thus this successful endeavour lead to establishment of many other law schools in Hyderabad, Kolkata, Bhopal and Jodhpur etc. that in today's date there are around 15 such law imparting legal educations in the country. It is often argued that the Law schools are able to attract the brighter students and also that the quality of the curriculum and methods of teaching makes these law schools produce the best possible law graduates.

These reforms did a great good to the society but along with it came the sufficient share of difficulties as well. The most important one was the cost factor because on one hand it could attract large number students to join legal education and on the other these schools were far beyond the reach of students belonging to the lower income families as only middle and upper middle class parents could afford such education for their child. Improvement in education is an important aspect but along with improvement accessibility and affordability cannot be forgotten. Most of these NLUs are universities in the full sense as they are not at the full governed or funded by the State and thus the amount of fee they charge remain exorbitantly high. The students gaining education in these law schools carry with them a huge financial burden which is imposed on in the form of loans and other advances which have been incurred because of the fat sum of fee they pay for the five year education in these universities. Thus, this financial burden forces these highly bright students to join private companies which to a large extent reimburse them this money instead joining the legal profession.

The reform system served the main purpose of bringing a positive change in the legal education only partially. The approach was a partial one as it was restricted only to the law schools and the changes brought also remained restricted to these law schools and some private universities while the system of education remained

out-dated in the traditional universities. There were substantial amount of changes brought in the curriculum and subjects of study which were to be undertaken by the law universities but the traditional universities were kept out of the applicability of changes. Thus the pattern of education followed in these traditional universities remained obsolete and did not match with the growing needs of the society. The law school system produces the best possible lawyers but at the same time those receiving such quality education are predominantly joining private sector. Thus, the justice delivery system suffers in a way as those actually dealing with the societal problems study in the out-dated education system.

Imparting legal education at the undergraduate level has been the key focus of the law school system and in this effort to provide such quality education at the undergraduate level, education at postgraduate level and legal research has been neglected and not been found even in the plan except few law schools. This neglect on the part of the law schools has led to dearth of quality of law faculties and legal researchers. One of the key elements in improving quality of education is to improve the quality of teachers imparting such education; this key element is lacking nowadays in most of the law schools and is one of key problems faced by these law schools. It is said that '*teaching is the mother of all professions'* but the trend which is observed today is that only a few lawyers and law students consider academia as a career and instead the bright students after attaining a quality education in law predominantly join the private sector.

One of the prominent reason because of which young lawyers get discouraged to pursue academia as a career are the poor financial incentives provided to them which need to be addressed. The law schools can work towards retaining talented faculty by bringing in feasible improvements in the law schools itself. The lack of career development opportunities in the law schools, repel those with interest in the profession of academics. The law teachers are required follow such a schedule which does not leave with enough time and space for their endeavours regarding legal research. The law schools should go for development of research

infrastructure including the resources to organise and participate in national and international conferences, and undertake serious research; a harmonious environment that fosters mutual respect; governance of the law schools in a transparent fashion; and, above all, faith in the leadership of the institution that excellence will not only be promoted as a general policy, but affirmative efforts will be taken to encourage and support excellence.[7]

V. CONCLUSION

In conclusion we would like to sum up by saying that there are many aspects which the legal education system has to take care of. To encourage bright students from all income groups of there should also be ample opportunities for scholarship, which can actually solve the problems relating to financial difficulties as discussed earlier. Also, another suggestion which may be pertinent in this regard is some exposure to law and legal systems at the school level so that students before joining a 5 year law school after high school can take a more informed decision in this regard. CBSE has taken a good initiative in this regard. The Central Board of Secondary Education (CBSE) has decided to introduce legal studies in classes XI and XII a pilot project in 200 schools in India and abroad.

These schools will offer legal studies as an elective subject that students can opt for along with three other elective subjects and a language. [8]

The education system demands today a combination of modernity and trans-nationality with ample research and scholarship imbibition with the same time knowing the indigenous philosophies and jurisprudence of our country.

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[7] C. Raj Kumar, *Improving legal education in India*, The Hindu, 27th June 2007, Available at http://www.thehindu.com/todays-paper/tp-opinion/improving-legal-education-in-india/article1861977.ece (last visited on 29th January 2016)

[8] Manash Pratim Gohain, *CBSE to offer legal studies in classes XI, XII* , The Times of India, Apr 9, 2013

Shakha Jha, *Tax Considerations of Licensing Technology Transfer Agreements in India*
2(1) ALEXIS J. PUB. POL'Y. & L. 31(2015)

TAX CONSIDERATIONS OF LICENSING TECHNOLOGY TRANSFER AGREEMENTS IN INDIA**

Shakha Jha*

Technology exists in different forms such as, intangible property, knowledge and skills. It's transfer from one country to another can take place in several ways such as change of ownership, through licensing or leasing, or through the provision of services.Payment for the transfer can be made through some type of recurring rental payment e.g. a royalty, or through a fee for the technical services rendered. These various methods of technology transfer have varying tax implications in the transferring as well as the recipient country. In general, the taxation structure affects technology transfer either by increasing the cost of the actual transfer or by reducing the subsequent return to the transferor.Thus, the formulation of a tax policy with respect to the importing of technology involves the balancing of conflicting objectives i.e. on one hand, the countries wish to facilitate the acquisition of technology: on the other, they wish to derive, in the form of tax revenue, a fair share of the profits that accrue to the foreign owner of that technology by virtue of such transfer.

Therefore, in the light of the above, the proposed paper would seek to address the tax implications on licensing and transfer of technology under which the author would also revisit the issues pertaining to taxability of IP as goods, information technology as services and payment of royalty and taxability of software licenses. Furthermore, the author would deliberate over the tax considerations in Cross border deals in TTA's and licensing, the discussion under this part is limited to four specific issues i.e., Double Taxation Avoidance Agreement, tax benefits for IP and transfer of technology, transfer pricing issues and arm length's price and the tax withholding source. Lastly, the author concludes

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the paper by looking at the road ahead for the taxation of royalties and fees for technical services, both at the domestic as well as the international level.

TABLE OF CONTENTS

I. INTRODUCTION

Over the past few years international transfer of technology (ToT) and licensing of Intellectual property rights (IPR) has become a robust development in India. With the evolution of technology and the ever-increasing volume of commercial transactions between the multinational enterprises, the income derived from the use of intangible property has increased manifold over time and these intangible assets generate a higher rate of return as such assets possess enormous international mobility. In the recent years, the technology transfer is majorly being done from the developed to developing countries which in a way helps in increasing access of the developing countries to technologies related to other developed countries and furthermore helps in utilizing the latest technologies and inventions whereas licensing is an allowance

which is granted by the patent owner to another person or organization for utilizing the patented invention on terms and conditions agreed between the parties where the patent owner continues to retain his ownership to the patent so when these two concepts of technology transfer and licensing are combined then, one would be benefitted from the technology research that has been previously done, as licensing creates a scenario which allows for the transfer of technology to a greater community of researchers and automatically curbs the expenses of conducting the research and such other costs as maintaining development activities or facilities etc. and hence forth aids in the eventual development of the existing technology.

With that being said, taxation is one of the major facets in cross border IP licensing agreements.The payments which is made to the people who own such intangible assets are termed as 'royalties'. In most of the countries, the governments have been acutely interested in the taxation of these payments known as royalties because of the higher rate of return generated, thereby making royalties a significant revenue source. Additionally, the immense growth and development of international trade has made the services of technical nature quite simpler and the taxation of the fees for such services has attracted the attention of several policy drafters.

In such a case, tax issues are generally considered in terms of IPOs, mergers, acquisitions or investment projects.[1] Transfer of technology results in income which can be in the nature of royalty, fees for technical services, business profits or even other income. Under domestic Indian law; the incidence of tax would be income which is deemed to accrue or arise in India.[2] However, in a case where exemption is available under a DTAA agreement then the beneficial provisions would apply. In this

[1]Tony Dong, Tax considerations for IP transfer (Aug. 16, 2012), http://www.chinalawinsight.com/2012/08/articles/corporate/tax-considerations-for-ip-transfer/.
[2]Direct tax laws - act - income-tax act 1961, S.9 (1961).

particular paper the author would focus on various tax considerations on licensing and transfer of technology agreements (TTA).

II. TAX IMPLICATION: LICENSING AND TRANSFER OF TECHNOLOGY

A. Taxability of IP as goods

There can be various situations wherein taxation of IPR licenses can occur. For instance; a company having ownership of IPR from India may transfer their licenses to a foreign company. There can also be a transfer from an owner in India to another person in India or vice versa. In all cases the transaction for licensing IPR shall be subject to tax. This is in accordance to the Constitution of India under Article 366 (29A) that is; tax can be levied on the sale or purchase of goods which includes a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration.[3] Therefore as per this provision of the Constitution it is clear that transfer of licenses and assignments of IPR can also be taxed provided that they are considered to be goods.

