Film Financing and Television programming

A Taxation Guide

Now in its eighth edition, KPMG LLP's ("KPMG") *Film Financing and Television Programming: A Taxation Guide* (the "Guide") is a fundamental resource for film and television producers, attorneys, tax executives, and finance executives involved with the commercial side of film and television production. The guide is recognized as a valued reference tool for motion picture and television industry professionals.

Doing business across borders can pose major challenges and may lead to potentially significant tax implications, and a detailed understanding of the full range of potential tax implications can be as essential as the actual financing of a project. The Guide helps producers and other industry executives assess the many issues surrounding cross-border business conditions, financing structures, and issues associated with them, including film and television development costs and rules around foreign investment. Recognizing the role that tax credits, subsidies, and other government incentives play in the financing of film and television productions, the Guide includes a robust discussion of relevant tax incentive programs in each country.

The primary focus of the Guide is on the tax and business needs of the film and television industry with information drawn from the knowledge of KPMG International's global network of member firm media and entertainment Tax professionals.

Each chapter focuses on a single country and provides a description of commonly used financing structures in film and television, as well as their potential commercial and tax implications for the parties involved. Key sections in each chapter include:

Introduction
A thumbnail description of the country's film and television industry contacts, regulatory bodies, and financing developments and trends.

Key Tax Facts
At-a-glance tables of corporate, personal, and value-added (VAT) tax rates; normal nontreaty withholding tax rates; and tax year-end information for companies and individuals.

Financing Structures
Descriptions of commonly used financing structures in film and television production and distribution in the country and the potential commercial tax implications for the parties involved. The section covers rules surrounding co-productions, partnerships, equity tracking shares, sales and leaseback, subsidiaries, and other tax-efficient structures.

Tax and Financial Incentives
Details regarding the tax and financial incentives available from central and local governments as they apply to investors, producers, distributors, and actors, as well as other types of incentives offered.

Corporate Tax
Explanations of the corporate tax in the country, including definitions, rates, and how they are applied.

Personal Tax
Personal tax rules from the perspective of investors, producers, distributors, artists, and employees.

Digital Media
For the first time, we have included a discussion of digital media tax considerations recognizing its growing role in the distribution of film and television content.

KPMG and Member Firm Contacts
References to KPMG and other KPMG International member firms' contacts at the end of each chapter are provided as a resource for additional detailed information.

Please note: While every effort has been made to provide up-to-date information, tax laws around the world are constantly changing. Accordingly, the material contained in this publication should be viewed as a general guide only and should not be relied upon without consulting your KPMG or KPMG International member firm Tax advisor.

Production opportunities are not limited to the countries contained in this Guide. KPMG and the other KPMG International member firms are in the business identifying early-stage emerging trends to assist clients in navigating new business opportunities. We encourage you to consult a KPMG or KPMG International member firm Tax professional to continue the conversation about potential approaches to critical tax and business issues facing the media and entertainment industry.

Thank you and we look forward to helping you with any questions you may have.

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India

Introduction[1]

The Indian film industry, with its century-old legacy, is causing ripples worldwide through its ability to attract numbers. Whether it is the number of films produced and released every year, viewers worldwide, minutes of run-time, or regional language films in one jurisdiction, the country's film industry continues to make, break, and remake new records.

The Indian film industry is multilingual. Films are produced in Hindi (the national language) and in several regional languages. While the overall box office collection of Hindi movies has declined compared to the previous year, regional markets continue to grow with the increasing reach of Marathi, Punjabi and Gujarati markets starting to demonstrate greater depth in addition to major South Indian language markets.

In 2016, the Indian film industry grew by a mere 3 percent over the previous year, which actually masks a decline in core revenue streams of domestic theatricals and satellite (C&S) rights. However, overseas theatricals along with the sale of digital rights and in-cinema advertisements have become a lifeline for the industry.

Year 2017 was expected to witness recovery of the industry as a result of the resurgence of domestic theatricals and the cable & satellite market, continuing growth of the overseas market and growth of ancillary revenue streams, such as the sale of digital rights and in-cinema advertisements.

Overall, the film industry is projected to grow at a CAGR of 7.7 percent until 2021 and will be worth INR 206.60 billion The growth is expected to be driven by additional new revenue streams in the form of the sale of digital rights, resurgence of the C&S market as a result of competition from digital platforms, continuing growth of the overseas market and growth of ancillary revenue streams such as in-cinema advertisements.[2]

The Indian television industry had a steady run in 2016, with another year of double-digit growth despite headwinds on account of demonetization. Digitization of cable has been a significant development in the Indian television industry. The industry stands at an estimated size of INR 588 billion in 2016, with a growth of 8.5 percent over 2015, and is projected to register a CAGR of 14.7 percent to reach INR 1,166 billion by 2021.

Entry of new broadcasters and shifts in viewing patterns have put pressure on the mainstream channels, forcing them to revisit their content strategy, quality of content, and new content formats.

Globalization continues to grow with collaborations by adaptation of formats of successful shows running globally being brought in India.

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[1] The data included has been compiled from KPMG in India's thought leadership with Federation of Indian Chambers of Commerce and Industry (FICCI): *KPMG India – FICCI Media and Entertainment Industry Report 2017.*
2 KPMG in India's analysis based on industry discussions conducted by KPMG in India.

Key Tax Facts

Corporate income tax rate: Domestic companies	30%[3]
Minimum Alternate Tax: Domestic companies	18.5%
Corporate income tax rate: Foreign companies	40%
Maximum Marginal personal income tax rate	30%
Partnership including Limited Liability Partnership[4]	30%
Alternate minimum tax (other than company)	18.5%
Withholding tax rates[5] on non-residents/ foreign companies:	
Dividends[6]	Nil
Royalties	10%
Fees for technical services	10%
Capital gains (on sale of shares):	
Long-term capital gain on listed shares (where shares are held for more than 12 months)	Refer to note below[7]
Long-term capital gain on unlisted shares (where shares are held for more than 24 months)	10% (in the case of non-resident)

[3] The Finance Act, 2018 has reduced corporate tax rate from 30% to 25% for companies whose turnover or the gross receipts in the financial year 2016-17 does not exceed INR 2,500 million.
[4] Surcharge of 12% is applicable if income of the firm/ LLP exceeds INR 10 million.
[5] These rates are as per the Income-tax Act, 1961 (Indian tax law). In case of a non-resident, there is an option to choose between the rate as per the Double Taxation Avoidance Agreement and the Indian tax law, whichever is more beneficial.
[6] Dividend Distribution Tax ('DDT') is applicable on the dividends declared as per the Indian tax laws. However, such dividend is exempt from tax in the hands of the recipient shareholder except where dividend in excess of INR 1 million is received by a resident individual, HUF or firm. In such case, dividend would be taxable at the rate of 10% on gross basis in the hands of resident individual, HUF or firm.
[7] Until financial year 2017–18, no capital gain was levied on a sale of equity shares listed on a recognized stock exchange in India and on which Securities Transaction Tax (STT) was paid. However, as per the Finance Act 0f 2018, long-term capital gains exceeding INR 0.1 million arising from the transfer of equity shares, unit of equity-oriented fund or unit of business trust wherein STT has been paid on acquisition and transfer of such capital asset, shall be taxed at the rate of 10% without indexation (plus applicable surcharge and cess, if any).

Short-term capital gain on listed shares (where shares are held for less than 12 months)	15%
Short-term capital gain on unlisted shares (where shares are held for less than 24 months)	40% (in the case of non-resident)
Indirect tax[8]	
Goods and Services Tax	Slab rate of 0%, 5%, 12%, 18%and 28%
Tax year-end: Companies and Individuals	March 31

Film Financing

Financing Structures

Under the extant Indian tax laws, taxable entities that engage in film production and distribution, *inter alia*, include:

— Individuals[9]

— Associations of Persons

— Limited Companies

— Partnerships

— Limited Liability Partnerships.

Association of Persons (AOP)

AOP is an unincorporated body and the rights of its members are governed by the agreement. All AOP members are taxed as a single entity, i.e. as an AOP. An AOP can result in joint and several liabilities with an unintended exposure of each party to the tax liability of other members of the AOP. When a member has incurred losses from his part of the activity, he may still be liable for taxes, given that the combined profits and losses of all members are considered in one assessment of the AOP. Further, there may be the inability to offset losses or expenses incurred by the members independently against their share of the AOP profit. The income so assessed is liable to be taxed at the maximum marginal rate i.e. 30 percent (plus applicable surcharge and cess) or taxed at a higher rate, applicable to the member of the AOP. To avoid AOP status, members are required to carefully plan the production and exhibition/distribution rights arrangements. This is required particularly to ensure that the respective rights, obligations, scope of work, and income of each party are clearly defined and demarcated. Further, once the AOP is set up, there could be potential practical challenges in meeting day-to-day compliance requirements under the Indian tax laws, i.e. in payment and withholding of taxes, filing of an income-tax return, etc.

[8] The new GST law (subsuming a number of indirect taxes like VAT, Excise Duty, Customs, Service Tax, etc.) became effective on July 1, 2017. Hence, the prevailing rates in the former regime have been re-visited post the enactment of GST law.
[9] Taxability of individuals is discussed later in the chapter under the section titled "Personal Taxation."

Limited Company

A limited company is considered an entity separate from its shareholders and is taxed as a separate entity. Dividend distributions from a domestic Indian company are not taxed in the hands of recipient shareholders; such companies are required to pay Dividend Distribution Tax (DDT) on dividends declared/distributed/paid. The company's liability is limited to its paid-up share capital, and the shareholders are not personally liable for losses and debts of the company.

Partnership Firm (firm)

Under Indian tax law, a partnership firm is assessed as a separate entity. A firm cannot have limited liability; the liability of all partners is joint and several. The partner's share in the firm's income is not included while computing his total income. Salary, bonus, commission, and interest payments due to or received by each partner are allowed as a deduction to the firm, subject to certain restrictions. Such payments to partners are taxed as business profits in their hands.

Limited Liability Partnership (LLP)

LLP combines the benefits of limited liability of a company and the flexibility of a general partnership firm, resulting in less onerous compliances and limited disclosure requirements. The corporate nature of LLP and the mode of functioning make it a unique structure.

In terms of Indian tax law, the provisions applicable to a partnership firm have also been extended to LLP.

Unlike LLPs in several other countries, Indian LLPs do not enjoy pass-through status. Accordingly, when a foreign partner receives his/her share of profits from an Indian LLP (which would be subject to tax in India in the hands of the LLP), claiming a tax credit in his home country may pose a problem in the absence of express provisions in the tax treaty(ies). Further, DDT is not applicable on distribution of profits by LLP to its partners.

LLP may be explored as a form of doing business when undertaking co-production activities in India, as discussed below.

Foreign Investment in Indian LLPs

While the government allowed foreign direct investment (FDI) in LLPs in 2011,[10] these changes were not simultaneously incorporated under the 1999 Foreign Exchange Management Act (FEMA)[11], leading to uncertainty among foreign investors in setting up LLPs in India. The Reserve Bank of India (RBI)[12] has incorporated the provisions related to FDI in LLP in FEMA.

FDI has been allowed in a calibrated manner in sectors where 100 percent FDI is allowed under the automatic route, i.e. where no prior approval is required and there are no FDI-linked performance-related conditions. Further, conversion of a company to an LLP is permissible under automatic route subject to the condition that the company having FDI is engaged in a sector where foreign investment up to 100 percent is permitted under automatic route and there are no FDI-linked performance conditions route.[13]

[10] Press Note No. 1 (2011 Series) dated May 20, 2011.
[11] The governing exchange control legislation.
[12] RBI is the apex body governing foreign exchange regulations in India.
[13] Notification no. FEMA 385/2017dated 3 March 2017.

Pricing of a partner's interest in an LLP should be as per internationally accepted pricing principles.

It is also pertinent to note that an Indian LLP, with foreign investment, is permitted to make downward investment in another LLP engaged in sectors in which 100 percent FDI is allowed under the automatic route and there are no FDI-linked performance conditions.[14]

The existing FDI policy permits 100 percent FDI under automatic route in the film sector. Therefore, as mentioned above, LLPs may be explored as another legal form of doing business in India, especially in the case of co-productions.

Other Financing Considerations

Modes of Film Financing

Producers engaged in film production in India rely essentially on the following modes of film financing:

- Self-funding
- Advances from distributors against distribution agreements
- Advances from financiers against financing agreements
- Sale of negative rights
- Sale of music rights
- Bank financing
- Venture capital investments
- Equity markets
- Corporate sponsorships and merchandising (including branded entertainment)
- Co-production.

For distribution agreements, which involve the grant of distribution rights by a producer to the distributor for a particular territory and/or period, the considerations are:

- A minimum guaranteed amount;
- A fixed percentage of commission/royalty on gross collections; and
- A combination of the above.

Financing agreements involve receipt of funds by the producers in consideration of:

- Interest;
- Percentage of receipts/profits; and
- A combination of the above.

Such agreements sometimes also provide for share of losses by financiers. Additionally, film producers, distributors, and financiers can raise capital through equity and preference shares, debentures or bonds, deposits, etc.

[14] Notification no. FEMA 385/2017dated 3 March 2017.

Access to Finance etc., via Film Co-production Treaties

India has concluded ten film co-production treaties[15] thus far and is in the process of entering into additional bilateral pacts (including with the Republic of Korea[16] and Israel[17]). Film co-production treaties are entered into with an objective of developing the film industries of the contracting countries, promoting economic and cultural cooperation, and extending national film status to the co-produced film. National film status extends benefits to films in the respective contracting countries such as:

- Tax incentives
- Access to government funding at nominal interest rates
- Regional grants
- Publicity and marketing budgets from the government.

In India, various state governments are incentivizing filmmakers to shoot films in their respective states. The film industry acts as an important partner for state governments to promote tourism. The incentives offered by local governments include:

- **Fiscal benefits:** Tax concessions provided to all filmmakers or grants provided to subsidize production costs.
- **Film festivals and awards:** Festivals, exhibitions, etc., to honor filmmakers and events to promote film shooting in states.
- **Facilitation of shooting of films:** Single window clearances for filming at locations, assistance in travel and accommodation, etc.
- **Others:** Film cities/studios, animation films and studios, etc.

Several such co-production treaties also take within their ambit third countries, with which the respective contracting countries have entered into other similar agreements, thereby, enabling the participation of such third countries in the agreement entered into by the contracting countries. Such treaties with third countries can also be explored for benefits available in those jurisdictions.

Foreign Exchange Regulations[18]

As discussed earlier, through the liberalization of the foreign exchange regulations, the Government of India has allowed 100 percent FDI in the Film Sector. For the purposes of FDI, film sector broadly covers film production, exhibition and distribution, including related services and products. FDI in the sector is permitted under automatic route, i.e. no prior approval is required and there are no entry-level conditions in the sector. However, investors must comply with certain post filing requirements, i.e. notifying the RBI within 30 days of the receipt of inward remittance in India, filing of certain documents within 30 days of allotment of shares, etc. Further, price of shares issued/transferred to foreign investors shall not be less than:

- **In the case of Listed companies –** Price worked out in accordance with the Securities and Exchange Board of India (SEBI) guidelines;

[15] Italy, United Kingdom, Germany, Brazil, France, New Zealand, Poland, Spain, Canada, and China.
[16] Press Release, dated 13 May, 2017.
[17] Press Release, dated 20 February, 2018
[18] The entire discussion is in respect of FDI in company; separate rules and regulations would apply vis-à-vis investment in LLP.

— **In the case of Unlisted companies –** Fair valuation of shares done by a merchant banker or chartered accountant as per internationally accepted pricing methodology; and

— **Where shares are issued on a preferential allotment basis –** Price determined as per pricing guidelines in terms of SEBI guidelines or as per internationally accepted pricing methodology.

Foreign investors seeking to acquire shares of an existing Indian company (engaged in film production, exhibition, or distribution) from the resident shareholders are granted a general permission, subject to compliance with prescribed terms and conditions. This means that a prior approval of the RBI is not required.

Further, remittance of hiring charges of transponders by TV channels requires prior approval of the Ministry of Information and Broadcasting. However, approval will not be required where withdrawal is made out of funds held in Resident Foreign Currency (RFC) Account or Exchange Earners' Foreign Currency (EEFC) account.

Loans and Borrowings

Borrowings in foreign currency are governed by the guidelines on External Commercial Borrowings (ECB guidelines) issued by the RBI. The revised ECB guidelines stipulate a list of eligible borrowers who are permitted to raise ECB from eligible lenders.

As the film/television sector may not fall into the eligible categories of borrowers, it is unlikely that permission for raising ECBs would be granted to the sector by the RBI.

In this regard, it may be noted that for the purpose of the foreign exchange regulations, non-convertible/optionally convertible/ partially convertible preference shares and debentures are considered ECB. Accordingly, these instruments would not be permitted for the film/television sector. However, investment can be made with fully and compulsorily convertible preference shares and debentures, which are treated as equity for the purposes of FDI policy.

Corporate Taxation (as per Indian tax laws)

Taxability of Income in the Case of Non-residents

Non-resident Filmmakers/ News Agency

The taxability of a person in India is determined based upon his/her residential status, i.e. whether such person is a resident or non-resident in India.

In the case of non-residents, the following income is taxable in India:

— Received or deemed to be received in India; and

— Accrues or arises or is deemed to accrue or arise in India.

Under existing Indian tax laws, income of non-residents arising from a business connection[19] in India is deemed to accrue or arise in India.

However, income from the following activities are not deemed to accrue or arise in India:

— Shooting of any cinematographic film in India

[19] Business connection is akin to the concept of a permanent establishment discussed in tax treaty(ies) entered into by India with other countries.

— Collection of news and views in India for transmission out of India for a non-resident who is engaged in the business of running a news agency or publishing newspapers, magazines, or journals.

Other Aspects

Taxability of income shall also be determined based on the manner in which the same is characterized, i.e. "royalty," "fee for technical services (FTS)," etc.

In this regard, it may be noted that the current Indian tax laws specifically exclude consideration for the sale, distribution, or exhibition of cinematographic films in India from the definition of 'royalty.'

Transactions between Related Parties

Given the increased linkage between the Indian media players and their counterparts across the globe (coupled with the impressive growth achieved and targeted for the sector), the transactions between Indian players and their related-parties overseas have increased manifold each year. Such related-party transactions come under the purview of transfer pricing (TP) regulations and require the same to be carried out at an arm's length price. These regulations prescribe mandatory documentation which needs to be maintained annually to justify the arm's length nature of such transactions.

The Indian tax authorities typically scrutinize TP aspects in a fairly large number of cases, and the media and entertainment industry is no exception. Key factors that need to be considered in the case of related-party transactions and analysis thereof include:

— Comprehensive function, asset and risk analysis to support methodology to determine the arm's-length price;

— Transaction-by-transaction approach; and

— Choice of most appropriate method and selection of tested party in an economic benchmarking analysis.

Robust Backup Documents and Agreements

Robust analysis, comprehensive documentation, and clarity in TP policies are of paramount importance. The TP policies should be based on thorough functional and economic analysis that identifies the various functions including the value drivers, risks, and location of the company's assets. The existence of TP documentation, alongside policy and procedural documentation, typically helps in streamlining the discussions with Indian tax authorities. In addition, establishing a robust set of TP policies and guidelines could help proactively identify and effectively manage new TP exposures that are created as a result of business expansions, acquisitions, restructurings, etc. As much as it acts as a tool for risk mitigation, it also enables easy fact finding during scrutiny by authorities, thereby highlighting the transparency maintained by the taxpayer.

Since the introduction of TP laws in India in 2001, there have been significant developments in practice, as the tax authorities in India consider TP one of the key focus areas. Given the volume of tax litigation and uncertainty arising therefrom, the multinational companies operating in India have generally considered TP as one of the most important tax exposure areas.

Considering the amount of tax litigation in this area, an Advance Pricing Agreements (APA) program was introduced in India in 2012. The APA program has provided the taxpayers with a way of attaining certainty with respect to taxation on their international transactions for a maximum of the next five years. It also provides taxpayers with an option for renewal of the APA for another term of five years, subject to prescribed conditions. The APA program has seen good success thus far with a large number of applications filed, reflecting heightened optimism from taxpayers.

Going forward, taxpayers in India should use the applicable guidelines, capture need, cost, and benefit analysis of transactions, undertake robust TP analysis backed up by contemporaneous TP documentation, and make use of programs like APA to achieve up-front certainty on complex TP issues.

Deduction of Expenditure

Film Production and Distribution Cost

There are specific rules[20] provided for under the Indian tax laws that govern the deduction of production expenses for feature films and for the acquisition of distribution rights.

As per the prescribed rules, a deduction is permitted for expenditures incurred on production of films or acquisition of distribution rights therein, either in the first year of release or over a period of two years, either based on when the copyrights/distribution rights in films are used or on the date of release of the film.

A film producer who sells the entire exhibition rights of the film is entitled to a deduction of the entire cost of production incurred in the same year in which the Censor Board certifies the film for release in India. A similar deduction is available to a film distributor for outright sale of the film distribution rights acquired. In the case of a partial sale and/or partial exhibition of film rights by the film producers/distributors, the film must be released at least 90 days before the end of the tax year to claim a full deduction of specified production costs or specified costs of acquiring distribution rights.

Where the film is not released at least 90 days before the end of the tax year, then the costs of production/acquisition costs of the film distributor, limited to the amount earned from the film, shall be allowed as a deduction in the current tax year and the remaining cost shall be allowed in the following year.

Where the producer does not exhibit the feature film himself or does not sell, lease, or transfer the film on a minimum guarantee basis or the distributor does not exhibit the film commercially or does not sell/lease the rights of exhibition, no deduction of the cost shall be allowed in the current tax year. The entire cost shall be allowed in the succeeding tax year(s).

The sale of rights of exhibition also includes the lease of such rights or their transfer on a minimum guarantee basis.

There are a few ambiguities surrounding the applicability of Rule 9A/ 9B, including whether it extends to satellite, music, home videos, and other rights in addition to theatrical rights, whether it is directory or mandatory, whether it overrides all other provisions of the Indian tax laws, e.g., whether the deduction of expenditure under Rule 9A/ 9B is allowable irrespective of whether it is capital or revenue in nature, whether tax has been deducted at source or not, etc., deductibility of expenses that are not covered by Rule 9A/ 9B, etc.

[20] Rules 9A and 9B of Income-tax Rules, 1962 (the Rules).

Other Expenditures

As a general rule, all expenses incurred 'wholly and exclusively' for business purposes are deductible. However, there are limits/disallowances on certain types of expenses, such as (illustrative list only):

- Expenses in the nature of interest, royalties, fees for technical service, or any other sum chargeable to tax paid to residents and non-residents on which tax has not been withheld or after withholding has not been deposited with the Government of India within the prescribed time. As per the Indian tax laws, the disallowance is limited to the extent of 30 percent of expenditures in relation to payments to residents. Deductions, however, will be allowed in the year in which such tax has been deposited with the government treasury subject to fulfillment of prescribed conditions;
- Corporate tax, securities transaction tax, etc.;
- Provisions in accounts for specified statutory liabilities pertaining to employees, duties, taxes, and interest on borrowings from financial institutions, not actually paid before the specified dates;
- Indirect general and administrative costs of a foreign head office in excess of 5 percent of taxable income (before unabsorbed depreciation, etc.); and
- Expenditures on social welfare activities[21] (Corporate Social Responsibility).

Depreciation

Depreciation is calculated with a reducing balance method on the 'block of assets.' The 'block of assets' concept requires aggregation of all assets of the same class with the same depreciation rate applied to a common block. Depreciation is allowed at varying rates on different classes of assets, subject to a maximum rate of 40 percent.

If in the year of purchase, an asset is used for less than 180 days, then the depreciation is allowed at half of the normal rate. In other cases, depreciation is allowed at full normal rates. In the year of sale of an asset, the sale proceeds have to be deducted from the value of the 'block of assets.'

Depreciation is also allowed on intangible assets like technical know-how, patents, copyrights, goodwill, etc.

WHT on acquisition of copyright

Under the Indian tax laws, payments to an Indian resident towards acquisition of copyright on content (for example, satellite rights, home video rights, music rights, etc.) attracts 10 percent WHT. This WHT rate is excessive considering the profit margins prevalent in the industry resulting in an adverse impact on taxpayers' cash flows. It could be worthwhile for the government to consider a lower WHT on such payments.

WHT on film negative printing

In the case of Yash Raj Films (P) Ltd.,[22] the Mumbai Tribunal held that payments for taking out multiple prints of the final negative would qualify as 'work' as per Indian tax laws and not as professional/technical services, as no specialized job is to be done, nor any professional/ technical skill is required for rendering such services to the taxpayer. The Tribunal held that while negative processing requires professional skill as it involves specific

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[21] The Companies Act of 2013 has made it mandatory for companies, both domestic and foreign (having presence in India), to spend 2 percent of their average net profits for three years on prescribed social welfare activities.
[22] DCIT (TDS) vs. Yash Raj Films (P) Ltd. (2016) 73 taxmann.com 73 (Mumbai Tribunal).

tasks of editing, enhancement of quality of film, etc., taking out multiple prints of such final negative does not involve professional/ technical skills. Thus, payments for taking out multiple prints would fall under the ambit of 'work,' and accordingly, tax would be withheld at 2 percent under section 194C of the provisions of the Indian tax laws. This is a welcome judgment, which should support the contention of the taxpayers that payment made for taking prints of a final negative of the film should qualify as work and be eligible to avail the benefit of a lower withholding tax rate under the provisions of Indian tax laws.

WHT on professional payments made in kind

In the case of Red Chillies Entertainment,[23] the assesse had gifted certain items to its business associates who had worked for a film. The Mumbai Tribunal held that the provisions of section 194J could not apply where the professional or technical fees are paid in kind. While deciding the issue, relying on certain judicial precedents of the Supreme Court and High Courts,[24] the Tribunal categorically concluded that the term "any sum" under the relevant provisions would only mean cash amount of money, and since payments are made in kind, there was no requirement to withhold tax.

Certain Specific Tax Issues

Broadcasting Industry

Taxation of transponder charges

Broadcasting companies pay transponder charges to satellite companies for transmission of their TV signals. The tax authorities contend that payments made towards transponder charges are in the nature of royalties. However, in the case of Asia Satellite Telecommunications Co. Ltd.,[25] the Delhi High Court has held that such payments do not constitute royalties and are not liable to tax in India.

Subsequently, the definition of "royalty" under the Indian tax laws was amended via the Finance Act 2012, with retrospective effect, to bring within its ambit payments made for transmission of signals by satellite.

Furthermore, the Delhi High Court[26] has held that even post the amendment, the definition of royalty under Indian tax law does not extend to payments received by foreign satellite companies for lease of transponders. Following this decision, the Calcutta High Court[27] and the Mumbai Tribunal[28] have held that transponder payments are not taxable as 'royalty' under the tax treaty.

Thus, non-resident taxpayers can contribute to avail benefit under tax treaties entered into with India to contend that such payments are not in the nature of royalty/ fees for technical services under the tax treaty and hence, not liable to tax in India. Further, tribunal decisions,[29] wherein connectivity charges paid to a non-resident are held as not for royalty under the Indian tax laws, could also apply to transponder payments.

[23] Red Chillies Entertainment Pvt Ltd vs. ACIT-ITA No. 1577/ MUM/ 2013 (Mumbai Tribunal).
[24] H.H. Sri Rama Verma vs. CIT (1990)187 ITR 308 (SC); CIT vs Hindustan Unilever Limited (2014) 361 ITR 1 (Karnataka HC); CIT vs. Chief Accountants Officer, Bruhat Bangalore Mahagar Palike – ITA no.94 of 2015.
[25] Asia Satellite Telecommunications Co. Ltd. [2011] 197 Taxman 263 (Delhi HC).
[26] DIT vs. New Skies Satellite BV and Shin Satellite Public Company Limited: [2016] 382 ITR 114 (Delhi HC).
[27] DITvs M/S ATN International Limited (2016):TII 41-HC-KOL- Intl (Delhi HC).
[28] M/s Taj TV Ltd. (ITA No.467A-MUM/ 2007,412/MUM/2008, 4176/MUM/2009, 5537/MUM/2008, 5537/MUM/2008 and 4706/MUM/2009) (Mumbai Tribunal) and United Home Entertainment P. Ltd. (ITA No. 5171 to 5181/ MUM/2013) (Mumbai Tribunal).
[29] Geo Connect Ltd(ITA Nos. 1927/ Del/ 2008 & 127/Del/2011) (Delhi Tribunal); Atos Information Technology HK Ltd. 2017(ITA Nos. 237 to 240/ MUM/2016) [Mumbai Tribunal]; Bharti Airtel Limited vs Income-tax officer (TDS) [2016] (67 taxmann.com 223) [Delhi Tribunal].

Tax Issues for Foreign Television Channels/ Telecasting Companies (FTC)
The two primary sources of revenues for FTCs are income from the sale of advertising airtime on the TV channel and subscription revenues:

Taxation of Advertisement Revenues
Under Indian tax law, advertisement revenue of FTCs are taxable in India, when FTCs have a 'business connection' to India. When an FTC operates from a country with which India has a tax treaty, the advertisement revenues would be taxable in India only if the FTC has a PE in India. The taxability in such cases is only on the income that is attributable to the PE/operations carried out in India. The circumstances in which the FTCs constitute a PE/business connection in India and the determination of income attributable to such PE/operations carried out in India continue to be a contentious issue between the FTCs and the tax authorities.

FTCs generally appoint agents in India for marketing advertisement airtime slots. Agents also facilitate collection of advertisement revenues from advertisers and its remittance abroad. The tax authorities contend that the agent of the FTC in India constitutes its PE for various reasons.

The Bombay High Court[30] has held that where an FTC has an agency PE in India, i.e. PE on account of its agent, a payment of arm's length remuneration by the FTC to its Indian agent extinguishes its tax liability in India. A similar view has been taken by the Delhi High Court,[31] Bombay High Court [32] and Mumbai Tribunal.[33]

However, the Mumbai Tribunal[34] has held that an Indian company procuring advertisement in India for a foreign company constituted a dependent agent in India. Further, it also rejected the argument that payment of arm's length remuneration to an agent extinguishes any further tax liability in India by distinguishing the decision of the Supreme Court in the case of Morgan Stanley and that of the Bombay High Court in the case of SET Satellite Singapore[35] (presently pending adjudication at the Supreme Court).

Taxation of Subscription Revenues
Subscription revenues are usually collected by the Indian distributors from MSOs/cable operators and subsequently paid to the FTCs. FTCs are of the view that the payment for grant of distribution rights in the TV channels is not for any copyright and hence is not in the nature of royalty (which is taxable on gross basis at a specified rate). FTCs are of the view that the payment is in the nature of business income and is not taxable in India in the absence of any PE in India. However, the tax authorities hold a contrary view and contend that the subscription revenue are liable to tax as royalties.

WHT on Various Payments by TV Channel Companies
Television broadcasting companies pay placement/carriage fees to Direct-To-Home (DTH) operators, multisystem operators and various cable operators towards placement/carriage of the channels. The channel companies are of the view that such payments attract WHT at

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[30] Set Satellite (Singapore) Pte Ltd. vs. Deputy Director of Income Tax (International Tax) – [2008] 173 taxman 475 (Bombay HC).
[31] DIT vs BBC Worldwide Ltd. (2011) 203 taxman 554 (Delhi HC).
[32]DIT vs B4U International Holdings Ltd [2015] 57 taxman.com 146 (Bombay HC).
[33] Taj TV Limited vs ADIT- ITA no. 9079/MUM/ 2010; 2065/MUM/2012; 456/MUM/2013 and ADIT vs Taj TV Ltd: ITA no.2073/ MUM/ 2012 and 391/ MUM/2013 and International Global Networks BV vs. ADIT, ITA no. 5689 to 5695 MUM/2014
[34] NGC Network Asia LLC vs. CIT (2015) 64 taxman.com 289 (Mumbai Tribunal).
[35] SET Satellite (Singapore) Pte. Ltd. vs DDIT (2008) 307 ITR 453 (Bombay HC).

the rate of 2 percent.[36] However, the tax authorities contend that such payments are liable for WHT at 10 percent on the ground that the payments are towards technical services/royalty. This has resulted in protracted litigation.

The issue relating to WHT on placement charges was decided by the Tribunal in favor of the broadcaster/telecaster in various cases[37] wherein it was held that the placement charges are liable for WHT at the rate of 2 percent as per Indian tax laws. However, the tax authorities have not accepted the same and are contesting the issue before higher authorities stating that carriage/placement fees involve rendering of technical services and should be taxed as FTS at the rate of 10 percent.

Television broadcasting companies also make significant payments to software production houses towards production of TV programs. With reference to the applicability of provisions dealing with WHT on payments made by broadcasters or television channels to production houses for production of content or programs, the issue has been clarified via a circular no. 4/ 2016, dated February 29, 2016 issued by the Central Board of Direct Taxes (CBDT). It has been stated in the circular that where the content is produced as per the specifications provided by the broadcaster/telecaster and the copyright of the content program is transferred to the broadcaster/telecaster, such contract is covered within the definition of 'work' which is liable for WHT as per the Indian tax laws. However, where the broadcaster/telecaster acquires only the broadcasting/telecasting rights of the content which is already produced by the production house, and there is no contract for carrying out any work, then such payments are not liable for WHT as per Indian tax laws (but may be liable for other applicable WHT provisions).

DTH industry

WHT on discount on sale of Set Top Boxes (STBs)/ Recharge Coupon Vouchers (RCVs)

From an income tax perspective, an issue arises vis-à-vis applicability of WHT on the discount given to distributors on the sale of STBs/ RCVs. Tax authorities are of the view that discount on the sale of STBs/RCVs is in the nature of commission, subject to WHT at the rate of 10 percent under section 194H of the Indian tax laws. However, the industry is of the view that the discount is not in the nature of commission and hence, section 194H is not applicable.

In the case of Ahmedabad Stamp Vendors Association,[38] wherein the stamp vendors bought stamp papers from the state government at a discounted price, the Supreme Court held that tax need not be withheld on the discount given to vendors since it is not in the nature of commission or brokerage. The DTH industry is of the view that the result of this decision should apply equally to discounts given to distributors for the sale of STBs/RCVs.

The Karnataka High Court in the case of Bharti Airtel Ltd,[39] held that the discount given to distributors on sale of SIM cards/RCVs does not generate income in the hands of the distributor since the distributors derive income only on subsequent sale of prepaid cards. However, the High Court held that if, in the books of accounts of the taxpayer, the discount is reflected separately, then the liability of deducting taxes under section 194J of the Indian

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[36] Section 194C of the Indian tax law.
[37] Zee Entertainment Enterprises Limited (2015) 38 ITR (T) 636 (Mumbai Tribunal); UTV Entertainment Television Limited (ITA Nos. 2699, 4205, 2700/ Mum/ 2012, dated 29 October 2014).
[38] CIT vs Ahmedabad Stamp Vendors Association (2012) 25 taxmann.com 201 (SC).
[39] Bharti Airtel Ltd.vs DCIT [2014]228 Taxman 219 (Karnataka HC).

tax laws arises on the taxpayer. Though the said decision is in the context of the telecom industry, the decision may also apply to the DTH industry.

In this regard, it could benefit the industry if the government issues a suitable clarification (similar to the one issued in the case of TV channel companies[40]) that discounts on the sale of STBs/RCVs is not subject to WHT, so as to avoid unnecessary litigation across the DTH sector.

Losses

The Indian tax law permits an offset of losses from one business against the gains of another. However, the net unabsorbed business losses can be carried forward and offset against the business profits of the subsequent years, for a maximum period of eight years. In the absence of adequate profits, unabsorbed depreciation can also be carried forward and offset against the profits of future years without any time limit.

Other developments/issues impacting the Media and Entertainment (M&E) industry

Equalization levy

The provisions relating to equalization levy were included in the Finance Act of 2016, in line with the recommendation of the OECD BEPS project. Effective June 1, 2016, payments to non-residents by Indian residents/Indian PEs of non-residents in relation to online advertising and other notified services shall attract equalization levy at the rate of 6 percent if the aggregate payment to a party during the year exceeds INR 100,000.

General Anti-Avoidance Rule (GAAR)

The GAAR provisions, which were introduced into Indian tax law by the Finance Act of 2012 have now become effective from April 1, 2017. GAAR is applicable to arrangements regarded as ‘impermissible avoidance arrangements,’ which could result in, among other things, re-characterization of such arrangements, denial of tax benefits or treaty benefits, etc.

