

PREFACE

The report for the year ended March 2010 containing the results of the performance audit of the taxation of assesseees engaged in film and television industry has been prepared for submission to the President under Article 151(1) of the Constitution of India.

The audit of Revenue Receipts – Direct Taxes of the Union Government is conducted under Section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971.

Our findings are based on mainly test audit conducted during the period 2009-10. Some findings of audit conducted in earlier years, but could not be covered in previous reports, have also been included.

Executive Summary

India, producing more than 1,000 feature films per year, is the largest film producing country in the world. During the period 2005-2009, film production registered a growth of 5 *per cent* per annum. The film industry registered growth of 9.7 *per cent* during the period 2005-2009 and generated revenues of around ₹ 9,500 crore in 2009. The television (TV) industry grew at 16.9 *per cent* per annum during the period 2005-2009 generating revenue of ₹ 26,550 crore in 2009. By the end of December 2009, there were 12.9 crore TV households with 8.9 crore subscribers to pay channels. Number of approved private channels at the end of December 2009 were 515 - 251 news channels and 264 other than news channels. The Film & TV industry is expected to grow at 16.5 *per cent* per annum in next five years to reach ₹ 65,850 crore by 2014.

Production of films is financed mainly from private sources. Banks started financing the films after 'industry' status was accorded to the film industry in May 1998. In addition NFDC and film development corporations promoted by many states' governments also provide financial support in the form of loan, grant, subsidy, etc.

The main objectives of our study were to ascertain that: the Department had broadened its tax base vis-à-vis film related personalities to increase tax collection commensurate with the growth of the industry; systems and procedures were sufficient and in place to ensure compliance with the provisions of the Act/Rules; mandatory information as required under the provisions of the Act as due from the assesseees related to the film and TV sector were being received regularly in time; there was a system to utilize the information for assessment, available with the Department in Income Tax Returns of film/TV related assesseees and in mandatory statements filed by the producers; there was a proper co-ordination between the Department and outside agencies for gathering information to detect undisclosed or incorrect information; the Department had taken action on the recommendations of the Public Accounts Committee (PAC).

We drew our primary audit samples from the records of the Income Tax Department. We also collected information from outside sources like State's Revenue Department, Central Board of Film Certification, Doordarshan Kendras, etc. and correlated the same with the assessment records of the assesseees.

An overview of the specific audit findings and key recommendations included in this Report is given below:

Oversight and linkages (Chapter 2)

Audit Findings

No tax is deducted or collected at source on sale of time slots or telecast fees though nearly 40 *per cent* of the total revenue of the advertising sector is associated with the TV industry. Production of feature films by and large is in the hands of private sector. NFDC and Film Development Corporations/ companies promoted by State Governments provide financial assistance and other support to the film producers. We observed that the Department has no mechanism to obtain information on subsidy/grants etc. granted by these development corporations to the film producers. The Department has no coordination with other Government Departments or the States' Revenue Department to identify the probable assesseees with a view to widen the tax base.

Key Audit recommendations

We recommend that

- *the Department maintain coordination with other Central Government Departments and States' Revenue Departments to identify the probable assesseees with a view to widen the tax base and prevent tax evasion;*
- *provisions for TDS on sale of time slots and on telecast fees should be incorporated in the Act;*
- *a mechanism may be developed to obtain information of such persons who got assistance from the Government/Government corporations by way of subsidy and grant, etc. on a regular prescribed interval.*

Systems Issues-Controls on assessments (Chapter 3)

Audit Findings

Despite special Film Circles being created in four cities with a view to assess all the assesseees involved in film and TV related activities at one unit, cases of film personalities were being assessed in other units also. Form 52A is deficient to the extent that it does not require the PAN of the person to whom payment has been made. There was no system in the Department to monitor the receipt of mandatory information in Form 52A for monitoring the expenditure on films. No penal action was taken in most of the cases for non/late filing of Form 52A. Information furnished in Form 52A was rarely verified or used by the Department. Expenditure on films was allowed without receipt of Form 52A. Provisions of section of 285B regarding filing of Form 52A were not made applicable to the producers of TV serials.

There is no provision in the Act for deducting TDS on revenue from sale of distribution rights of films. In absence of clear provisions and instructions for assessment of income of foreign telecast companies huge sums had been blocked in litigation.

Key Audit recommendations

We recommend that

- *the Department may put a system in place to ensure that all assesseees related to the film and television industry are assessed in the specially created Film Circles and that case records of those assesseees who file their return outside Film Circles are migrated to Film Circles;*
- *provisions for deduction of TDS on sale of distribution rights and sharing of proceeds from exhibition of films may be introduced;*
- *a suitable system may be devised to collect the information about the films which are under production;*
- *in respect of Form 52A we recommend that*
 - ◆ *receipt of Form may be suitably monitored;*
 - ◆ *suitable provisions be made in the Act to disallow the expenditure on the films if Form is not received before filing of income tax return;*
 - ◆ *Form be amended to include PAN of the person to whom payment is being made;*
 - ◆ *submission of Form may be made mandatory to the producers of TV programmes.*

360 Degree Analysis (Chapter-4)

Audit Findings

The Department rarely used information given by an assessee during his assessment to cross verify the correctness of the information furnished by another assessee (who had transacted with the former) during the assessment.

Key Audit recommendation

- We recommend that the Department should develop a system which may ensure that the information furnished by an assessee is used to cross verify the correctness of the information given by other assesseees having transactions with the former, to avoid the evasion of tax by way of furnishing incorrect information.

Mistakes in assessment (Chapter 5)

Audit Findings

There were errors in applying provisions relating to allowance of cost of production of film and acquisition of distribution rights of film. There were errors in assessment due to wrong application of provisions of the Act.