In *Vikas Sales Corporation's case,*[4]the Supreme Court considered the question as to whether import licences called replenishment licences or exim scrips are goods leviable to tax on sales? While analysing the law on the subject, it was held that these licences have their own value. "They are freely transferable and bought and sold as such in the market. They are treated and dealt with in the commercial world as merchandise goods. A REP licence/exim scrip is neither a chose-in-action nor an

[3]*THE CONSTITUTION OF INDIA (46th CONSTITUTIONAL AMENDMENT) a. 366 (29A) (D).(2008,)* .

[4]*Vikas Sales Corporation v. Commissioner of Commercial Taxes*, 1996 102 STC 106.

actionable claim. It is also not in the nature of a title-deed. It is by itself a property. For all intents and purposes, REP licences/exim scrips are goods leviable to tax on the sale or purchase thereof."[5]

Further, in the *Scientific Engineering case*,[6] it was decided that technical know-how in the shape of drawings and designs, charts, plants, processing literature etc. comprised in "documentation service" falls within the definition of "Book" and "Plant". Further; it was considered to be "a capital asset" and also "a depreciable asset", thus falling within the ambit of "goods" and hence taxable under the Income tax Act, 1966.

In addition, the Supreme Court in *TATA Consultancy Services v. State of Andhra Pradesh*,[7] held that software, which is incorporated on a media, would be goods and therefore, liable to sales tax. A software program may consist of various commands which enable the computer to perform a designated task. The copyright in that program may remain with the originator of the program. But the moment copies are made and marketed, it becomes goods, which are susceptible to sales tax.

In another case of *S.P.S. Jayam and Co. vs Registrar, Tamil Nadu Taxation Special Tribunal and others*[8] the High Court held that the Royalty received as consideration of use of trade mark is consideration of transfer of right to use an immovable asset and upheld its taxation under the sales tax laws. The court observed that "For transferring the right to use the trademark, it is not necessary to hand over the trademark to the transferee or give control or possession of trademark to him." The court further

[5] *Id,* see also *Liberty Enterprises v. State Of Haryana And Anr* (2007) 5 VST 12 P H, at paragraph 7.
[6] *Scientific Engineering House Pvt. Ltd. v. Commissioner of Income Tax, Andhra Pradesh* : 1986 (1) SCC 11 (AIR 1986 SC 338).
[7] *TATA Consultancy Services v. State of Andhra Pradesh*, 2004 (271 ITR 401).
[8] *S.P.S. Jayam and Co. vs Registrar, Tamil Nadu Taxation Special Tribunal and others* (2004) 137 STC 117(MAD)

observed that "Simply because the assessee retained the right for himself to use the trademark and reserved the right to grant permission to others to use the trademark, it would not take away the character of the transaction as one of transfer of a right to use."

Furthermore, in the case of *Asia Satellite Telecommunications Co. Ltd. v. Commissioner of Income Tax* [9].The Tribunal considered three issues out of which two of them are relevant which are: (a) whether there was 'use' of property,(b) whether the satellite use amounted to a process in which case they would be taxable as royalties? With regard to the first issue, the Tribunal held that the term 'use' refers to taking advantage out of the properties and that in the case at hand, there was advantage derived by utilizing the process in the transponder. As such the process in the transponder was being 'used.' With respect to the second question, applying Indian domestic law, the Tribunal decided that the fees paid for satellite use were indeed royalties, on the ground that they were payments for the use of a process. The process in question was the use of the transponder to relay satellite signals into India.

Also in the case of New Skies Satellites N.V. v. ADIT[10], the Tribunal concluded that the payments received by the assesses from their customers are on account of the use of a process involved in the transponder and therefore, amount to royalty within the meaning of s. 9(1)(vi) of the Act. Consequently, it was concluded that these also amount to Royalty within the meaning of the DTAA.

Therefore, intangibles such as IP licenses are considered to be taxable goods in India. Nevertheless, tax implications may be different with different forms of transfer and

[9] *Asia Satellite Telecommunications Co. Ltd. v. Commissioner of Income Tax* (2003) 78 TTJ (High Court of Delhi) 489

[10] *New Skies Satellites N.V. v. ADIT* (2009) 126 TTJ 1 (High Court of Delhi)

licensing of IP. They may be subject to sales tax, service tax, R&D cess, customs, income tax or central excise. The implication to tax is directed according to whether the IP licensed is considered to be goods, services or both.

B. Taxation of Information Technology as Services

According to Section 65(105) (zzzze),[11] "taxable services" means any service provided or to be provided to any person, by any other person in relation to information technology software[12] including;

(i) development of information technology software,[13]

(ii) study, analysis, design and programming of information technology software,[14]

(iii) adaptation, upgradation, enhancement, implementation and other similar services related to information technology software,[15]

(iv) providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the start-up phase of a new system, specifications to secure a database, advice on proprietary information technology software,[16]

(v) providing the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information

[11]The Finance Act, 1994 Chapter V (1994)...
[12]The Finance Act, 1994§ 65(105) (zzzze), (2008)
[13]*Id.*
[14]*Id.*
[15]*Id.*
[16]*Id.*

technology software and right to use software components for the creation of and inclusion in other information technology software products,[17]

(vi) providing the right to use information technology software supplied electronically and the term "service provider" shall be construed accordingly.[18]

Contrary to the above provision royalty paid under a technology/technical know-how agreement cannot be subjected to the levy of Service Tax. This was held in the case of *M/s. Navinon Ltd. v. CCE*,[19]since the agreement comes under the heading "Consulting Engineer" the supplier of the technology is not a consulting engineer who provides a service in the capacity of the engineering but a manufacturer and hence would not fall within the description of a "Consulting Engineer" for the levy of Service Tax.

C. Payment of Royalty and Taxability of Software Licenses

Black's Law Dictionary defines "royalty" as "compensation for the use of property, usually copyrighted material or natural resource, expressed as a percentage of receipts from using the property or as an account per unit produced."[20] In general terms, royalty is the fee paid to the owner of IP for the use of his/her creation. The Indian Taxation Act, 1961 defines royalty to mean any consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital Gains"). Royalty is said to be taxable in the hands of non-residents if the same are received in or accrued in India.[21]According

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[17]*Id.*

[18]*Id.*

[19]*M/s. Navinon Ltd. v. CCE*,(2004) 172 ELT 400 [Tribunal-Mum].

Black's law dictionary - free online legal dictionary, (2nd ed., 1910,)

[21] Taxation of income of Non-residents from transfer of Technology - Tax treatment of Royalty and fees for technical Services , available at:http://www.incometaxindia.gov.in/publications/9_Income_Tax_For_NRI/Chapter008.asp

to the OECD Model, royalties are defined as "payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including .... any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience". The definition is very broad and would seem to embrace virtually all forms of payment for all forms of technology.[22]

Due to conflicting debates over the taxability of software and royalty payment; explanation 4 to Section 9(1) (vi) of the Income Tax Act, 1961 has been inserted vide the Finance Act, 2012. It provides that royalty includes the transfer of all or any rights for use or the right to use computer software including licenses irrespective through which the right is transferred.[23] Such questions came before the Tribunal in *DDIT v. Reliance Infocom Ltd*[24]*,* the question was whether payment made for the license granted for the use of shrink wrap software is taxable as royalty?

The Court in this case relied on previous judgments made by the Karnataka High Court in the cases of *Samsung Electronics Ltd.*[25] and *Synopsis International.*[26] The Karnataka HC in *Samsung Electronics Ltd.* held that the right to make use of the software integral for business is considered to be royalty under section14(1) of the Copyright Act.The transaction did not involve the sale of the copyrighted article but an amount was paid for the supply of shrink wrapped software and licenses thereof.

[22]UNCTAD, *Transfer of Technology for Successful Integration into the Global Economy Taxation and Technology Transfer: Key Issues*,UNCTAD 2005 (2005)., Available at: http://unctad.org/en/Docs/iteipc20059_en.pdf
[23]Finance Act, 2012
[24]*DDIT v. Reliance Infocom* Ltd (2013-TII-164-ITAT-MUM-INTL).
[25]*CIT v. Samsung Electronics* Co Ltd (2012) 345 ITR 494 (Kar.HC.).
[26]*CIT v. Synopsis International* Old Ltd. (2013) 212 Taxman 454 (Kar. HC).

Thus the Court held that the right that was transferred was copyright and the payment made was in the form of royalty and hence taxable.

Further, in *Synopsis International* assessee was granted a non-exclusive non-transferable software license without right of sub-licence. However, licensee might make a reasonable number of copies of licensed software for backup and /or archival purposes only. Even if it was not transfer of exclusive right in copyright, the right to use was given to the assesse making it clear that there was transfer of certain rights. In terms of DTAA between Ireland and India consideration paid for use or right to use said confidential information in form computer software would thus constitute royalty and attract tax. The Court held that it is not necessary that there should be a transfer of exclusive right in copyright in such cases.

Therefore in *Reliance Infocom* the Tribunal was of the opinion that if the software is an integral part of the supply of equipment, the consideration for that is not assessable as "royalty". However, in a case where the software is sold separately, the consideration for it is assessable as "royalty". Looking at the facts of this case, the assessee had attained the software independent of the equipment. It had received a license to use the copyright in the software belonging to the non-resident. The non-resident supplier continued to be the owner of the copyright and all other intellectual property rights. As there was a transfer of the right to use the copyright, the payment made by Reliance to Lucent was "for the use of or the right to use copyright" and constituted "royalty" under s. 9(1)(vi) and Article 12(3) of the India-USA DTAA.[27]

[27] *Id.* also available at : http://itatonline.org/archives/index.php/ddit-vs-reliance-infocom-ltd-lucent-technologies-itat-mumbai-consideration-for-supply-of-software-which-is-not-embedded-in-equipment-is-taxable-as-royalty/

III. TAX CONSIDERATIONS IN CROSS BORDER DEALS IN TTA'S AND LICENSING

A. Double Taxation Avoidance Agreement

Section 90 of the Income Tax Act, 1961 empowers the Central Government to enter into agreements with the government of another country to grant relief to avoid double taxation.

Section 90(2) says: Where the central government has entered into an agreement with the government of any other country outside India under sub-section (1) for granting relief of tax or as the case may be, for avoidance of double taxation, then in relation to the assessee to whom such agreement applies the provisions of this Act shall apply to the extent they are more beneficial to the assessee (resident of the foreign country). Under this provision a right is given to the resident of the foreign country to choose between the provisions of the applicable DTAA and those of the Income Tax Act, 1961, whichever is more beneficial.

However, the Central Board of Direct Taxes' circular no 333 dated April 2, 1982[28] seems to indicate otherwise. According to this circular, where a double taxation avoidance agreement provides for a particular mode of computation of income, the same should be followed, irrespective of the provisions in the Income-tax Act. Where there is no specific provision in the agreement, it is basic law, i.e., the Income-tax Act that will govern the taxation of income.[29]

[28] Circular No. 333 *(*F. No. 506/42/81-FTD*) (*1982*)*, also available at*:* http*://*law.incometaxindia.gov.in/Directtaxlaws/act2005/sec_090.htm

[29] *Id.*

Nevertheless, conflicts between Section 90(2) and circular no. 333 have been explained in various cases. One such case include *CIT v. Hindustan Paper Corpn. Ltd.*[30] which stated that "It is by now well-settled that wherever there is a conflict between a Double Taxation Agreement (DTA) and the specific provisions contained in the Income-tax Act, the provisions of DTA will prevail over the statutory provisions contained in the said Act. In this connection reference may be made to Circular No. 333, dated 2-4-1982. The CBDT made it quite clear that where a specific provision is made in the DTA, which provisions will prevail over the general provisions contained in the Act.

In fact, the DTA which has been entered into by the Central Government under section 90 of the Act, also provides that the laws in force in a country will continue to govern the assessment and taxation of income in that country except where provisions to the contrary had been made in the agreement. Thus, where a DTA provides for a particular mode of computation of income, the same should be followed irrespective of the provisions in the Act. Where there is no specific provision in the agreement, it is the basic law, i.e., the Act, that will govern the taxation of income."

B. Tax Benefits for IP and Transfer of Technology

The Indian taxation regime has laid down certain beneficial provisions in order to promote sharing of technical know-how and advancement of technology. This is in the form of deductions for IPR and of transfer of technology. Section 35A (1) for instance allows for each of the relevant previous years, a deduction equal to the appropriate fraction of the amount of expenditure acquisition of patent rights or

[30] *CIT v. Hindustan Paper Corpn. Ltd.* [1994] 77 Taxman 450 (Cal.).

copyrights. Further, in the case of export of technology or transfer of technology; deductions are also given under Sections 80-O and 80-HHE of the Income Tax Act, 1961.

Section 80-HHE relates to deduction in respect of profits from export of computer software, etc. where an assessee, being an Indian company or a person (other than a company) resident in India, is engaged in the business of, exporting or providing technical services outside India. This is in connection with the development or production of computer software, the section thus allows in computing the total income of the assessee, derived by the assessee from such business.

Section 80-O relates to the gross total income assessed, being that of an Indian company or a person (other than a company) who is resident in India, includes any income received by the assessed from the Government of a foreign State or foreign enterprise in consideration for the use outside India of any patent, invention, design or registered trademark and such income is received in convertible foreign exchange in India.

Or having been received in convertible foreign exchange outside India, or having been converted into convertible foreign exchange outside India, is brought into India, by or on behalf of the assessed in accordance with any law for the time being in force for regulating payments and dealings in foreign exchange, there shall be allowed, in accordance with and subject to the provisions of this section, a deduction of an amount equal to--

(i) forty per cent for an assessment year beginning on the 1st day of April, 2001; (ii) thirty per cent for an assessment year beginning on the 1st day of April, 2002; (iii) twenty per cent for an assessment year beginning on the 1st day of April, 2003;

(iv) ten per cent for an assessment year beginning on the 1st day of April, 2004, of the income so received in, or brought into, India, in computing the total income of the assessed and no deduction shall be allowed in respect of the assessment year beginning on the 1st day of April, 2005 and any subsequent assessment year:

Provided that such income is received in India within a period of six months from the end of the previous year, or within such further period as the competent, authority may allow in this behalf:

Provided further that no deduction under this section shall be allowed unless the assessed furnishes a certificate, in the prescribed form, along with the return of income, certifying that the deduction has been correctly claimed in accordance with the provisions of this section.

The object of Section 80-O is to encourage Indian Companies to develop technical know-how and make it available to foreign companies and foreign enterprises so as to augment the foreign exchange earnings.[31]However, the provision is often being misused by companies. Hence, taxation authorities keep a check by certifying deductions to such claims. Taxation authorities may also appear before the Court/ Tribunal to determine such claims.

For instance; in the case of *Anand and Anand,*[32] while the ultimate beneficiary of the service rendered by the petitioner is located outside the country, the service for which the payments have been received by the appellant was rendered in relation to litigation pending in Indian Courts. The amounts received by the appellant, therefore, represented the remuneration of the work which the appellant-company had done for

[31]*The Commissioner of Income Tax v. M/s. Triumph International Finance (I) Limited*, ITA No.5746 of 2010, paragraph 20.
[32]*Anand and Anand v. Commissioner of Income Tax*, IT Appeal No. 752 of 2005, paragraph 10.

a foreign client in India. The professional services could not, therefore, be said to have been rendered from or outside India so as to qualify for a deduction under Section 80-O of the Act.[33]

C. 3.3. Transfer Pricing Issues and Arms Length Price

When a trade transaction between two companies that are part of the same multinational group occurs; the price established between the two parties for such transaction, is transfer pricing.[34] In the case of taxation Section 92C is applicable in terms of avoidance of tax-Transfer pricing-Arm's length.Section 92 states the Computation of income from international transaction having regard to arm's length price.[35] It states that:

1. Any income arising from an international transaction shall be computed having regard to the arm's length price.
2. In computing income under sub-section (1), the allowance for any expense or interest shall also be determined having regard to the arm's length price.
3. Where in an international transaction, two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be

[33]*supra note 33*

[34]Transfer pricing - tax justice network (Tax Justice Network Jun. 2010), http://www.taxjustice.net/topics/corporate-tax/transfer-pricing/.

[35]Income Tax Act, 1961.

> determined having regard to the arm's length price of such benefit, service or facility, as the case may be.

The arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely[36] :--

a. comparable uncontrolled price method ;
b. resale price method ;
c. cost plus method ;
d. profit split method ;
e. transactional net margin method ;
f. such other method as may be prescribed by the Board.

The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed : Provided that where more than one price may be determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices.[37]

Thus, arm's length price, is the price at which two unrelated parties will make a deal. Since these two parties are unrelated, hence market forces of supply-demand will

[36]Income Tax Act, 1961§ 92 C (1961)
[37]Income Tax Act, 1961§ 92 C(2) (1961)

work, the (share) price will be rational. So, government will get the full tax it deserves.[38]

In India transfer pricing referral is time-barred according to a decision in *Himalaya Drug Co. v. DCIT*.[39]In this case the Bangalore Bench of the Income-tax Appellate Tribunal issued an order quashing proceedings for assessment that were already completed and when subsequent events failed to reveal incriminating evidence relating to transfer pricing.

In this case the taxpayer was engaged in the manufacture and sales of herbal pharmaceutical and health care products.During assessment proceedings for the assessment year 2009-10, the Assessing Officer did not make a transfer pricing referral of the taxpayer's international transactions for a determination of the arm's length price. Rather, certain expenses were disallowed, and certain additions were made.In the meantime, the police seized a large amount of cash from the residence of a company director. Following this, the tax authorities initiated proceedings relating to "undisclosed" income, and a reference was made to the Transfer Pricing Officer for a determination of the arm's length price of the taxpayer's international transactions.

The Transfer Pricing Officer proposed transfer pricing adjustments, and after this, the Transfer Pricing Officer was directed by the Dispute Resolution Panel (DRP) to make additional transfer pricing adjustments. The taxpayer initiated an action before the tribunal contenting, in part, that the transfer pricing adjustments were time-barred because: (1) the DRP had failed to issue directions within nine months from the end

[38]Mrunal, *Budget 2014: CGT, APA, DTC, GAAR, transfer pricing cases*, ECONOMY (Mrunal Jul. 23, 2014), http://mrunal.org/2014/07/budget-advance-pricing-agreement-arms-length-vodafone-transfer-pricing-dtc-gaar-advance-tax-ruling-explained.html#632..

[39]*Himalaya Drug Co. v. DCIT* (ITA Nos. 1634 to 1639/Bang/2012).

of the month when the draft assessment order was served on the taxpayer; and (2) the reference to the Transfer Pricing Officer was not valid. The tribunal concluded that the assessment order for years that had obtained "finality" was barred by the time limitations.

Further in the *GE India case*[40] analysis of functional profile is of paramount importance in selection of appropriate comparables. The taxpayer provided research & development and engineering services by using computer aided technology to its affiliates. It selected comparables providing software development services to benchmark the services. The TPO held that the activities were in the nature of 'Service Provider' working for 'Research and Development' and not 'Software Development'. The Tribunal held that the taxpayer was a research and development service provider.[41]

D. Tax Withholding Source

High rates of withholding tax, especially on royalty payments, constitute an obvious deterrent to TOT.[42] Certain imports of technology may be exempted by custom duties or the foreign entity which is supplying the requisite technology may escape withholding taxes.[43] In India dividends are not subject to withholding tax only the

[40]*GE India Technology Centre Pvt. Ltd. v. Dy. Director of Income-tax*, for AY 2004-05, 2005-06 and 2006-07, ITA
No. 789/Bang/2010 and ITA No. 487 & 925/Bang/2011 dated 31st December 2012.
[41] Deloitte, Tax Briefly: Stay On top, http://www.deloitte.com/assets/Dcom-India/Local%20Assets/Documents/Tax%20Briefly/Tax%20Briefly_May%202013_web.pdf
[42]supra note 23
[43]*Id.*

company paying dividends is subject to pay DDT of 16%.[44] Royalties paid to a non-resident is subjected to 25% withholding tax as per March 1, 2014, however such rates can be reduced under a tax treaty.[45]

The Supreme Court of India in *GE India Technology Centre Pvt. Ltd.*[46] has held that any payments made to non-residents will be subject to withholding tax only when such payments are chargeable to tax in India. Meanwhile, it may be recalled that the Karnataka High Court in the Samsung case had earlier stated that any person making a payment for the import of shrink wrap software was under a statutory obligation to deduct tax at source.

Hence, by implication all payments for the import of any goods, irrespective of their chargeability to tax in India, became subject to withholding tax to the detriment of the foreign party. The only way to avoid the tax withholding was to make an application to the Indian tax authorities and obtain a written permission that the payer need not deduct taxes at source.

I. CONCLUSION

Above all, it is amply observed that the fees for technical services as well as taxation of royalties is, and will continue to be a significant issue of consideration for the policy drafters. The developed countries supplying such technology often debate for a tax regime favorable to them whereas the developing countries continue to argue that

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[44] Deloitte, India Highlights-2014, http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-indiahighlights-2014.pdf

[45] Withholding Tax Rates, Deloitte, http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-withholding-tax-rates-2014.pdf, rates are current as of March 1, 2014.

[46] *GE India Technology Centre Private Ltd v. CIT*, [2010] 327 ITR 456 (SC).

they need to have access to the technology, which is generally in the form of royalties and technical know-how, however at the same time they are not interested in giving any exemption to such technology from the tax structure prevailing in their countries.. Thus, both at the international level as well as the domestic level, the issue of taxability of such incomes, is quite unsettled and continues to remain a consistent moot topic for litigation and trade disputes. The situation in India is nevertheless the same as the majority of the Courts and Tribunals have passed such contradictory judgments on the taxability of royalties and technical fees under both the Income Tax Act, 1961 Act, and the DTAAs,.

With the ever increasing development of trade in intangibles, such a source of taxation constitutes a very prominent source of revenue to the Governments, especially Governments of developing countries and in the long term a better and a permanent solution is required which would be expected to eliminate the possibility of a clash between international taxation and international trade

In countries, especially India, the traditional spaces of business is being gradually replaced by a virtual trading world, where commodities exist in the nature of mostly intangibles. This demands for an unambiguous and a concrete law in place which can be achieved by creating a harmonious balance between the taxation system and the various treaties entered into and also with the established goals of international trade, *i.e.,* maximizing revenue along with attracting business.

Lastly, it can be analyzed on the whole that the taxpayers may enhance favorable tax policies while entering into IP transactions. Moreover, in the case of international IP transactions, it would be advantageous to look into tax treaty benefits, transfer pricing

issues, tax policy and other such considerations in India to manage the risks in a better manner and to ensure optimum benefits in such transactions.

G.Sneha Sindhu, *Non-compete clauses in employment contracts: Legal implications*
2(1) ALEXIS J. PUB. POL'Y. & L. 52(2015)

NON-COMPETE CLAUSES IN EMPLOYMENT CONTRACTS : LEGAL IMPLICATIONS[**]

By

G.Sneha Sindhu*

In an age where information is almost a form of currency it is vital to take measures to protect the dissemination of information. Non-compete clauses are a way to ensure the regulation of flow of information. This paper aims to look into the need for such clauses in employment contracts and how they are incorporated into such contracts, the meaning and the legality of these clauses in light of Section 27 of the Indian Contract Act and also examines the views of the Supreme Court through various case laws. The paper also briefly delves into the effect of such clauses on the employer and the employee signing it, and lastly, also tries to briefly examine the need for a mechanism to protect the interests of employee companies in light of the blanket protection given to the employees under Section 27 of the Indian Contract Act.

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TABLE OF CONTENTS

I. INTRODUCTION

We live in a world driven by information. It has been proven again and again that information helps build and destroy empires, in both the business and the real world. In this day and age, people who have access to information are usually the ones with power. To put the above very briefly, information is power. In such a scenario, it is no wonder that most multinational and national companies, which have an extremely large workforce often resort to having what is called a "Non-compete clause" in their employment contracts. The legality of these clauses has provided an interesting topic for legal debates in the recent times.

The issue when looked at from the side of the employer is very simple. Their argument is that when they have recruited and trained a person for a period of time, however large or small it maybe, that person becomes a walking storage of that particular information, which is extremely essential to the functioning of the company, and it is only fair that the company's multitude of secrets be protected. They argue that the person leaving the company may go ahead and embark on an entrepreneurial venture using the information that he gained while he was working with the Company.

With the advent of many multinational companies in India, especially in the Information Technology Sector (hereinafter referred to as the IT Sector), clauses like the non-compete, non solicitation, and confidentiality clauses have become commonplace in all employment contracts. These clauses are usually a hindrance

to the entrepreneurial aspirations of the employees. They also restrict an employee from competing with the employer or joining a competitor during the term of the employment and for a period thereafter. Safeguarding and protecting their trade secrets, commercial relationships or customer data are the main motivations behind most companies making their new employees sign these clauses.

The legality of these clauses differs from country to country throughout the world. In European countries like the Netherlands, Germany, Spain and France, they are valid but with certain restrictions, mostly in terms of time. These covenants are legally not enforceable in India as they are a direct violation of section 27 of the Indian Contract Act which talks about restraint of trade. It is a blanket ban on all agreements that are in restraint of trade:

'Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.'

The literal interpretation of the section makes it clear that in India, restraint, partial or total, in trade is void to that extent. The Supreme Court through the ages has upheld this section, however, recently the Apex Court has in a few cases displayed an inclination towards protecting the rights of the employer.

This paper aims to closely view the meaning and the legality of non-compete clauses, look at the Supreme Court's views through the years, and also examine the need for a mechanism to protect the interests of the employer companies.

II. NON-COMPETE CLAUSE – MEANING AND SCOPE

Before delving into its legality, it is important to understand exactly what a non-compete clause entails. A non-compete contract is a contract wherein a party is limited from competing with the business or trade of another party. This can be a clause in a contract or it can be in the form of a contract itself. A non-compete has

been defined as a contract which restricts participation in a certain market by a certain individual or a business under certain circumstances[1].

Non-compete clauses are usually drafted with an aim to safeguard the business know-how, which gives a business or a company its distinctive competitive edge. Employers generally enter into these covenants to ensure that while leaving the company and joining a rival company, the employees do not compromise on the business security of the enterprise. Any restrictions which they wish to impose on the said employees are laid down in the non-compete clause. However, these covenants are not confined to only employment contracts but are often entered into between businesses also[2]. They are increasingly being resorted to in cases of distribution agreements, licensing, joint ventures and partnership dissolution agreements and also most often in case of sale of businesses.

When signed on an even level, especially in a sale of business scenario, they bring a direct or indirect obligation upon a party to the acquisition agreement not to manufacture, purchase, sell or resell independently like goods or services which compete with the buyers, generally in respect to a certain geographical market[3]. Such an obligation on the seller of the assets guarantees that the acquirer receives the full value of the assets transferred and hence, is normally considered as ancillary to the main agreement[4].

While selling businesses, non-compete contracts play a very crucial role. They are often entered into primarily because of the imperfect and lopsided nature of the

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[1] *Non-Compete Agreement ,* INVESTOR WORDS, http://www.investorwords.com/3308/non_compete_agreement.html#ixzz1TBKY7ogc (A better source is highly recommended. Black's Law Dictionary online has a similar definition) .

[2] *Non Compete Covenants Time For Change In The Indian Perspective*, HELPLINE LAW, http://www.helplinelaw.com/business-law/NCCTCIP/non-compete-covenants-time-for-change-in-the-indian-perspective.html.

[3] *Id.*

[4] *Glossary of Competition Clauses: Non competition Clause*, INSTITUTE OF COMPETITION LAW, http://www.concurrences.com/article.php3?id_article=12156&lang=en..

information associated with such ownership rights. As they are information centric, these ownership rights are generally transferred from one company to another with relative ease when an employee shifts or where the seller starts a fresh company. Non-compete agreements mainly protect all ownership rights in the form of intellectual property, business know-how, trade secrets and any information falling short of trade secrets, which gives the company the competitive edge that it needs to succeed in a market.

An infringement of such rights would therefore be difficult to keep track of because knowledge as to the point where an infringement of rights actually occurs is often sought after but found with much difficulty. Also an actual infringement which happens due to the actions of a single person is hard to pin down, often resulting in the loss of valuable information. The source of infringement is usually very hard to track down and thus, an atmosphere of uncertainty and insecurity is created. Furthermore, the monetary cost associated with creating and maintaining a mechanism to watch out for any infringement is very high. So prevention of such infringement is a safe option.

The next part of this essay aims to look at the legal implications as regards to the enforceability of these covenants in India.

III. ENFORCEABILITY OF NON-COMPETE AGREEMENTS IN INDIA

At a global level, the legal validity of non-compete clauses differs from country to country, and often from one legal system to another. For example, in the United States, laws with regard to non-compete clauses vary in every state. With respect to this aspect of law, Indian law has chosen not to follow English law. Indian law in this regard is extremely unyielding and inflexible. Non-compete contracts are

governed by Section 27 of the Indian Contract Act, 1872 which deals with agreements in restraint of trade.

Section 27 of the Indian Contract states as follows:

> "*Agreement in restraint of trade void – Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void. Saving of agreement not to carry on business of which good-will is sold.*"

It can be seen from a reading of the above section, this is a law designed to offer blanket protection to anyone who agrees to enter into an agreement which is in restraint of trade, except clearly in cases where goodwill is sold. This is a rigid provision which clearly states that, any agreement is void to the extent that it restrains any person from exercising a lawful profession, trade or business of any kind. The word 'restraint' is an extremely important word here. It has not been made clear in the section whether this restraint can be complete restraint or a partial restraint. It should be noted that, the phrase '*to that extent void*' implies that only the non-compete clause in the agreement will be rendered void not the entire agreement.

The legal position of the Indian Contract Act with respect to non-compete clauses in employment contracts is that clauses imposing any restraint or restrictions pertaining to an employee's post-employment period are null and void, while the ones imposed on employees during the actual time of employment are legally enforceable. The Supreme Court has over the years dealt with a plethora of cases relating to Section 27 of the Indian Contract Act.

The Supreme Court as early as 1980 held that a contract, which had for its object a restraint of trade, was prima facie void[5]. This same principle was upheld by the

[5] Superintendence Company of India v. Krishan Murgai, AIR 1980 SC 1717.

Gujarat High Court in *Sandhya Organic Chemicals P.Ltd v. United Phosphorous*[6]. It was also held by the Gujarat High Court in this case that the principles laid down by the English Courts on common law and equity will not be applicable in view of Section 27 of the Indian Contract Act. In *Taprogge Gesellschaft MBH v. IAEC India Ltd*[7], the Bombay High Court held that a restraint operating after termination of the contract to secure freedom from competition from a person, who no longer worked within the contract, was void. The court refused to enforce the negative covenant and held that, even if such a covenant was valid under German law, it could not be enforced in India.

In the case of *V.V. Sivaram and others v. FOSECO India Limited*[8], an employee was restrained from using secrets and confidential information, which he gained during his job even after moving out of the job. The employee had access to confidential information pertaining to various products including the patent 'Turbostop'. He left under the voluntary retirement scheme. An injunction which was obtained for restraining him from manufacturing and marketing a product similar to 'Turbostop' was held to be not violating Section 27.

The Apex Court, in 2006, thoroughly examined the principle laid down in Section 27 of the Contract Act in *Percept D' Mark (India) Pvt. Ltd v. Zaheer Khan*[9], in which it observed that under Section 27 of the Act, a restrictive covenant extending beyond the term of the contract is void and not enforceable. The court also noted that the doctrine of "restraint of trade" is not confined to contracts of employment only, but is also applicable to all other contracts with respect to obligations after the contractual relationship is terminated.

[6] Sandhya Organic Chemicals P. Ltd. v. United Phosphorous Ltd. & Anr., AIR 1997 Guj. 177.
[7] Taprogge Gesellschaft MBH v. IAEC India Ltd., AIR 1988 Bom. 157.
[8] V.V. Sivaram & Ors. v. FOSECO India Ltd., (2006) 133 Comp. Cas. 160 Kar. .
[9] Percept D' Mark (India) Pvt. Ltd v. Zaheer Khan, AIR 2006 SC 3426.

Almost immediately after the above Judgement in 2007 in *V.F.S. Global Services Ltd. v. Mr. Suprit Roy*[10] the Bombay High Court held that a fully paid three-month "garden leave" agreement with a senior manager did not renew the employment contract and constituted a "restraint of trade" which is unenforceable by V.F.S. Global Services.

This principle as laid down by the Apex Court was followed by several High Courts and was clearly reaffirmed in a 2009 decision by the New Delhi High Court in *Desiccant Rotors International Pvt. Ltd. v. Bappaditya Sarkar & Anr*[11], wherein the Delhi High Court ruled that in a clash between the attempt of employers to protect themselves from competition and the right of employees to seek employment wherever they choose, the right of livelihood of employees must always prevail.

However, the Apex Court in the 1960s departed from the general pattern of being very employee friendly. In *Nilanjan Golokari v. The Century Spinning And Mfg*[12], the often inflexible Indian Courts departed from the general law on the restraint of trade. In this case the Hon'ble Supreme Court ruled that these non-compete clauses cannot be considered as restraint of trade against the employee, if they are operating during the course of employment. As a matter of fact, said the Apex Court, it is logical that the employer has an exclusive right of the services of his employees during the course of employment.

In this case an employee was given special training by his employer, on condition that he would serve the company for 5 years, and that if he left his employment before such period, he would not directly or indirectly engage in the same business and also pay liquidated damages. The Supreme Court held that, the negative covenants, which operate during the period of service, are generally not regarded

[10] V.F.S. Global Services Ltd. v. Mr. Suprit Roy, 2008 (2) Bom.CR 446.
[11] Desiccant Rotors International Pvt. Ltd. v. Bappaditya Sarkar & Anr., I.A. No.5455/2008, I.A. No.5454/2008 & I.A. No.5453/2008(CS(OS) No.337/2008).
[12]Nilanjan Golokari v. The Century Spinning & Mfg., AIR 1967 SC 1098.

as restraint of trade and therefore, do not fall within Section 27 of the Act, unless the contract is unconscionable or unreasonable. It was therefore held that this was a valid contract.

The court went on to hold that a person may be restrained from carrying on his trade by reason of an agreement voluntarily entered into by him with that object. In such a case, the general principle of freedom of trade must be applied with due regard to the principle that public policy requires the utmost freedom to the competent parties to enter into a contract, and that it is public policy to allow a trader to dispose of his business and to afford to an employer an unrestricted choice of able assistance, and the opportunity to instruct them in his trade and its secrets without fear of their becoming his competitors. Where an agreement is challenged on the ground of its being in restraint of trade, the onus is upon the party supporting the contract to show that the restraint is reasonably necessary to protect his interests. Once, this onus is discharged by him, the onus of showing that the restrain is nevertheless injurious to the public is upon the party attacking the contract.

A thorough examination of the above cases only makes it clear that Indian courts are clearly completely in favour of not enforcing the non-compete clause. Thus, it can be safely said that non-compete clauses in employment contracts are unenforceable in India.

IV. CONCLUSION

After examining the present situation with regard to the clauses, the author only seeks to bring out one point, i.e. the plight of the employers. With the courts so blatantly in favour of the employees, the need of this hour is a way to protect the rights of the employer. These companies more often than not, use huge amount of

men and money and various other resources, to create and develop various innovative and ground breaking softwares and programs, which, will always be at risk as the employee will inevitably move to a better paying competitor.

An argument can be made in favour of the Court's decisions as the right to livelihood is a fundamental right under Article 21of the Indian Constitution, and thus, it has to be upheld. It is of utmost importance and must not be overlooked, as it is a right guaranteed to every Indian citizen. In light of this very solid ground it becomes easy to understand why courts would be hesitant to try and enforce non-compete clauses. In conclusion, it can only be said that the need of the hour is a mechanism to protect the rights of the employers as the employees' rights are already protected in a very airtight manner.

Aditi Bajaj and Anusha Nagoji, *Determination of Arms Length Price*
2(1) ALEXIS J. PUB. POL'Y. & L. 62(2015)

METHODS USED TO DETERMINE THE ARMS LENGTH PRICE IN INTERNATIONAL TRANSFER PRICING[**]

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TABLE OF CONTENTS

I. INTRODUCTION: THE CONCEPT OF TRANSFER PRICING

Commercial transactions between the different parts of the multinational groups may not be subject to the same market forces shaping relations between the two independent firms. One party transfers to another goods or services, for a price. That price is known as "transfer price". This may be arbitrary and dictated, with no relation to cost and added value, diverge from the market forces.

Transfer price is, thus, a price which represents the value of good; or services between independently operating units of an organisation. But, the expression "transfer pricing" generally refers to prices of transactions between associated enterprises which may take place under conditions differing from those taking place between independent enterprises. It refers to the value attached to transfers of goods, services and technology between related entities. It also refers to the value attached to transfers between unrelated parties which are controlled by a common entity.

Suppose a company A purchases goods for 100 rupees and sells it to its associated company B in another country for 200 rupees, who in turn sells in the open market for 400 rupees. Had A sold it direct, it would have made a profit of 300 rupees. But by routing it through B, it restricted it to 100 rupees, permitting B to appropriate the balance. The transaction between A and B is arranged and not governed by market forces. The profit of 200 rupees is, thereby,

shifted to the country of B. The goods are transferred on a price (transfer price) which is arbitrary or dictated (200 hundred rupees), but not on the market price (400 rupees).

Thus, the effect of transfer pricing is that the parent company or a specific subsidiary tends to produce insufficient taxable income or excessive loss on a transaction. For instance, profits accruing to the parent can be increased by setting high transfer prices to siphon profits from subsidiaries domiciled in high tax countries, and low transfer prices to move profits to subsidiaries located in low tax jurisdiction. As an example of this, a group which manufactures products in a high tax country may decide to sell them at a low profit to its affiliate sales company based in a tax haven country. That company would in turn sell the product at an arm's length price and the resulting (inflated) profit would be subject to little or no tax in that country. The result is revenue loss and also a drain on foreign exchange reserves.

II. THE CONCEPT OF ARM'S LENGTH PRICING

A separate code on transfer pricing under Sections 92 to 92F of the Indian Income Tax Act, 1961 (the Act) covers intra-group cross-border transactions which is applicable from 1 April 2001 and specified domestic transactions which is applicable from 1 April 2012. Since the introduction of the code, transfer pricing has become the most important international tax issue affecting multinational enterprises operating in India.

The regulations are broadly based on the Organisation for Economic Co-operation and Development (OECD) Guidelines and describe the various transfer pricing methods, impose extensive annual transfer pricing documentation requirements, and contain harsh penal provisions for noncompliance.

According to Section 92F(ii) "arm's length price" means a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.[1]

Section 92C provides that the arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the methods listed there under, being the most appropriate method, having regard to the nature of transaction or

[1] Section 92F, Income Tax Act, 1961

class of transactions or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe.[2]

The regulations do not provide any hierarchy of the methods and support the concept of "most appropriate method", which provide the most reliable measure of an arm's len gth result under a particular set of facts and circumstances.[3]

III. ADVANCE PRICING AGREEMENT

An Advance Pricing Agreement is an agreement entered into specifically to regulate the transactions that form the basis for international transfer pricing. According to the OECD Guidelines on this subject, an Advance Pricing Agreement is defined as "an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time."[4] An APA may be unilateral, bilateral or multilateral. A unilateral APA is entered into solely between the taxpayer and the tax authority. A bilateral APA is based on a single mutual agreement between the competent authorities of two tax administrations under the relevant treaty. A multilateral APA is a term used to describe a situation where there is more than one bilateral mutual agreement.[5]

Although not a new concept to many other countries in the world, APAs are quite new to the Indian scenario. APAs in India were brought into existence by a Notification issued by the Ministry of Finance in 2012.[6] This notification has amended the Income Tax Rules of 1962, to include Rules 10F to 10T. These Rules cover various aspects of the APA, including the procedure to file an application and enter into an APA,[7] the procedure for termination,[8] etc. As is clear from a reading of Rule 10M,[9] one of the terms that must be agreed upon in the APA is the methodology that will be used to calculate the Arms' Length Price for the transfer pricing transaction covered by that APA.

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[2] Section 92C, Income Tax Act, 1961

[3] United Nations Practical Manual on Transfer Pricing for Developing Countries, published by the Department of Economic and Social Affairs, 2013, available online at http://www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf (visited on 20th February, 2014)

[4] Paragraph 4.124, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July, 2010

[5] Paragraph 4.130, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July, 2010

[6] Notification No. 36 of 2012, dated 30th August, 2012, Ministry of Finance

[7] Rule 10I, Income Tax Rules, 1962

[8] Rule 10R, Income Tax Rules, 1962

[9] Rule 10M(1)(ii), Income Tax Rules, 1962

The reason for this is that such a methodology is necessary to be decided so that both parties can be agreed that the Arms' Length Price is being calculated in a correct manner and there is no scope for unfair advantage to either party. The methodology is selected after due consultations and deliberations held by both parties. This methodology is determined on the basis of the transaction that is sought to be undertaken and the predictable profits and other outcomes from such a transaction. This can be best understood with a hypothetical example, as given below.

IV. A HYPOTHETICAL EXAMPLE

There is a certain company ("taxpayer") which has entered into a multilateral APA with the tax authority. This company is engaged in the manufacture of pharmaceutical products and has recently developed a medicine which is a breakthrough in medical science. This company has a wholly owned subsidiary located in Ireland, which is a low tax jurisdiction. The parent company contemplates transferring this formula for this medicine to its Irish subsidiary for further sale. To this end, it enters into the APA with the tax authority, to determine the methodology to calculate the Arms' Length Price for this transaction. The appropriate method which has been decided is the Cost-Plus Method (CPM). The APA is entered into.

Interestingly, instead of the Irish subsidiary selling the medicine itself, it creates its own wholly owned subsidiary in Netherlands, which in turn creates its own subsidiary, another one in Ireland itself, to the end of saving tax. The medicine is sold by this final subsidiary and earns billions of dollars in profit almost immediately. This being the case, the taxing authority now wants to cancel the APA, stating that had this been the original plan, the methodology which would have been adopted would have most likely been the Profit-Split Method (PSM).

This type of a situation does exist and is called a "Dutch Sandwich", which has been undertaken by companies like Google[10] and Facebook.[11] If the taxpayer wins, the CPM method will be used, and only the original sum as agreed would be received by the tax authority. If the tax authority wins, then the PSM method will be used, and the tax authority will be able to tax the additional amounts of income of the taxpayer, not envisage at the time of entering into the

[10] John Sokatch, "Trasnfer-Pricing with Software Allows for Effective Circumvention of Subpart F Income: Google's "Sandwich" Costs Taxpayers Millions", Vol. 45 *Int'l Law* (2011) p. 727

[11] "Facebook Mirrors Google's Offshore Tax Scheme", *Forbes,* available online at http://www.forbes.com/sites/robertwood/2012/12/27/facebook-mirrors-googles-offshore-tax-scheme/ (visited on 19th February, 2014)

APA. From this, the importance of understanding and choosing the right methodology becomes apparent.

V. THE DIFFERENT METHODS TO CALCULATE ARMS' LENGTH PRICE

A. COST-PLUS METHOD (CPM)

The Income Tax Act in India is the source which provides for the different methods that can be used to compute the Arms' Length Price.[12] One of these methods is the Cost-Plus Method. This method basically focuses on the costs incurred for the property or service which is being transferred. The first consideration when applying this method is that of the costs incurred in the development/manufacture/production of such a property or service, which is being transferred to the associated enterprise in the transfer pricing transaction. An appropriate mark-up, determined by reference to the mark-up earned by suppliers in comparable uncontrolled transactions, is then added to these costs, to make an appropriate profit in light of the functions performed and the market conditions.

To determine the ALP, there must be a reference to the mark-up that the same supplier earns in comparable uncontrolled transactions (internal comparables) or by reference to the mark up that would have been earned in comparable transactions by an independent enterprise (external comparables). Thus, the determination of the ALP by the CPM method depends heavily on its comparison with available comparables. In the example given above, this would mean other life-saving drugs that would also have sold in billions of dollars in a short span of time.

Thus, in a cost-plus method, the mark-up on costs that the manufacturer or service provider earns from the controlled transaction is compared with the *mark-up* on costs from comparable *uncontrolled* transactions.

This method probably is most useful where:

[12] Section 92C, Income Tax Act, 1961

i) Goods are sold by a manufacturer that does not contribute valuable unique intangible assets or assume unusual risks in the controlled transaction, such as may be the case under a contract or toll manufacturing arrangement;[13] or

ii) The controlled transaction is the provision of services for which the provider does not contribute any valuable unique intangible assets or assume unusual risks.[14]

Cost-Plus Method can be best understood by the following illustration:

Cost of raw materials……..200
Other direct and indirect production costs……..100
Total cost base……..300
Mark-up on costs (eg., 20%)……..60
Transfer Price…….360
Overheads and operation expenses…….40
Operating profit……20

Here, the 20% mark-up has been determined by comparing the costs with those of other, uncontrolled comparables, as discussed above. The transfer price is the sale price to the associated enterprise.

This method is considered most useful where there is a transfer of services.[15] For example, in the hypothetical situation given above, if the first Irish subsidiary had sent some of its employees to the parent company to research and develop the medicine along with the employees of the parent company, it would have been a contract of Research and Development. This is a service.[16]

Thus, when determining the most appropriate method to be used to calculate ALP, CPM becomes the most appropriate method where there is a transfer of services and there are external, uncontrolled comparabales to determine the mark-up.

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[13] "Transfer Pricing Methods", published by the Organization for Economic Co-operation and Development, July 2010, p. 5
[14] Ibid
[15] Paragraph 2.39, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2010
[16] *Philips Software Center Private Limited* v. *Assistant Commissioner of Income Tax,* (2008) 119 TTJ (Bang) 721

B. PROFIT-SPLIT METHOD (PSM)

The Profit-Split Method is used where it becomes very difficult to conduct a transfer pricing analysis on a transactional basis. The profit split method evaluates whether the allocation of the combined operating profit or loss attributable to one or more controlled transactions is arm's length by reference to the relative value of each controlled taxpayer's contribution to that combined operating profit or loss.[17] The combined operating profit or loss must be derived from the most narrowly identifiable business activity of the controlled taxpayers for which data is available that includes the controlled transactions (relevant business activity).

The relative value of each controlled taxpayer's contribution to the success of the relevant business activity must be determined in a manner that reflects the functions performed, risks assumed, and resources employed by each participant in the relevant business activity.[18]

Such an allocation is intended to correspond to the division of profit or loss that would result from an arrangement between uncontrolled taxpayers, each performing functions similar to those of the various controlled taxpayers engaged in the relevant business activity. The profit allocated to any particular member of a controlled group is not necessarily limited to the total operating profit of the group from the relevant business activity.[19] For example, in a given year, one member of the group may earn a profit while another member incurs a loss. In addition, it may not be assumed that the combined operating profit or loss from the relevant business activity should be shared equally, or in any other arbitrary proportion.

The profit split method is typically applied when both sides of the controlled transaction own significant intangible properties.[20] The profit is to be divided such as is expected in a joint venture relationship.

The profit split method might be used in cases involving highly interrelated transactions that cannot be analysed on a separate basis. This means that the profit split method can be applied in cases where the associated enterprises engages in several transactions that are

[17] "Profit-Split Method", available online at http://www.law.cornell.edu/cfr/text/26/1.482-6 (visited on 20th February, 2014)
[18] Ibid
[19] Ibid
[20] Markham, Michelle, "Transfer Pricing Of Intangible Assets In The US, The OECD And Australia: Are Profit-Split Methodologies The Way Forward?" *UWSLawRw* (2004) p. 3; Mukesh Butani, *Transfer Pricing: An Indian Perspective,* 2nd Ed., (Lexis Nexis Butterworths, New Delhi, 2007) p. 125.

interdependent in such a way that they cannot be evaluated on a separate basis using a traditional transaction method.[21] The transactions are thus so interrelated that it is impossible to identify comparable transactions. In this respect, the profit split method is applicable in complex industries.[22]

One such case is the example explained above. Here, the transactions are not simply limited to the parent company and its wholly owned Irish subsidiary, but to two further subsidiaries as well. In such a case, there is such an interrelation between the transactions that to be able to tax the large sums of newly acquired profits as well, the taxing authority would more appropriately have to split the profit based on the assets and risks assumed by each associated enterprise. For example, if the profit attributed to the parent company is 70%, then that is the amount on which tax can be levied. This was what was decided in the case of *Bausch & Lomb Inc.* v. *Commissioner*[23] as well.

C. COMPARABLE UNCONTROLLED PRICE METHOD (CUP)

The OECD Guidelines define the CUP method as "a transfer pricing method that compares the price for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances."[24]

A CUP may be determined mainly in any one of the following two ways:

i. If the enterprise sells (or buys) the same product under same circumstances to (or from) an unrelated third party, that price can be used as a CUP.

ii. If a transaction is undertaken either by the company with a third party or by two unrelated parties and there are some differences in the product traded, or in the circumstances of the transaction, and adjustments can be made to the price to take account of these differences, then the adjusted price can be used as a CUP.

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[21] Chapter 5, Working Draft of a Chapter of the Practical Manual on Transfer Pricing for Developing Countries, published by the UN Committee of Experts on International Cooperation in Tax Matters, 2010, available online at http://www.un.org/esa/ffd/tax/sixthsession/CRP4_Ch5.pdf (visited on 20th February, 2014)

[22] Ibid

[23] *Bausch & Lomb, Inc. And Consolidated Subsidiaries* v. *Commissioner Of Internal Revenue*, 92 T.C. 525 (1989)

[24] Paragraph 2.13, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2010

As per Article 2.7 of the said Guidelines, an uncontrolled transaction is comparable for purposes of the CUP method if any one of the two conditions are met:

i. None of the differences (if any) between the transactions being compared or between the enterprises undertaking those transactions could materially affect the price in the open market.
ii. Reasonably accurate adjustments can be made to eliminate the material effects of such differences.[25]

In applying the CUP method, all the facts and circumstances that are likely to affect the price must be considered. *The market location, the volume of transactions, the risks involved, the warranty and payment terms, the market conditions, etc., may have an implication on the price of the product.* Adjustments are made to the uncontrolled price to negate the effect of the differences in facts and circumstances, to arrive at the CUP.

EXAMPLES: (A) USCO, a US company, sells computer monitors to its Indian subsidiary (ICO) for resale. USCO also sells computer monitors to other computer resellers (say, CMI) in India on identical terms. In case USCO sells the monitors to CMI for Rs. 10,000, the CUP price for the computer monitors being sold by USCO to ICO would also be Rs. 10,000.

(B) Suppose, in the aforesaid illustration, the terms are different for warranty:

The warranty in case of sale of monitors by ICO is handled by ICO. However, for sale of monitors by CMI, USCO is responsible for the warranty for 3 months. Suppose, USCO and ICO offer extended warranty at a standard rate of Rs. 1,000 per annum. In such a case, if USCO sells the monitors to CMI for Rs. 10,000, the arm's length price for the computer monitors being sold by USCO to ICO would be:

	Rs.
Third party sale price	10,000
Less : Value of 3 months warranty [Rs. 1,000/12 × 3]	250
CUP	9,750

[25] United Nations Practical Manual on Transfer Pricing for Developing Countries, published by the Department of Economic and Social Affairs, 2013, available online at http://www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf (visited on 20th February, 2014)

Strengths and Weaknesses:

The strengths[26] of the CUP Method include:

1. It is not a one-sided analysis as the price is arrived at between two parties to the transaction.
2. There methods determine a transfer price based on the perspective of the tested party in the analysis. For example, if the resale price method is used, the related party sales company is the tested party in the transfer pricing analysis. However, if the cost plus method is used, the related party manufacturer will be the tested party. The resulting transfer prices based on these two methods will probably differ from each other.
3. It involves a detailed transactional comparison.

The weaknesses[27] of the CUP Method include:

1. It will very often be difficult to find closely comparable uncontrolled transactions, as a strict comparability standard is required, particularly with respect to product comparability.
2. Internal comparables typically don't exist and external comparables are difficult to find, as a practical problem.

The CUP Method will be most appropriate in the following circumstances:

1. One of the associated enterprises involved is engaged in comparable uncontrolled transactions with an independent enterprise (i.e., an internal comparable is available). In such a case, all relevant information on the uncontrolled transactions is available and it is therefore probable that all material differences between controlled and uncontrolled transactions will be identified.
2. The transactions involve commodity type products, but only those in which product differences are very limited or negligible.

D. RESALE PRICE METHOD (RPM)

The OECD Guidelines define RPM as "A transfer pricing method based on the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. The resale price is reduced by the resale price margin. What is left after

[26] Ibid
[27] Ibid

subtracting the resale price margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g., custom duties), as an arm's length price of the original transfer of property between the associated enterprises."[28]

For the above purposes, the OECD's Guidelines define Resale Price Margin as "a margin representing the amount out of which a reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit."

The Guidelines further provide that "the resale price margin of the reseller in the controlled transaction may be determined by reference to the resale price margin that the same reseller earns on items purchased and sold in comparable uncontrolled transactions. Also, the resale price margin earned by an independent enterprise in comparable uncontrolled transactions may serve as a guide." (para 2.15 of the Guidelines)The resale price method is ordinarily used when the reseller has not added substantial value by either physically altering the property or using its intangible property before resale.

EXAMPLE: ICO is a distributor of software developed by its parent company in the US. The end customer price (or retail price) of the software is Rs. 5,000. Assuming comparable independent distributors in India earn margins of 10%, the arm's length transfer price would be as follows:

	Rs.
Final Retail Price in India	5,000
Less : Margin earned by comparable distributors	500
Transfer Price using RPM	4,500

Strengths and Weaknesses

The strengths[29] of the resale price method include:

[28] Paragraph 2.21, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2010

[29] United Nations Practical Manual on Transfer Pricing for Developing Countries, published by the Department of Economic and Social Affairs, 2013, available online at http://www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf (visited on 20th February, 2014)

1. It is based on the resale price, a market price, and thus represents a demand-driven method.

The weaknesses[30] of the resale price method include:

1. It is a one-sided analysis, as it focuses on the related sales company as the tested party in the transfer pricing analysis. It is possible that the arms' length gross profit margin and hence, transfer price, which is based on a benchmarking analysis, can lead to an extreme result (i.e., loss-making) for the related supplier of the sales company.
2. The data on gross margins may not be comparable due to accounting inconsistencies.

The Resale Price Method is most appropriate to use in cases which involve the purchase and resale of tangible property in which the reseller does not add substantial value to the tangible goods by way of physically modifying the products before resale or in which the reseller contributes substantially to the creation or maintenance of intangible property.

E. TRANSACTIONAL NET MARGIN METHOD (TNMM)

The Guidelines define TNMM as "a transactional profit method that examines the net profit margin relative to an appropriate base (e.g., costs, sales, assets) that a taxpayer realises from a controlled transaction (or transactions that it is appropriate to aggregate)."[31]

The Guidelines further provide that the net margin of the taxpayer from the controlled transaction (or transactions that are appropriate to aggregate) should ideally be established by reference to the net margin that the same taxpayer earns in comparable uncontrolled transactions. Where this is not possible, the net margin that would have been earned in comparable transactions by an independent enterprise may serve as a guide. A functional analysis of the associated enterprise and, in the latter case, the independent enterprise is required to determine whether the transactions are comparable and what adjustments may be necessary to obtain reliable results.[32]

[30] Ibid
[31] Paragraph 2.58, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2010
[32] Paragraph 3.26, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2010

Strengths and Weaknesses:

The strengths[33] of the TNMM include the following:

1. Net margins are less affected by transactional differences (than price) and functional differences (than gross margins). Product and functional comparability are thus less critical in applying the TNMM.
2. Less complex functional analysis is needed, as the TNMM is applied to only of the related parties involved.
3. Because TNMM is applied to the less complex party, it can be used even though one of the related parties holds intangible assets for which comparable returns cannot be determined.
4. It is applicable to both sides of the controlled transaction (i.e., either the related party manufacturer or distributor).

The weaknesses[34] of the TNMM include:

1. Net margins are affected by factors (eg., variability of operating expenses) that do not have any effect, or have a less significant effect on price or gross margins. These factors affect net profits and hence the results of the TNMM, but they have nothing to do with the company's transfer pricing. It is important to consider these non-pricing factors in the comparability analysis.
2. Information challenges, including the availability of information on profits attributable to uncontrolled transactions.
3. Furthermore, in case the companies are engaged in different activities, it will also be very difficult to allocate sales revenue, operating expenses and assets between the relevant business activity and other activities of the tested party or the comparables. This measurement aspect is an important practical problem.
4. Several countries do not recognize the use of TNMM. Consequently, the application of TNMM to one of the parties of the transaction may result in unavoidable double taxation when the results of the TNMM analysis are not acceptable for the other party.

[33] United Nations Practical Manual on Transfer Pricing for Developing Countries, published by the Department of Economic and Social Affairs, 2013, available online at http://www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf (visited on 20th February, 2014)
[34] Ibid

TNMM is most appropriately used when two related parties engage in a continuing series of transactions and one of the parties controls intangible assets for which the arms' length return is not easily determined. Since TNMM is applied to the party performing routine manufacturing, distribution or other functions which do not involve control over such intangible assets, it allows the appropriate return to the party controlling unique or difficult-to-value intangible assets to be determined indirectly.

VI. CONCLUSION

Transfer pricing is a sphere which is rapidly gaining momentum around the world. With increasing globalisation and access, there are new multinational corporations being set up, and there are constant transfers between the associated enterprises. Examples such as Google and Facebook have proved that such companies have found legitimate ways to avoid large amounts of taxes which need to be paid. Given this scenario, Advance Pricing Agreements are proving more and more important.

The whole purpose behind an APA is that of certainty, and avoiding of tedious litigation. An APA provides certainty that a particular transfer pricing method alone will be used and that a particular transaction alone will be taxed. It serves as a reassurance to both the taxpayer and the tax authorities. Therefore, the proper determination of the method to calculate the ALP becomes significant.

It is necessary to first and foremost determine what kind of transaction is being controlled, and what the implications of the transaction will be. For example, if it is essentially a contract of services, the CPM method is most suitable. If it is a transfer of unique intangibles, the PSM method would be most appropriate. It is also important to determine if there are any available comparables, as certain methods require the use of comparables for determination of the ALP. To be able to decide the method requires that the various methods first be properly understood and studied, so that an intelligent and mutually agreed solution may be reached. Thus, a study of the different methods is imperative.