Place of Effective Management (POEM)

The 2016 Finance Act made a significant amendment to the definition of ‘resident in India’ in the context of companies. A company having turnover or gross receipts exceeding INR 500 million shall now be considered as ‘resident’ if its POEM (i.e., place where key management and commercial decisions necessary for conduct of business are in substance made) is in India. The government has issued guiding principles for determining POEM.[41]

Amendments in tax treaties

The Indian government has renegotiated treaties with the governments of Mauritius, Cyprus and Singapore amending, *inter alia*, the capital gain tax provisions. Taxation of capital gains arising from transfer of shares changed from residence-based taxation to sourced-based taxation. Limitation of Benefit clauses have been introduced/modified in the Mauritius/ Singapore tax treaties specifying the conditions necessary for the taxpayer to satisfy to avail the treaty benefit. With this, the government has sought to plug the tax loopholes exploited by companies to avail tax benefits under these treaties vis-à-vis capital gains.

[40] CBDT Circular No.5/ 2016 dated 29 February, 2016.
[41] CBDT Circular No.8/ 2017 dated 24 January, 2017.

Indirect Taxation

Key tax issues

Film Industry

Service tax on fees of actors/ technicians

Services by way of licensing copyright in cinematographic films for theatrical exhibition was exempt from service tax;

15) Services provided by way of temporary transfer or permitting the use or enjoyment of a copyright,-

    (b) of cinematograph films for exhibition in a cinema hall or cinema theatre;

However, the producers of cinematographic films availed various input services (such as services of actors and technicians) which were liable to service tax. Accordingly, there was substantial loss of Central Value Added Tax (CENVAT) credit on input services attributable to revenue from theatrical exhibition. This resulted in a huge cost for film producers which could be avoided by exempting the input services of actors and technicians from the levy of service tax.

Under Goods and Service Tax (GST) regime, state-level entertainment tax has been subsumed. Therefore, the exemption on theatrical rights has not been continued and the same is now subject to GST. Accordingly, there is no credit loss to the film producers, since the input as well as the output is subject to GST and the credit of input GST can be offset against output GST.

DTH industry

Key tax issues

Dual levy of tax on DTH service

Several DTH players provide STBs to customers on an entrustment basis, without charging any consideration. While there should be no VAT applicable on such a transaction, VAT Authorities contended that installation and activation charges included the price of STBs and sought to levy VAT on such transactions. This lead to double taxation on the same consideration (i.e., VAT and service tax), thereby causing significant strain on the industry.

Since installation and activation charges were service revenue and service tax was levied thereon, the same could be kept outside the purview of VAT.

Under the GST regime, the DTH service is subject to GST as 'services.' Movement of STBs between the locations of the DTH service provider from one state to another, for installation at customers' premise is subject to GST. Further, the credit of such GST paid on inter-state transfer of STBs is available against output GST liability on DTH services.

Taxability of RCVs

Previously, DTH players were paying service tax on the Maximum Retail Price (MRP) of RCVs and the selling agents of RCVs were not required to pay any taxes or undertake any compliances. Under the GST regime, DTH players are required to pay GST on the price at which such vouchers are sold to the selling agents. Further, subject to the threshold limits, the selling agents are required to pay GST on the price at which such RCVs are sold to the end customers and take credit of the GST paid by DTH players. The selling agents are also liable to undertake the related compliances, if the threshold limit is crossed.

Judicial decisions:

Digital media/Out of Home (OOH) industry

Service tax implication on sale of space or time slots for advertisements

The negative list entry pertaining to 'selling of space or time slots for advertisements' was restricted to include only print media, widening the service tax base to include sale of space for advertisements on internet websites, out-of-home media, on film screens in theatres, bill boards, conveyances, buildings, cell phones, Automated Teller Machines (ATMs), tickets, commercial publications, aerial advertising, etc., which were earlier outside the service tax bracket.

Other developments/issues impacting the M&E industry

Service tax on fees paid to the Ministry of Information and Broadcasting (MIB)

All services provided by the Government or Local Authority had been brought under the service tax net effective April 1, 2016. Further, the Government had been defined as the department of Central Government, State Government and its Departments, Union Territories and its Departments.

In view of the above, license fees payable by broadcasters and DTH service providers to the Ministry of Information and Broadcasting was subject to service tax under the reverse charge mechanism in the hands of broadcasters and DTH service providers. This resulted in huge CENVAT credit accumulation for the broadcasters and DTH service providers.

Levy of Service Tax on Online Information Database Access or Retrieval Services (OIDAR services)

Effective December 1, 2016 the Government has brought about the following amendments:

— OIDAR services include services such as, advertising on the internet; providing cloud services; provision of e-books, movie, music, software and other intangibles via telecommunication networks or internet; providing data or information, retrievable or otherwise, to any person, in an electronic form through a computer network; online supplies of digital content (movies, television shows, music, etc.); digital data storage; and online gaming.

— The place of provision of such services shifted from place of service provider to place of service receiver.

— Exemption in respect to such services provided to the Government, a Local Authority or an individual in relation to any purpose other than commerce, industry or any other business or profession, was withdrawn

— The service provider located in the non-taxable territory providing such services to the Government, a Local Authority, a Governmental Authority or an individual located in taxable territory, in relation to any purpose other than commerce, industry or any other business or profession, is liable to pay service tax in India;

— In case of such service provided to persons other than mentioned above, the service tax is payable under reverse charge mechanism.

By virtue of the above amendments, the foreign entity located outside India providing OIDAR services to individuals located inside India, is required to obtain registration, make service tax payments and adhere to service tax compliances in India.

VAT and service tax on copyright

Licensing of copyright in cinematographic film for theatrical exhibition was exempt from the levy of service tax. Accordingly, licensing of copyright in cinematographic film (other than theatrical exhibition) was liable for service tax. Various state governments had made copyright liable to VAT, treating the same as intangible goods. Therefore, the dual levy of service tax and VAT on the same transaction/consideration pertaining to copyright in cinematographic films continued, which has been addressed by the Government.

The issue of taxability on transactions of the transfer of rights to use intangibles has always been a matter of litigation. The decision of the Bombay High Court has re-raised the controversial issue of transfer of right to use intangibles. In light of this High Court judgment, the issue of dual taxation on transactions of transfer of right to use intangibles, with or without exclusive and unconditional transfer, was likely to re-open the debate regarding the meaning of the transfer of the right to use goods. This was expected to further increase the litigation on the issue of dual taxation on licenses in respect to intellectual property such as trademarks, copyrights, patents, etc., which were already subject to service tax.

Under the GST regime, temporary or permanent transfer of Intellectual Property Rights (IPRs) shall be treated as supply of service and shall be subject to single levy of GST.

Impact of GST on the sector

GST is one of the biggest Indirect tax reforms in the history of India. It is a comprehensive tax levied on manufacture, sale and consumption of goods and services with a mechanism for allowance of input tax credit paid at each stage of supply. GST, which is generally described as 'one tax for one Nation,' has subsumed all previous indirect taxes such as Excise Duty, Service Tax, CVD, Value Added Tax (VAT), Entertainment Tax at State level, Entry Tax etc. and only one tax i.e. GST is levied and collected on value additions at each stage of the supply of goods and services at National level. In India, there is a dual levy of GST, i.e. on all Inter-State supplies, Integrated Goods and Service Tax (IGST) is levied and on all Intra-State supplies, Central Goods and Service Tax (CGST), and State Goods and Service Tax (SGST) are levied.

GST is the destination-based tax wherein the tax revenue would be earned by the state where goods and services are consumed rather than the place where they are produced or the services are being provided.

As compared to the time taken in arriving at a consensus on the Constitutional Amendment Bill for GST, the manner in which subsequent events carried out by the Government after its implementation indicates that the Government and the States have done remarkably well in taking all necessary steps for implementation of GST. Accordingly, GST was implemented on July 1, 2017.

Following several meetings in 2017, the GST council has broadly approved the GST rates for certain goods and services at 0 percent, 5 percent, 12 percent, 18 percent, and 28 percent.

The impact of GST on different trade and business varies. In the ongoing paragraphs of this section, we have broadly touched upon certain impact areas for the media and entertainment segment.

Impact on account of Place of Supply (POS):

Previously, because service tax is central levy, service providers were not required to determine the place of provision of service for those provided within India. However, under GST, since IGST is applicable on all inter-state supplies and CGST and SGST are applicable on all intra-state supplies, it is necessary to determine the place of supply of service in each case. Impact on certain segments on account of POS provisions under the GST Act are discussed below:

Broadcasters:

As per the GST law, POS for broadcasting services shall be determined based on where the cable connection or dish antenna is installed. In this regard, Section 12(11)(a) of the IGST act states as follows:

"The place of supply of telecommunication services including data transfer, broadcasting, cable and direct to home television services to any person shall,—

(a) in case of services by way of fixed telecommunication line, leased circuits, internet leased circuit, cable or dish antenna, be the location where the telecommunication line, leased circuit or cable connection or dish antenna is installed for receipt of services…;"

DTH/ Cable operators:

The GST law specifies that POS in respect to cable and direct-to-home television service shall be determined based on the location where the cable connection or dish antenna is installed. Accordingly, DTH/Cable operators shall be required to determine the customers' location for appropriately ascertaining the intra/inter-State supplies in each case.

Advertisers:

Previously, Place of Provision of Service Rules under the service tax law did not provide for place of provision of advertisement services to Government/non-Government entities. Hence, it was determined as per the general rule i.e. location of service recipient. However, the GST law provides for POS of advertisement service provided to Government entities and does not state anything in respect to POS of advertisement services provided to non-Government entities. Accordingly, the POS of advertisement service supplied to Government entities needs to be determined as per specific rule and POS of advertisement services supplied to non-Government entities needs to be determined as per the general rule of location of recipient.

Impact on account of other factors

Production houses and theatres

Exemption on theatrical rights

Under the previous regime, transfer of theatrical rights was exempt from service tax and VAT (in certain states). Such exemption was in view of the entertainment tax levied on the theatrical exhibition of movies. However, under the GST regime, state level entertainment tax has been subsumed. Therefore, theatrical rights are no longer exempt and shall be subject to GST.

Availability of input tax credit

Under the previous tax regime, since theatrical rights were exempt from Service Tax, CENVAT credit on corresponding inputs and input services attributable to such exempt income was not available. Under GST, since the exemption on theatrical rights has not been continued, no reversal of input tax credit on inputs and input services is required. This may lead to a decrease in overall cost of production, which is a positive impact on the segment.

Treatment of Intellectual Property Rights

Under the previous regime, temporary transfer of IPR was treated as provision of service as well as deemed sales and accordingly were subject to dual levy of service tax and VAT. However, under the GST regime, transfer of IPRs, whether temporary or permanent, shall be treated as supply of service and subject to a single levy of GST.

Broadcasters

Transfer of equipment/IRD boxes

Under the previous regime, services provided without consideration were not subject to Service Tax. However, under GST, any supply of goods made to a related person in the course or furtherance of business, even without consideration, shall be treated as supply and subject to GST. Accordingly, the broadcasters transferring equipment/IRD boxes to related persons without consideration in the course of provision of services shall be treated as supply of goods in addition to supply of broadcasting service subject to GST.

Advertisers

Taxability of sale of space in print media

Under the previous regime, service provided in selling space for advertisements in print media was covered under the negative list of service and hence were not subject to service tax. Under GST regime, the said service has been made leviable to GST and the recipient shall therefore be entitled to use the full input tax credit.

General impact

Registrations

Under the previous regime, where service tax was a central levy, an option of Centralized registration was available. However, under GST, registration must be obtained in each state of operations and there is no option available for centralized registrations. Hence, it has become necessary to obtain separate registrations and file separate returns in respect to each registration obtained under GST.

Input tax credit

Under the previous service tax regime, input tax credit was available when invoiced. However, under GST, input tax credit shall be available if the vendor has actually paid the tax into government treasury and the details uploaded on the GSTN portal by the recipient matches with the details uploaded by the vendors (subject to fulfilment of other specified conditions).

Previously, VAT paid on goods was not available as a credit to discharge output service tax liability and vice versa. However, under GST, cross credits between goods and services has been made available.

A summary of aforementioned impact areas of GST on various segments of media and entertainment sectors is tabulated below for ease of reference:

Sr. No.	Particulars	Positive's	Negative's
1.	Production houses and theatres	Ambiguity on whether licensing of copyright would be classified as goods or services has been resolved; under GST, it is specified copyright licensing will be treated as a service. Decrease in overall cost of production due to availability of input tax credit since cross credits between goods and services will be available. Decrease in effective tax rate due to entertainment tax being subsumed.	Increase in compliances due to state-wide registration and return requirements.
2.	Broadcasters	Ambiguity on whether licensing of copyright will be classified as goods or service has been resolved; under GST, it is specified licensing will be treated as service. Under GST, cross credits between goods and services will be available.	Free supplies given to related parties will be subject to GST. Increase in compliances due to state-wide registration and return requirements Increase in effective tax rate
3.	DTH/ Cable operators	Decrease in effective tax rate due to state-level entertainment tax being subsumed.	POS needs to be appropriately determined as per location where cable or dish antenna is installed Increase in compliance's due to state-wide registration and return requirements.
4.	Advertisers	Under GST, cross credits between goods and services will be available.	POS on account of advertisement service provided to non-Government entities Increase in compliance due to state-wide registration and return requirements.

Conclusion

All in all, GST is having a positive fiscal impact on the M&E sector due to a simplified tax structure, reduction in costs from availability of input tax credits at various stages of supply, etc. However, there are certain concerns such as, continuity of various exemptions, increase in compliance requirements in respect to obtaining registrations, filing returns etc. which may create some problems for the segment despite the positive impact.

Transfer Pricing

The Indian TP regulations require a taxpayer to undertake international transactions and Specified Domestic Transactions ('SDTs') with Associated Enterprises on an arm's length basis. Further, the regulations mandate the use of one of the six prescribed methods as the Most Appropriate Method for the determination of the arm's length price ('ALP'). From a compliance perspective, the regulations prescribe maintenance of mandatory documentation by taxpayers on an annual basis in relation to their international and SDTs and also cast a compliance obligation on the taxpayers, which involves filing of an annual TP certificate (known as Accountant's Report) with the tax authorities disclosing details of such transactions in a prescribed format.

Recent developments

TP landscape in India has constantly evolved over the years from the 2001 Finance Act which introduced the TP regulations in India for the first time to the implementation of a three-tiered documentation requirements contained in the Action Plan 13 of Organization for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project by the Union Budget 2016.

BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations resulting in little or no overall corporate tax being paid. In the post BEPS era, multi-national enterprises (MNEs) would be called upon to review and realign their structures to ensure consistency between allocation of income and value creating activity. Consequently, the implementation of Action Plan 13 of OECD BEPS project regarding Country-by-Country (CbyC) reporting from financial year 2016–17 was seen as a game changer, and not only increased the documentation burden, but also invited additional attention by tax authorities.

The TP environment has further undergone a significant change over the past 12 months. The 2017 Finance Act proposed important amendments to the TP regulations, such as introductions of secondary adjustment provisions and thin capitalization norms in line with the Action Plan 4 of OECD BEPS project., changes were proposed to the domestic TP regulations to exclude payments made to persons specified in section 40A(2)(B) of the Indian tax laws from the scope of Section 92BA of the Act (payments to director or relatives, payments made to related entities with direct ownership relationship, etc.).

The APA provisions have proved to be a step in the right direction and the Indian government has consciously put the APAs on a fast track which has helped in boosting taxpayers' confidence in the government's APA program.

Additionally, the tax authorities have taken various measures to improve the TP landscape in India during the last year. With a view to reduce litigation, the government has recently introduced certain far-reaching measures to move away from a quantitative basis for selection of cases for transfer pricing audit to a risk-based system. In this regard, CBDT has issued revised instructions prescribing certain additional mandatory criteria for reference of matters to TPOs. This is expected to reduce the number of cases under audit and thus reduce litigation.

Key transfer pricing issues for the M&E industry

The increased cross-border activity coupled with the peculiarities of the nature of transactions undertaken in the M&E industry poses several practical challenges in establishing the fact that the transactions undertaken between related parties are at arm's length. The sections below provide an overview of TP-related issues faced by the M&E industry.

Comparability for distinct transactions

The Indian TP regulations provide that the comparability of an international transaction with an uncontrolled transaction should be judged with reference to:

- The specific characteristics of the property transferred or services provided in the transaction;
- Functions performed, taking into account assets employed or to be employed and risks assumed, by the respective parties to the transactions;
- The contractual terms (whether or not such terms are formal orin writing) of the transactions which describe, explicitly or implicitly, how responsibilities, risks and benefits are to be divided between the respective parties to the transactions; and
- Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, laws and government orders in force, costs of labor, overall economic development, level of competition, and whether the markets are wholesale or retail.

In consideration of the above mentioned parameters, if the nature of international transactions entered into between parties in the M&E industry are analyzed, it would be seen as distinct, peculiar and not comparable to those undertaken in any other industry, mainly due to the nature of assets or intangibles being traded between the parties. The following examples will help provide a better understanding of the concept.

- An Indian TV broadcasting company purchases film rights from a related party situated abroad. However, the price paid may vary significantly for various films and would depend on factors such as whether a film is being telecast on television for the first time, the timing of telecast, etc.
- Similarly, in the case of an Indian company which owns a channel being telecast in a foreign country and grants advertisement rights on a revenue split basis to related parties abroad, the proportion of split may vary significantly depending upon economic and commercial factors.

Given the nature of transactions undertaken, it poses peculiar challenges from a benchmarking perspective. Firstly, it is usually difficult to gather information from the public domain on similar independent transactions undertaken in this industry. Secondly, even if some data is available on certain similar transactions undertaken between unrelated parties, they can seldom be used for benchmarking the related party transactions because of material differences between the two transactions being compared.

Difficulty in application of prescribed methods

The Indian TP regulations have prescribed six methods under the law (as prescribed by the CBDT) for the purpose of determination of the arm's length price, viz., (1) Comparable Uncontrolled Price ('CUP') Method; (2) Resale Price Method ('RPM'); (3) Cost Plus Method (CPM); (4) Profit Split Method (PSM); (5) Transactional Net Margin Method (TNMM); and (6)

Other Method [notified by the CBDT on 23 May, 2012 vide a Notification and Rule 10AB inserted in the Income-tax Rules, 1962 (the Rules) thereafter].

Rule 10AB describes the other method as "any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts." This rule is effective from financial year 2011–12.

Given the distinctiveness of international transactions entered into between related parties in the M&E space, it is often felt that the benchmarking analysis may not always be possible within the purview of the five methods prescribed under the law.

With the introduction of the 'other method,' taxpayers may have a little more flexibility to use tender documents, third-party bids, proposals, valuation reports, standard rate cards, price quotations, and commercial and economic business models, etc. to demonstrate arm's length intent. The application of the 'other method' could be particularly helpful in cases where application of the other five specific methods is not possible due to difficulties in obtaining comparable data as a result of distinctiveness of transactions such as intangible transfers, etc.

Increased compliance burden on the foreign M&E entities undertaking TP compliances in India

In a landmark decision of a foreign taxpayer,[42] the Special Bench of Kolkata Tribunal dealt with an emerging issue in India, namely 'base erosion,' which otherwise has gained significant attention in the global international tax community.

In this case, the taxpayer (foreign entity) had offered interest-free loans to its Indian subsidiary for commercially justified reasons. The TPO did not accept the lack of interest charge and made a TP adjustment in the hands of the taxpayer. The taxpayer argued that such adjustment ought not be made following the principles of 'base erosion' since any increase in the income of the foreign company (e.g., additional WHT at 10 percent) will imply a corresponding higher claim of expenses by the Indian company (e.g., additional corporate tax deduction of 30 percent) and hence, the overall effect of the adjustment will lead to a reduction of tax base for the country (of 30 percent *Less* 10 percent = 20 percent). The Kolkata Tribunal constituted a Special Bench to adjudicate on the taxpayer's appeal.

The Special Bench refused to accept the taxpayer's plea and held that establishing whether there is an erosion of the overall Indian tax base is not a relevant factor in determining whether TP provisions apply to a transaction. Therefore, the principle of 'base erosion' was not upheld.

The Special Bench has rejected the base erosion theory in principle which would not be restricted only to interest free loans but to wider classes of transactions. If implemented by the tax authorities, this ruling could have wide spread ramifications for foreign M&E entities complying with TP rules in India. In the immediate short-term, the ruling may increase the compliance and litigation burden for taxpayers and the overall impact could be adverse.

The lower authorities may use this aforementioned decision to frame aggressive TP assessments of foreign M&E entities. It is possible that the TPO may make an ALP

[42] Instrumentarium Corporation Limited [TS-467-ITAT-2016 -TP] (Kolkata Tribunal SB).

adjustment in the hands of the foreign M&E entities and the taxability or otherwise of the Indian entity may not be considered to be relevant based on what has been articulated by the Special Bench. Consequently, foreign M&E entities undertaking TP compliances in India by taking support of the base erosion argument would need to reassess arm's length justification reasons in light of this decision.

Country-by-Country (CbyC) reporting

Introduction of CbyC norms in India has by far been one of the most important developments from a TP perspective. These provisions have been adopted by an amendment to Section 92D and introducing Section 286 to the Indian tax laws effective as of assessment year (AY) 2017–18 i.e. financial year 2016–17. These norms are based on recommendations issued by the OECD's BEPS Action Plan 13.

Action Plan 13 provides for a three-tier structure of TP documentation, namely – (a) master file, (b) local documentation file, and (c) CbyC reporting. CbyC reporting provisions apply to a multinational group having consolidated revenue, based on consolidated financial statements, exceeding the threshold of EUR 750 million equivalent in local currency. This threshold in Indian currency would be equivalent to INR 53,950 million. Consequently, the CbyC provisions apply to all entities who are considered residents of India including PEs.

While, currently, there are no set formats provided in BEPS Action Plan 13 regarding presentation, or an exhaustive list of details to be mandatorily incorporated in the master file, it is expected that CBDT may develop such guidelines going forward.

It is pertinent to note that a graded penalty structure has been provided in case of non-furnishing of report or necessary information. Resulting penalties range from INR 15,000 to INR 50,000 per day, depending upon the stage and recurrence of the default. Further, furnishing of inaccurate information, may result in a penalty of INR 0.5 million.

While awaiting detailed rules, compliance with BEPS Action Plan 13 will have different ramifications for Indian headquartered M&E groups and an Indian arm of foreign headquartered M&E groups. An Indian headquartered M&E group satisfying the quantitative criteria, will have to comply with the master file and CbyC reporting whereas an Indian arm of the foreign headquartered M&E group, will only have to comply with the local file requirements.

Furthermore, under certain circumstances, Indian subsidiaries/PEs of an M&E group headquartered out of India would be responsible to file the CbyC report in India which otherwise would be the responsibility of the foreign parent of the M&E group. Since this is the first year of implementation of BEPS Action plan 13, it could pose certain challenges especially with regard to timing of compliance in India may differ from the other countries. One will have to wait for the CBDT guidelines in this regard.

Update on Advance Pricing Agreements

The APA Scheme was introduced to Indian tax law in 2012 and the 'Rollback' provisions were introduced in 2014. The scheme aims to provide certainty to taxpayers by specifying the method and determining the prices of international transactions in advance thus avoiding future TP disputes.

Since its inception, the APA scheme has received a lot of interest from taxpayers which has resulted in more than 815 applications (both unilateral and bilateral) filed in approximately five years. CBDT has already signed 152 APAs (141 unilateral APAs and 11 bilateral APAs), which has been highly appreciated nationally as well as internationally.

Further, a CBDT press release dated November 17, 2016 stated that more than 100 cases under the Mutual Agreement Procedure (MAP) between India and USA have been set to be resolved. Terms and conditions of the first bilateral APA involving India and USA have also been agreed upon.

Until recently, signed APAs pertained to mainstream industry transactions. However a growing number of APAs have been signed for complex and litigious transactions. The APAs signed for management cross charges and royalties have particularly helped in boosting taxpayers' confidence in India's APA program. Further, the Indian government has consciously put the APAs on a fast track which has helped in boosting taxpayer confidence in the government's APA program.

M&E players in India have significant intercompany transactions in the nature of royalty given their tie-ups with international M&E entities and nature of their operations. While the recent APA and MAP for brand royalty was not signed for an entity in the M&E industry, payment of brand royalty being a contentious TP issue in Indian TP audits, conclusion of an APA/ MAP on the same is a welcome move, and M&E players could benefit from the precedent set by the said APA.

Other key developments

Thin Capitalization Rules

These Rules were introduced via the 2017 Finance Act. The rules apply when an Indian company or permanent establishment incurs any expenditure from interest or of similar nature exceeding INR 10 million in respect to any debt issued by the AE. The expenditures incurred would be restricted to 30 percent of its Earnings before Interest, Taxes, Depreciation and Amortization ('EBITDA') while considering alignment with recommendations of the OECD's BEPS Action Plan 4. The debt to be considered while computing the 30 percent interest expense deduction limit shall include the debt directly issued by the AE and the debt issued by a third party, where the AE has provided an explicit or implicit guarantee or extended indirect funding. In cases where the whole interest expenditure cannot be claimed in the relevant AY, it shall be carried forward for eight years.

Secondary Adjustment

Secondary adjustment postulates a situation of adjustment to income of a taxpayer which has been accepted by the taxpayer under certain defined circumstances. It is provided that such an adjustment to the income (referred to as primary adjustment) of the taxpayer results in underlying excess cash with the foreign associated enterprise and the same should be repatriated into India (i.e. money should be brought into India) and accounted for as income of the Indian taxpayer. Failure to do so beyond a specified period of time would render re-characterization of such adjustment as an advance given by Indian taxpayer to its AE and interest shall be imputed thereon.

While the rules define the period beyond which the adjustment would be characterized as an advance and rate of interest to be charged, there remain certain ambiguities in the law (e.g. whether interest charge would be one time or each year, etc.).

Personal Taxation

Residential Status and Taxability of Income in India

Residential Status

An individual is taxable in India based on his "residential status" in the relevant financial year[43]. Residential status is determined on the basis of physical stay/presence in India. The residential status of an individual could be that of a "resident" or a "non-resident."

Resident

A person is said to be a "resident" of India if:

(a) He stays in India for 182 days or more in the relevant financial year

(b) He stays in India for a period of 60 days or more in the relevant financial year coupled with a stay of 365 days or more in the four financial years immediately preceding the relevant financial year.

When an Indian citizen leaves India during the relevant financial year for the purpose of employment or an Indian citizen comes to India on a visit during the financial year, his residential status would be that of a "resident" only if he stays in India for 182 days or more.

"Resident" is further subdivided into:

*Resident but Not Ordinarily Resident (NOR)***:** An individual is said to be an NOR if he is:

a) A *nonresident* in India in 9 out of 10 financial years preceding the relevant financial year

b) Present in India for 729 days or less during the 7 financial years preceding the relevant financial year.

Resident and ordinarily resident (ROR): A person becomes an ROR if he does not satisfy any of the above said conditions, i.e., neither condition (a) nor condition (b) is met.

Non-resident (NR)

A person is said to be a "non-resident" if he does not satisfy any of the above two conditions, i.e., neither condition (a) is satisfied nor condition (b) is satisfied.

Normally, a foreign citizen who is visiting India for the first time would become an ROR in the third/fourth financial year, from the year of the start of his assignment.

Taxability of Income Based on Residential Status

Based on the residential status, an individual is taxable as below:

ROR: Liable to tax on worldwide income, i.e., salary income and income other than salary earned/received in India or abroad

NOR: Liable to tax on the income sourced, i.e., accruing or arising/deemed to accrue or arise, from India or received/deemed to receive in India or on the income derived from a business controlled or profession set up in India

[43] Indian financial year runs from April 1 to March 31 of the following year.