Key Audit recommendation

- We recommend that responsibility for material errors in assessment may be fixed to reduce their incidence.

CHAPTER 1

INTRODUCTION

The Industrial status

Sources of funding

Why we chose the topic

Objectives of audit

Scope of audit

Legal Provisions

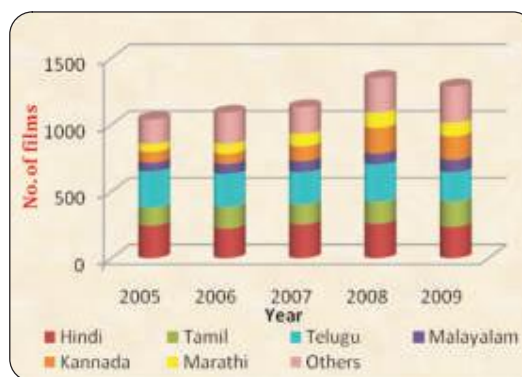
Acknowledgement

CHAPTER 1

Introduction

1.1 The first short film in India 'The Flower of Persia' was directed by Shri Hiralal Sen in 1898. However, the journey of the Indian film industry began with Shri Dhundiraj Govind Phalke's, (popularly known as Dadasaheb Phalke) 'Raja Harishchandra', India's first fully indigenous silent feature film which was released in May 1913. A major milestone in the history of Indian film industry was the release of first talkie 'Alam Ara' by Shri Ardeshir Irani on 14 March 1931. At the same time two South Indian films namely 'Bhakta Prahlada'¹ in Telugu and 'Kalidas'² in Tamil were also released. Thereafter, the Indian cinema has grown exponentially. Today, India is the largest film producing country in the world, producing more than 1000 feature films per year, of which about 75 *per cent* films³ are in various regional languages. During the period 2005-2009, film production registered a growth of 5 *per cent* per annum. About 300 foreign films were also certified every year for release in India.

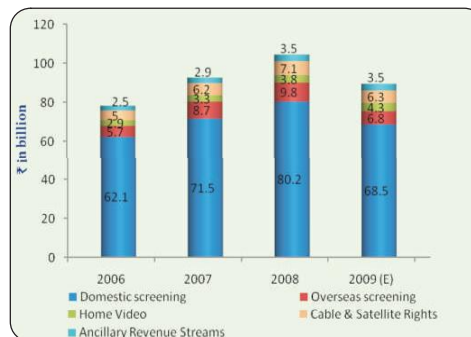
Chart 1: No. of feature films certified for release



1.2 The first Indian chain of cinema theatres was owned by Shri Jamshedji Framji Madan, a Calcutta (now Kolkata) based entrepreneur. Single screen cinema theatres are gradually paving way for theatres with multiple screens, known as multiplexes. India's first multiplex 'PVR Anupam' with four screens was opened in 1992 at Delhi. 'Mayajaal' in Chennai with 14 screens is the largest multiplex in India. INOX, PVR, Cinemax and Adlabs are some major multiplex cinema chains in the country.

1.3 The film industry generated revenues of around ₹ 9,500 crore⁴ in 2009 registering a growth of 9.7 *per cent* per annum during the period 2005-2009. The main sources of revenue for the Film industry are screening of films (both domestic and overseas), cable and satellite rights, home video rights, music rights etc.

Chart 2: Growth of film industry



¹ Produced and directed by Shri H. M. Reddy

² Produced by Shri Ardeshir Irani and directed by Shri H. M. Reddy

³ Source: Annual reports of Ministry of Information and Broadcasting. Figures for 2008 are for the period from 01.04.2008 to 31.03.2009

⁴ Source: Indian Entertainment and Media Outlook 2010 by Price Waterhouse Coopers

1.4 People of India were introduced to television on 15th September 1959 in Delhi with the experimental telecasting through a small transmitter and a makeshift studio. The regular daily transmission started in 1965 as part of 'All India Radio'. The television services were extended to Bombay (now Mumbai) and Amritsar in 1972. Upto 1975 only seven cities in India had television service. National telecasts were introduced in 1982 and the same year colour television was also introduced. Around the same time second channel known as DD-2 subsequently renamed as DD Metro was also introduced. The Government of India launched a series of economic and financial reforms in 1991. Under the liberalized regime, new policies allowed private and foreign broadcasters to engage in operations in India. The story of television which started in India with a single channel and 41 TV sets in 1962 continues today with 515 approved private channels and 12.90 crore TV households as on December 2009. Sony, Star and Zee are some of the prominent private channel groups in India.

1.5 Indian television which started with a free channel has now converted into a big pay TV market. In the early days, the limited channels were received on the TV set through an antenna fixed at the roof of the house. Now, TV channels are received with cables and small dish (DTH). There were 8.90 crore⁶ subscribers to pay channels as on December 2009.

1.6 The TV industry grew at 16.9 *per cent* per annum during the period 2005-2009 as revenue generated increased from ₹ 15,850 crore in 2005 to ₹ 26,550 crore⁷ in 2009. The main source of revenue to the Television industry, projected to be the major contributor to the overall entertainment industry, is subscription (distribution) fee from viewers, which is about 61 *per cent*. Other sources of revenue of TV industry are advertisement (around 34 *per cent*) and content production (around 5 *per cent*).

1.7 Before launch of private channels, Doordarshan was the only agency to telecast news and programmes covering entertainment, information and education. Doordarshan reaching to about 92 *per cent* population of the country has been transformed into an autonomous entity named as Prasar Bharti (Broadcasting Corporation of India)⁸. