MEDIA AND ENTERTAINMENT

Film Financing and Television Programming

A Taxation Guide
Sixth Edition

kpmg.com
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KPMG LLP’s (KPMG) Film Financing and Television Programming: A Taxation Guide, now in its sixth edition, is a fundamental resource for film and television producers, attorneys, tax, 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. Its primary focus 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 media and entertainment Tax professionals.

KPMG published the first guide more than 15 years ago as a resource for global coverage of incentives and tax updates as they apply to the film and television industry. Subsequent editions expanded into coverage of financing techniques, credits/incentives, and a thorough appendix of withholding tax rates—a valuable reference tool for all finance and tax professionals.

Each chapter of the sixth edition 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. Additionally, the United States chapter focuses on both federal and state incentives, highlighting the states that offer the more popular and generous tax and financial incentives. 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 VAT tax rates; normal non-treaty withholding tax rates; and tax year-end information for companies and individuals.

**Financing Structures**
Descriptions of commonly used financing structures in film and television 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-effective 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.

Appendices
Additionally, withholding tax tables setting forth the non-treaty and treaty-based dividend, interest, and film royalty withholding tax rates for the countries surveyed are included as an appendix and can be used as a preliminary source for locating the applicable withholding rates between countries.

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

The sixth edition of KPMG’s Film and Television Tax Guide is available in an online PDF format at www.kpmg.com/filmtax and on CD. The guide is searchable by country.

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 book 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.

Finally, we would sincerely like to thank all of the KPMG International member firm Tax professionals from around the world who contributed their time and effort in compiling the information contained in this book and assisting with its publication. Production opportunities are not limited to the 35 countries contained in this guide. KPMG and the other KPMG International member firms are in the business of 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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Chapter 15

India

Introduction

The Indian film industry is considered to be the largest film industry in the world in terms of the number of feature films produced and released every year (more than 1,200). In addition, over 1,800 short films, documentaries, and non-feature films have been released during the year 2010 (several of which have won international awards). India’s film industry is multi-lingual. Films are produced in ‘Hindi’ (the national language) and in several regional languages. In the year 2000, the film industry was granted the status of an ‘industry’. Since then, the Government of India has taken several initiatives to liberalize the Foreign Policy regulations relating to films. It has also entered into co-production treaties with several countries and is in the process of entering into more bilateral pacts (e.g. with Australia, China, Canada, etc.).

The film industry contributes approximately 13 percent directly to the entire entertainment industry and is projected to grow at a CAGR of 9.6 percent and to reach a size of INR 132.1 billion by 2015.

The Indian television and broadcasting industry has grown tremendously over the last two decades and has emerged as the world’s third largest TV market. The industry added almost 100 million viewers in 2010, to reach 600 million viewers and crossed the 650 channel mark from 460 in 2009 (more than 250 channels are also awaiting approval). Entry of new broadcasters and shifts in viewing patterns have put pressures on the mainstream channels, necessitating them to revisit their content strategy- quality of content/developing new content formats.

Globalization has also emerged with the collaboration/adaptation of formats of successful shows running elsewhere being brought into India, e.g., Kaun Banega Crorepati (based on Who Wants To Be A millionaire), Indian Idol (based on American idol).
### Key Tax Facts

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<th>Rate</th>
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<td>Corporate income tax rate: Domestic companies</td>
<td>32.445 percent</td>
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<tr>
<td>Minimum Alternate Tax: Domestic companies</td>
<td>20 percent</td>
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<tr>
<td>Corporate income tax rate: Foreign companies</td>
<td>42.024 percent</td>
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<td>Maximum Marginal personal income tax rate</td>
<td>30.9 percent</td>
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<td>Partnership (including Limited Liability Partnership)</td>
<td>30.9 percent</td>
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<td>State-Value Added Tax (VAT) rates</td>
<td>General rate ranges between 4 – 15 percent&lt;sup&gt;4&lt;/sup&gt;</td>
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<td>Interstate sale is generally subject to Central Sales Tax</td>
<td>2 percent&lt;sup&gt;5&lt;/sup&gt;</td>
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<td>Service Tax rate</td>
<td>10.30 percent&lt;sup&gt;6&lt;/sup&gt;</td>
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<tr>
<td>Dividends</td>
<td>Nil</td>
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<tr>
<td>Interest</td>
<td>21.012 percent</td>
</tr>
<tr>
<td>Royalties (pursuant to an agreement made on or after June 1, 2005)</td>
<td>10.506 percent&lt;sup&gt;3&lt;/sup&gt;</td>
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<tr>
<td>Fees for technical services (pursuant to an agreement made on or after June 1, 2005)</td>
<td>10.506 percent&lt;sup&gt;3&lt;/sup&gt;</td>
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<tr>
<td>Capital gains (on sale of shares)</td>
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<sup>3</sup>The indicated tax rates are applicable for the financial year 2011–12 and include surcharge, education cess and secondary & higher education cess; surcharge is levied on companies where the total income exceeds INR 10 million.