NR: Liable to tax only on the income sourced, i.e., accruing or arising/deemed to accrue or arise from India or received/deemed to be received in India

The salary income earned by an NOR/NR for "services rendered in India" is liable to tax in India, irrespective of the place of receipt of such income, i.e., whether the salary income is received in India or overseas.

Taxability of Self-Employed in India

Non-resident Artists (self-employed)

Income from Profession

Artists are taxed in India with respect to income earned from performances in India. The Indian taxpayer is obliged to withhold at the appropriate rate of income tax applicable to nonresident individuals. However, this is, subject to any benefits that may have been available to the artist under the relevant double tax avoidance treaty (article on "artistes and sportsmen") and Indian tax law, respectively.

Some specific cases, where the consideration paid to an artist may be taxed in India,[44] have been illustrated hereunder:

- For acquiring copyrights of performance in India for subsequent sale in India (of CDs, etc.); and
- Portion of endorsement fees relating to artist's performance in India.

Resident Artists (self-employed)

Taxability of Income

Indian residents are taxed on their worldwide income from all sources.

Relief for Foreign Taxes in India

A resident in India is entitled to a credit for foreign taxes paid on foreign-sourced income in the following manners:

- Where agreement for avoidance of double taxation exists between the two countries, in accordance with the terms of that agreement; and
- Where there is no double taxation avoidance agreement, as per the provisions of the Indian tax laws.

Maintenance of Books of Account

Every person carrying on a profession notified by the CBDT (like film artist, company secretary, etc.) is required to maintain books of account in the prescribed format as per Indian tax law for the income earned in India and expenses incurred in the course of profession.

Compulsory Tax Audit

Every person carrying on a profession, whose gross receipts exceed INR 5 million in the current tax year, shall have his accounts audited by an accountant and furnish the report in the prescribed format before the specified date.

[44] Circular No. 787 dated February 10, 2000.

Social Security Regime in India

General Principles of the Social Security Scheme

Persons Covered

Social security regime in India is primarily governed by Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (the EPF Act) and comprises the following schemes:

a) Employees' Pension Scheme, 1995 (EPS);

b) Employees' Provident Funds Scheme, 1952 (EPFS); and

c) Employees' Deposit Linked Insurance Scheme, 1976 (EDLI).

The above schemes provide for the social security of employees working in an establishment employing 20 or more persons.

The Ministry of Labour and Employment, Government of India issued a notification, dated 1 October 2008, wherein special provisions were introduced in the EPF Act to define a new category of workers called International Workers (IWs).

IWs have been defined[45] to mean:

(i) An Indian employee who have contributed to the social security programme of a country that has a Social Security Agreement (SSA) with India and who have gained or are going to gain eligibility for benefits under this SSA; and

(ii) An employee other than an Indian employee, holding other than an Indian passport, and working for an establishment in India to which the EPF Act applies.

Provided that the worker who is a Nepalese national on account of Treaty of Peace and Friendship of 1950 and the worker who is a Bhutanese national on account of India-Bhutan Friendship Treaty of 2007, shall be deemed to be an Indian worker.

The IWs i.e., non-Indian passport holders has to be enrolled from the first day of his employment in India or from 1 November, 2008, whichever is later.

All employees who fall within the definition of IWs are required to become members of the Schemes under the EPF Act unless they qualify as "excluded employees."

An "excluded employee" has been defined to mean:

i. An International Worker, who is contributing to a social security programme of his country of origin, either as a citizen or resident, with whom India has entered into a social security agreement on reciprocity basis and enjoying the status of detached worker for the period and terms, as specified in such an agreement; or

ii. *An International Worker, who is contributing to a social security programme of his country of origin, either as a citizen or resident, with whom India has entered into a bilateral comprehensive economic agreement containing a clause on social security prior to 1st October 2008, which specifically exempts natural persons of either country to contribute to the social security fund of the host country."*

[45] 2(ja) of paragraph 83 of the EPF Scheme.

In view of the above, IWs are exempt from contributing to Indian social security/ PF if:

— They are contributing to social security in their country of origin and obtained a Certificate of Coverage (CoC) under the relevant SSA; or

— Deputed from a country with which India has entered into a bilateral comprehensive economic agreement before October 1, 2008. (Currently with Singapore only); or

— They are Nepalese national on account of Treaty of Peace and Friendship of 1950 and the worker who are Bhutanese national on account of India-Bhutan Friendship Treaty of 2007, shall be deemed to be Indian workers. (Date of effect: November 2, 2016)

Scheme for salaried persons

The above mentioned schemes are applicable only to employees working with covered establishments. Every employee, as mentioned above, working with a covered establishment, is required to become a member of the schemes. Both employee and employer are required to contribute towards the schemes. The schemes provide for retirement savings, retirement pension, and life insurance benefits to the employees.

Scheme for self-employed persons

The above schemes do not cover the self-employed persons and are applicable only to employees.

Incomes Subject to Social Security Contribution

Scheme for salaried persons

Calculation of the contributions to be paid by salaried persons is based on the salary earned by the employee.

"Salary" for the purpose of the PF contribution would include basic wages, dearness allowance (including cash value of any food concession), and retaining allowance.[46]

Dearness allowance is likely to include any allowance granted to an employee to compensate for the rise in the cost of living.

Scheme for self-employed persons

As mentioned above, the above schemes are not applicable to the self-employed persons.

However, for self-employed persons, Public Provident Fund, National Pension System and private pension plans are some of the schemes available in India.

Social Security Rates

The above schemes are financed by collecting contributions paid by the employees and employers.

— Employee's social security rate;

— Every employee is required to contribute to the EPFS at the rate of 12 percent of his eligible salary; and

— Employer's social security rate.

[46] Section 6 of the EPF Act.

An employer is also required to make a matching contribution of 12 percent. Employees who joined the Indian establishment on, or after, September 1, 2014 and have not been covered under the PF Act earlier, shall apply the complete 12 percent of employer contribution under the EPFS. In the case of an employee who has been a member of EPFS prior to September 1, 2014, the employer would require the employee to contribute towards pension fund i.e. EPS. Therefore, from the 12 percent of employer's contribution, 8.33 percent will be contributed towards the pension fund (EPS) and 3.67 percent will be diverted towards EPFS. Apart from the above, the employer is also required to contribute towards the administrative costs levied by the PF authorities.

How Social Security Contributions are levied?
Scheme for salaried persons

Generally, the employer is required to withhold the employee's contribution from the salary of the employee and contribute the same along with its own contribution to the fund. The employer is also required to comply with certain filing requirements at the time the employee joins and on a monthly basis.

Scheme for self-employed persons

As mentioned above, the social security schemes are not applicable to the self-employed persons.

Benefits Covered (for Salaried Persons)

Provident Fund

The amounts contributed by the employee and employer are accumulated in a separate account maintained by the regional provident fund commissioner, which also allows interest on the said amount on a monthly basis.

IW(s) can withdraw the amount standing to their credit under the PF scheme in the following situations:

— On retirement from service in the establishment at any time after the attainment of 58 years of age;

— On retirement on account of permanent and total incapacity from work due to bodily or mental infirmity duly certified by the medical officer/registered medical practitioner designated by the organization;

— On suffering from tuberculosis, leprosy, or cancer, even if contracted after leaving the service on the grounds of illness but before the payment has been authorized; or

— In respect to the member covered under an SSA, on ceasing to be an employee in an establishment covered under the EPF Act.

Pension

The employee is entitled to *monthly pension* in the following manners:

— Superannuation pension: In the case of employees (both from SSA as well as Non-SSA countries) with 10 years or more of contributory service, they would be qualified to receive a monthly pension.

— Early pension: A member, if he so desires, may draw an early pension from a date earlier than 58 years of age but not earlier than 50 years of age. In such a case, the amount of pension shall be reduced at the rate of 4 percent for every year the age falls short of 58 years.

Pension Accumulation

In relation to pension withdrawal, the lump sum refund will be available only to those employees who are covered under an active SSA and who have not completed the eligible service of 10 years even after including the totalization of service under the respective SSAs.

An employee who is covered under an SSA and who has not completed eligible service of 10 years may withdraw the full amount standing to his credit in the pension account:

— On retirement from service after attaining the age of 58 years; or

— On exit from employment.

In the case of employees from non-SSA country, they will not receive the lump sum refund.

Life Insurance

The employee is required to nominate a person at the time of joining a scheme. The nominated person is entitled to the amount of life insurance in case of a death of the individual.

Tax Implications in Respect of PF Scheme

— *At the time of making of contribution*

Employees can claim deduction up to the maximum amount prescribed. Presently, the maximum amount of deduction prescribed under the Indian tax laws is INR 150,000 per financial year. Further, employer's contribution up to 12 percent of the salary is exempt from tax under the Act.

— *At the time of withdrawal of accumulated balance*

When the employee has rendered less than five years of continuous service

In this case, the refund of employer's contribution and the interest thereon would be fully taxable as salary income. The employee's contribution would be taxable to the extent of deduction claimed, if any, under the Act. The interest earned on employee's total contributions would be taxable as income from other sources in the hands of the employee.

When the employee has rendered more than five years of continuous service

In this case, the entire accumulated balance received by an employee would be exempt from tax under the Act.

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