<sup>4</sup>Depending upon the items, rates vary from State to State. Certain specified items also attract VAT @ Nil/1 percent/20 percent.

<sup>5</sup>2 percent rate is applicable only on fulfillment of prescribed conditions. Where such conditions are not fulfilled, applicable VAT rate is leviable.

<sup>6</sup>Including Education Cess and Secondary & Higher Education Cess.

<sup>7</sup>These rates are as per the Income Tax Act, 1961 (‘the 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 (‘the treaty’) and the Indian tax law, whichever is more beneficial.

<sup>8</sup>Currently, a dividend declared, distributed or paid by an Indian company is tax-exempt for its shareholders. However, an Indian company declaring a dividend would be required to pay 16.223 percent dividend distribution tax (including surcharge and education cess) on such dividend declared/distributed/paid.
Long term capital gain (where shares are held for more than one year)  
1 Nil

Short term capital gain (where shares are held for one year or less)  
15.759 percent

Notes: The Indian tax year is from April 1 to March 31. The same is uniform for all tax payers.

Film Financing

Financing Structures
Under the existing Indian tax law, taxable entities that engage in film production and distribution, *inter alia*, include:

- Individuals
- 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 inter-se. An AOP can result in joint and several liabilities with an unintended exposure for each party to the tax liability of other members of the AOP. All the AOP members are taxed as a single entity. In the case of a member having a lower share in profits, has incurred losses from his part of the activity, he will still be liable for taxes, given that the profits of all members are considered in one assessment. Further, there may also be the inability to off-set 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 same rates applicable to an individual. This income is also included in the total income of the individual for rate purposes. To avoid the 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.

9 Where the shares sold are listed on a recognized stock exchange in India and securities transaction tax (‘STT’) has been paid. In case of sale of unlisted shares or listed shares on which STT has not been paid, tax is charged @ 10.506 percent (without adjusting the inflation index notified by the revenue authorities) and 21.012 percent (after adjusting the inflation index).

10 Where the shares sold are listed on a recognized stock exchange and STT has been paid; in other cases, corporate Income tax rate would apply.

9 Taxability of Individuals has been discussed later in the Chapter under section “Personal Taxation”
Limited company
A limited company is considered as 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 the shareholders; such companies are required to pay dividend distribution tax at 16.223 percent 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 the 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 is a new form of doing business in India, introduced recently by the enactment of Limited Liability Partnership Act, 2008 (‘LLP Act’).

LLP combines the benefits of limited liability of a company and flexibility of a general partnership firm (less onerous compliance and limited disclosure requirements). LLP as a form of doing business may be explored for undertaking co-production activities in India.

Under the Indian tax law, the provisions applicable to a partnership firm have also been extended to an LLP.

Unlike LLPs in several other countries, Indian LLPs do not enjoy a pass through status. Accordingly, where a foreign partner receives its share of profits from an Indian LLP (which would be subject to tax in India), claiming tax credit in his home country may pose a problem in absence of express provisions in the tax treaties.

Foreign investment in Indian LLPs
The Government has recently10 allowed Foreign Direct Investment (‘FDI’) in LLPs in a calibrated manner beginning with open sectors, where 100 percent FDI is allowed under the Automatic Route, no prior approval is required, and there are no FDI-linked performance related conditions.

It is also pertinent to note that LLPs with FDI would not be eligible to make downstream investments.

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The FDI policy permits 100 percent FDI under Automatic Route in the Film Sector. Accordingly, LLPs may be explored as another legal form of doing business in India, especially in 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); and
- Co-Production.

For distribution agreements, which involve the lease 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 the receipt of financing 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. In addition to this, film producers, distributors and financiers can raise finance through equity and preference shares, debentures or bonds, deposits, etc.
Access to finance, etc via film co-production treaties

India has concluded six film co-production treaties to date and is in the process of entering into additional, similar bilateral pacts. Film co-production treaties are entered into with an objective of developing the film industries of the contracting countries, promoting economic and cultural cooperation, extending national film status to the co-produced film (thereby the benefits that are available to such films in the respective contracting countries). Certain countries extend several benefits to their national films, including:

a) Tax incentives;

b) Access to government funding at nominal interest rates; and

c) Regional grants and publicity and marketing budgets from the government.

However, India does not provide any defined benefits to Indian films. Accordingly, the benefits offered by other contracting jurisdictions may be explored.

Several such co-production treaties also take within their ambit third countries with respective contracting countries that 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

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 without any prior approval (‘Automatic Route’). Further, there are no entry level conditions for FDI in the sector. However, investors must comply with certain post filing requirements, namely, notifying the Reserve Bank of India (‘RBI’12) within 30 days of 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 case of Listed companies – The price is worked out in accordance with the Securities and Exchange Board of India guidelines;

- In case of Unlisted companies – The fair valuation of shares done by a Merchant Banker or Chartered Accountant per the discounted free cash flow method; and

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11 India has entered into film co-production treaty with Italy, the U.K., Germany, Brazil, France and New Zealand

12 RBI is the apex body governing foreign exchange regulations in India
- Where shares are issued on a Preferential allotment basis – The price is determined per pricing guidelines laid down by the RBI.

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 drawal is made out of funds held in Resident Foreign Currency Account (‘RFC’) Account.

**Loans and borrowings**

Borrowings in foreign currency are governed by the guidelines on External Commercial Borrowings (‘ECB guidelines’) issued by the RBI. The guidelines stipulate that ECB can be raised by entities engaged in:

- Industrial and Infrastructure sector in India; and
- Qualified services sector (hotels, hospitals and software companies).

As the film/television sector may not fall in the above categories of qualified service sector, it is unlikely that the permission for raising ECBs is allowed to the sector.

In this regard, it should be noted that for purposes of the foreign exchange regulations, non-convertible/optionally convertible/partially convertible preference shares, and debentures are considered as ECB. Accordingly, these instruments would not be permitted in the film/television sector.

However, investment can be made by way of fully and compulsorily convertible preference shares and debentures which are treated as equity for the purpose of FDI policy.

**Corporate Taxation (as per Indian tax law)**

**Direct Taxes Code Bill, 2010**

As part of the tax reform process in India, the country’s Finance Minister released a draft of the proposed new Direct Taxes Code for public debate in August 2009. After considerable consultations and representations received from various stakeholders, the Government unveiled the revised draft of the Direct Taxes Code Bill, 2010 (‘DTC’ or ‘the Code’) in August 2010. The Code proposes several changes in the current direct tax regime including taxation of foreign companies and introduction of General Anti Avoidance Rules.

It is proposed to come into force on April 1, 2012, after due introduction and approval by the Indian Parliament.
It is pertinent to note that only a draft of the DTC has been unveiled by the government. Further, no rules and procedures to implement the provisions of the proposed Code have been released for public discussion. Accordingly, the final impact of the proposals can only be ascertained post enactment of the Code and rules there under.

We have hereinafter discussed key provisions aspects of the existing income tax legislation in India relevant for non-residents and the impact of the DTC based on the current draft.

**Taxability of Income in case of non-residents**

**Non-resident filmmakers/news agency**

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

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

- received or deemed to be received in India; and/or
- accrues or arises or is deemed to accrue or arise in India.

Under the existing income tax laws, income of non-residents arising on account of a ‘Business Connection’ in India is deemed to accrue or arise in India [business connection is akin to the concept of a Permanent Establishment (‘PE’) discussed in tax treaty(s) entered into by India with other countries].

However, incomes from following activities are not deemed to accrue or arise in India–

- shooting of any cinematographic film in India; and/or
- 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 of publishing newspapers, magazines or journal.

**Impact of the DTC**

The aforesaid specific exclusions have not been covered under the DTC. However, in this regard, recourse may be taken to tax treaty(s) which may contain beneficial provisions.
Other aspects
Taxability of income shall also be determined based on the manner in which the same is characterized, namely ‘royalty’, ‘fee for technical services’, etc. In this regard, it may be noted that the existing income tax law does not cover consideration for the sale, distribution or exhibition of cinematographic films in India within the ambit of ‘royalty’.

Impact of the DTC
It is proposed to include ‘Transfer of all or any rights (including the granting of a license) in respect of cinematographic films or work on films, tapes or any other means of reproduction’ within the ambit of royalty.

However, given that certain tax treaties may have a narrower definition of ‘royalty’, such treaties being beneficial would prevail over the provisions of the DTC.

Transactions between related parties
Given the increased linkages between the Indian media players with 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. Such related party transactions come under the purview of Transfer Pricing (‘TP’) regulations and require the same to be carried out at an arms-length price. These regulations prescribe mandatory documentation which needs to be maintained annually.

In the recent past, a number of companies in this industry have been scrutinized by the Indian TP administration on account of related party transactions. Key factors that need to be considered in case of related party transactions and analysis thereof include:

• Detailed Functions, Assets and Risks analysis to support adequacy of the arm’s length price;
• Transaction specific approach; and
• Choice of tested party in an economic benchmarking analysis.

TP policies should be based on a thorough functional and economic analysis that identifies the various functions including the value drivers, risks and location of the company assets. The existence of TP documentation, alongside policy and procedures documentation, could streamline the discussions with Indian tax authorities. In addition, establishing a robust set of TP policies and guidelines could help to proactively identify and effectively manage new TP exposures that are created as a result of business expansions, acquisitions, restructuring, etc.
Impact of the DTC

The DTC proposes to introduce ‘Advance Pricing Agreements’ (‘APA’) for determining arm’s length price in case of international transactions. APAs are likely to offer several benefits to the taxpayers such as, greater certainty on the transfer pricing method adopted, mitigating the possibility of disputes and facilitating the financial reporting of potential tax liabilities.

Deduction of Expenditure

Film production and distribution cost

There are specific rules provided under the Indian tax law which govern the deduction in respect of expenditure on production of feature films/acquisition of distribution rights thereon.

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

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

Where the feature film is not exhibited by the producer himself or not sold, leased or transferred 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 in respect of the cost shall be allowed in the tax year. The entire cost shall be allowed in the succeeding tax year(s).

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

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13 Rule 9A and 9B of Income tax Rules, 1962 ("the Rules"); As stated earlier in this chapter, impact of the proposed rules under the Direct Taxes Code corresponding to Rules 9A and 9B would be ascertained post enactment of the final code and the rules thereunder.
**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 not been deposited with the Government of India within the prescribed time. 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, wealth tax, securities transaction tax, etc.;
- Provisions in accounts for specified staff welfare expenses, duties, taxes, and interest on borrowings from financial institutions, not actually paid before the specified dates; and
- Indirect general and administrative costs of a foreign head office in excess of 5 percent of taxable income (before unabsorbed depreciation, etc.).

**Depreciation**

Depreciation is calculated on 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 into a common block. Depreciation is allowed at varying rates on different classes of assets. Further, if in the year of purchase an asset is used for less than 180 days, then the depreciation is allowed at half the normal rate. In other cases, depreciation is allowed at full normal rates. No depreciation on the asset is permissible in the year of sale of an asset and 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, etc*

**Certain specific tax issues**

**Tax issues for foreign television channels/telecasting companies (‘FTC’)**

*Taxability only when Permanent Establishment exists in India*

The two primary sources of revenue for FTC’s, *inter alia*, is income from the sale of advertising airtime/sponsorships on the TV channel and subscription revenues. Under the Indian domestic tax law, income of the FTC’s is taxed in India in the case where a business connection exists in India. In the event an FTC operates from a country that India has a tax treaty with, such revenue is taxable in India only if such FTC maintains a PE in India.
The provisions of a tax treaty apply to the FTC to the extent they are more beneficial as compared to the provisions of the domestic law. The term ‘business connection’ is widely interpreted and is based on case laws. The definition of PE is generally narrower as compared to the term business connection. In case the FTC has a business connection/PE in India, the profits attributable to such presence in India need to be computed. In case the FTCs do not maintain country wise accounts as prescribed under the domestic law, then this could pose considerable difficulty in computing the profits which can be taxed in India.

Subscription revenues are usually collected by the Indian distributors and subsequently paid to the FTCs. Technically, these revenues should be taxed in India only if a business connection/PE of the FTC exists in India. However, the Indian tax authorities are contending that the payment of subscription fees repatriated to the FTCs are subject to withholding tax, considering such payments to be royalties.

The Indian tax authorities are also increasingly litigating the existence of a PE in case of airtime/subscription revenues of FTC. Further, even where payments have been made on an arm’s length basis, the tax authorities are agitating the attribution of income in the hands of the FTCs before the courts.

**PE exposure under Downlinking Guidelines of the Indian Government**

In case a non-resident wishes to broadcast a TV channel in India, it has to comply with the downlinking guidelines issued by Ministry of Information and Broadcasting, Government of India (‘MIB’). These guidelines mandate that either the applicant company should be the owner of the channel or it should have exclusive marketing/distribution rights for the territory of India, which includes rights to advertisement/subscription revenues for the channel. If the applicant has such rights, it should also have the authority to conclude contracts on behalf of the channel for advertisements, subscription and program content. It is necessary to comply with the aforesaid conditions to obtain approvals from the MIB.

However, conforming to the aforesaid conditions may lead to a creation of PE exposure for the foreign company in India, as authority to conclude contracts on behalf of the foreign company is a trigger point for PE, pursuant to various tax treaties with India.
Withholding tax implications on payments to Satellite Companies

Some other issues which the TV channel companies need to consider is withholding taxes on the payments made in respect of up linking and use of transponder and satellite space. The withholding tax issues may arise on account of characterization of payment as royalty or fees for technical service, existence of permanent establishment/business connection of the non-resident payee (e.g., Satellite Company) in India.

In the past, Indian tax authorities have held that payments made by a TV channel company to a non-resident company owning satellites towards lease of transponder capacity is in the nature of royalty for “use of process” under the tax treaty. On this issue, there have been contradictory decisions at the Tax Tribunal level.

Recently the Delhi High Court\(^\text{14}\) has held that payments made for using transponder capacity for up linking/down linking data do not constitute ‘royalty’ under the provisions of the Indian tax law. The High Court held that the customers did not make payments for the use of any process or equipment, since control over the process or equipment was with the satellite company and not with the broadcasters.

The High Court reiterated that because the satellite merely had a footprint in India, it would not mean that the process took place in India, and accordingly, the payments could not be taxed in India due to insufficient territorial nexus with India.

Given that the High Court is a court superior to the Tribunal, the aforesaid judgment comes as a welcome relief for TV broadcasters due to the uncertainties caused by earlier unfavorable decisions of the Tax Tribunals. The case is likely to achieve finality only at the Supreme Court level. However, the issue will have to be analyzed taking into consideration the particular facts and circumstances of each case.

Impact of the DTC

The DTC proposes to specifically include payments for the “use or right to use of transmission by satellite” within the ambit of ‘royalty’. Such specific inclusion would need further analysis for determining the impact thereof and way forward for the stakeholders.

\(^{14}\) Asia Satellite Telecommunications Co. Ltd. vs. DIT [2011] 332 ITR 340 (Del)
Losses
The Indian tax law permits off-set of losses from one business against the gains of another. However, the net unabsorbed business losses can be carried forward and off-set against the business profits of the subsequent years, for a maximum carryover period of eight years. In the absence of adequate profits, unabsorbed depreciation can also be carried forward and off-set against the profits of future years without any time limit.

Impact of the DTC
No time limit has been specified in relation to carry forward of unabsorbed losses and accordingly, such losses may be allowed to be carried forward for an indefinite period.

Foreign Tax Relief
Pursuant to increase in cross border transactions, foreign source income of Indian Companies is on the rise. Such foreign source income may also have been subject to Income-tax in the source country.

Indian companies which have suffered such foreign tax are allowed to claim credit for such taxes while determining their tax payable in India, under the relevant provisions of the Indian tax law/treaty.

Further, the Government of India has been empowered to make such provisions as may be necessary for adopting and implementing an agreement between specified associations for double taxation relief.

Tax Incentives in India: Special Economic Zones (‘SEZ’)
The SEZ regime in the country allows tax breaks (subject to fulfillment of certain conditions) to eligible entities on export earnings for a period of 15 years (in a phased manner). However, SEZ units are liable to Minimum Alternate Tax at 20 percent (including applicable surcharge and cess) even during the period of the tax holiday effective from April 1, 2011.

The benefits are available to entities operating in various sectors and can be explored for media activities such as content development, animation, film restoration etc. However, feasibility of the same needs should be analyzed on a case to case basis.

Impact of the DTC
The DTC proposes to replace the existing profit linked incentives with investment linked incentives. However, existing units as well as units commencing operations before April 1, 2014 would continue to avail incentives on profit linked basis for the unexpired tax holiday period.
Indirect Taxation

Central and state levies
There are levies, central as well as state, which directly affect the media and entertainment industry – central levies being Central Excise duty, Customs duty and Service tax and State levies being state-VAT and Entertainment tax. Of the various indirect taxes applicable in the media sector, Service tax and state-VAT merit special attention. Applicability of these taxes on program production, in-film placements, grant of various rights such as distribution rights, theatrical rights, cable and satellite rights, sale of airtime for advertisement purposes, recording/editing of program, sale/lease of program content, etc. are becoming increasingly contentious and leading to disputes with authorities.

Applicability of State VAT on Sale of a Film
Factors such as interplay of multiple indirect taxes, availability of various options for computation of tax, frequent evolution of concepts in taxation through changes in law and judicial rulings, have given rise to complex tax issues in this space. For example, a High Court has held that production and sale of a film resulted in creation of a work of art and not sale of goods. However, some other state-VAT laws have included films as ‘goods’ liable to sales tax/VAT. Further, certain states levy state-VAT on intangibles like copyright and also on grant of film rights to use/hire. There is need for greater consistency and uniformity in taxation for such an important industry.

Service Tax
Service tax is levied on provision of certain notified categories of services (including copyright, intellectual property right, broadcasting, cable, development and supply of content, sound recording and video production services). Service tax being an indirect tax, normally the service provider recovers the Service tax from the service recipient. However, in some cases such as services provided by non-residents, goods transport agencies, sponsorship services etc., the reverse charge mechanism is applicable (i.e., the obligation to pay Service tax is that of the service recipient and not of the service provider). A mechanism\(^\text{15}\) for credit of input Service tax and Central Excise duty on input services, inputs and capital goods is also put in place by the Government.

Effective from March 1, 2007, subject to fulfillment of specified conditions, exemption\(^\text{16}\) is granted from levy of Service tax to services provided for granting right to authorize any person to exhibit cinematograph film, the content of the film being in digitized form and is transmitted through use of satellite to a cinema theater.

\(^{15}\) CENVAT Credit Rules, 2004
\(^{16}\) Notification 12/2007 dated 1 March 2007
Entertainment Tax
Entertainment tax is levied on various modes of entertainment such as on film tickets, cable television, live entertainment, etc. India has one of the highest rates of entertainment tax across the globe and there has been a constant cry from the stakeholders to reduce it. Recently, some states have granted exemption from entertainment tax to multiplexes.

Other challenges
The key challenge under indirect tax regime in India includes analysis of transactions and identification of the indirect tax implications on such transactions and entities involved. Some typical transactions include:

- Internet services (e.g. sale of space, including ‘content’ provided to telecom companies, e-mail subscription services, e-commerce transactions, etc.);
- Taxability of subsidiary/agent in India where the principal broadcasting agency is outside India;
- Sale of advertisement time/space by media companies to advertisement agency and subsequent sale from agency to advertisers;
- Transactions involving transfer of right to use film/programme content; and
- Special transactions (e.g. cost sharing arrangements, import of technology, sharing of telecom revenues generated through contests/opinion polls, hiring of equipments for film production, etc.).

Proposed Goods and Service Tax (‘GST’)
To overcome issues under the present tax regime, the Government has proposed to implement GST which is expected to include most Indirect taxes at the Centre and State level. Though, the expected date for the implementation of GST is October 2012, there could be some delay in its implementation.

Draft GST legislation is yet to be finalized. However, the Draft Constitution Amendment Bill, 2011 (‘the Bill’) has been presented before the Parliament suggesting the proposed changes in the Constitution of India in order to implement GST. Under the Bill, taxing power in relation to Entertainment tax has been proposed to remain with the municipalities/local bodies, until the State Legislatures concerned, repeal the relevant laws.
Personal Taxation

Residential status and taxability of income in India

Residential status
An individual is taxable in India based on their ‘residential status’ in the relevant financial year. 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) the individual stays in India for 182 days or more in a financial year; or

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

“Resident” is further sub-divided into:

• Resident but Not Ordinarily Resident (‘NOR’): An individual is said to be an NOR if he is:
  – a non-resident in India in 9 out of 10 financial years preceding the relevant financial year; or
  – 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 satisfied].

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 ROR in the fourth financial year, from the year of start of their assignment.

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17 Indian financial year runs from 1 April to 31 March of the following year
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.
- **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 receive 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 payer is obliged to withhold tax at the appropriate rate of income tax applicable to non-resident individuals. This is, however, subject to any benefits that may have been available to the artist under the relevant double tax avoidance treaty (article on ‘Artistes and sportsmen’).

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

- For acquiring copyrights of performance in India for subsequent sale in India (of CDs, etc.);
- For acquiring the license for broadcast or telecast in India;
- Portion of endorsement fees relating to artist’s performance in India; and
- For a live performance in India or simultaneous live telecast or broadcast of such performance is taxable in India.

**Additional capital gain tax issues for Non Residents in India**

For non residents, capital gains arising from the transfer of shares or debentures of an Indian company are calculated in the same foreign currency as was initially used to purchase such shares or debentures and the cost inflation index is not applicable to such gains.

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18 Circular No. 787 dated 10 February 2000
Long term capital gains arising from the transfer of specified bonds or Global Depository Receipts issued in foreign currency are taxed at the rate of 10 percent. Exemption from the long term capital gains may be claimed by making investment in residential house and/or certain bonds subject to certain conditions.

**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 credit for foreign taxes paid on foreign sourced income in the following manner:

- 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, under the provisions of domestic tax law.

**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 PF Act’) and is comprised of the following schemes:

- Employees Pension Scheme, 1995 (‘EPS’);
- Employees Provident Fund Scheme, 1952 (‘EPFS’); and
- Employee Deposit linked Insurance Scheme.

The above schemes provide for the social security of employees working in the establishment employing 20 or more persons. The employer is mandatorily required to contribute towards these schemes for the employees earning wages below INR 6,500.

The Ministry of Labour and Employment, Government of India, has issued a notification dated October 1, 2008 (‘Notification’) introducing a new concept of “International Workers” (‘IWIs’) which includes expatriates (foreign passport holders) working for an employer in India and the Indian employees working overseas.
The existing IWs are required to become members by joining the PF Scheme and the Pension Scheme effective from November 1, 2008. A relief has been provided in case of “Excluded Employee”\(^{19}\) which primarily refers to IWs coming from a country with which India has entered into a Social Security Agreement (‘SSA’).

As per the PF Scheme, an employee earning a salary of more than INR 6,500 per month may opt not to contribute under the scheme. However, the said exemption limit of salary of INR 6,500 per month applicable for Indian employees is not applicable in the case of IWs. Accordingly, in the case of IWs, it is mandatory for the employer and IWs to contribute to the PF Scheme irrespective of the salary income.

- **Scheme for salaried persons**
  The above schemes are applicable only to employees working with the covered establishments. Every employee as mentioned above, working with a covered establishment is required to become member of the schemes. Both employee and employer are required to contribute toward 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.

**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 deduction would include basic wages, dearness allowance (including cash value of any food concession) and retaining allowance.\(^{20}\)

  Dearness allowance is likely to include any allowance by whatever name called, granted to an employee to compensate towards 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.

\(^{19}\) As per the Notification dated 1 October, 2008 “Excluded Employee” means an International Worker, who is contributing to a social security programme of his/her country of origin, either as a citizen or resident, with whom India has entered into social security agreement on reciprocity basis and enjoying the status of detached worker for the period and terms, as specified in such an agreement.

\(^{20}\) Para 29 of the PF Scheme.
However, for self employed persons, Public Provident Fund, National Pension Scheme 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 their salary.

- **Employer’s social security rate**
  The employer is also required to make a matching contribution of 12 percent. A portion of the employer’s contribution, i.e., 8.33 percent of the salary (forming part of the 12 percent of employer contribution) is mandatorily contributed by the employer into the EPS. However, the ceiling of INR 6,500 per month is applicable as far as the contribution under the EPS is concerned. Accordingly, out of employer’s contribution of 12 percent, an amount of INR 541, i.e., 8.33 percent of INR 6,500, per month is contributed towards pension scheme and the balance is contributed towards Provident Fund.

  Effective September 2010 and onwards, the employer contribution to pension fund in respect of IWs will no longer be limited to INR 541 per month, i.e., 8.33 percent of INR 6,500.\(^2\)

  Additionally, administration charges at 1.11 percent of the salary are required to be deposited by the employer in relation to the PF charges. These charges need to be deposited by the employer and cannot be recovered from the employees. The limit of INR 6,500 is not applicable in case of IWs and local employees for the purpose of administration charges. Accordingly, the administration charges will be made at 1.11 percent of the salary for the purposes of PF of the IW.

  Further, it is also mandatory for the employer to contribute at 0.5 percent of salary into the EDLIS every month. The limit of INR 6,500 is applicable in case of IWs for the purpose of EDLIS. Accordingly, the contribution to EDLIS will be made at 0.5 percent of INR 6,500 [i.e., INR 33 (approx.)].

  Additionally, inspection charges at 0.01 percent need to be deposited by the employer. These contributions need to be made by the employer and cannot be recovered from the employees. The limit of INR 6,500 is applicable in case

\(^2\) Notification G.S.R. 148 and 149 dated 3 September 2010
of IWs. Accordingly, the inspection charges will be 0.01 percent of INR 6,500 subject to a minimum of INR 2 per employee per month.

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 towards the fund set-up by the Regional Provident Fund Commissioner (‘RPFC’). The employer is also required to comply with certain filing requirements at the time of joining of employee and on a monthly/annual basis.

Benefits covered (for salaried persons)
**Provident Fund**
The amounts contributed by the employee and employer are accumulated in a separate account maintained by the RPFC which also allows interest on the said amount on a monthly basis.

Effective September 2010 and onwards, IW(s) can withdraw the amount standing to their credit under the PF Scheme under 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; and
• In respect of the member covered under a SSA, on such grounds as specified in such agreement.

*Prima facie it appears that the funds will get blocked in India until the age of 58 years (subject to other conditions mentioned above).*

*It is pertinent to note that under the Act, for the Indian national employees the age limit for withdrawal for PF accumulations on account of retirement is prescribed as 55 years.*

**Pension**
The local employee is entitled to monthly pension in the following manner:

• Superannuation pension if the employee has rendered eligible service of 10 years or more and retires on attaining the age of 58 years;
• Early pension, if the employee has rendered eligible service of 10 years or more and retires or otherwise ceases to be in employment before attaining the age of 58 years; and

• A member if the employee so desires may be allowed to 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% for every year the age falls short of 58 years.

The IWs is entitled to pension in the following manner:

• For IWs coming from a country with which India has a SSA, the totalization/withdrawal benefit will be allowed.

• In case of IWs coming from countries with which India has no SSA, the totalization/withdrawal benefit will be not allowed. Prima facie, it appears that the pension benefit seems to be available only to IW’s from SSA countries.

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

Tax Implications in respect of PF Scheme
As mentioned above, the social security schemes are not applicable to the self-employed persons. Accordingly, the tax implications as discussed below are not applicable in case of self-employed persons.

At the time of making of contribution
Employees can claim deduction under the Income-tax Act, 1961 (“the Act”) up to the maximum amount prescribed. Presently, the maximum amount of deduction prescribed under the Act is INR 100,000/- per financial year.

At the time of withdrawal of accumulated balance
The tax treatment at the time of withdrawal would need to be examined on a case-to-case basis:

• In case employee has rendered less than 5 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.
• In case employee has rendered more than 5 years of continuous service
  In this case, the entire accumulated balance of received by an employee would be exempt under the Act.

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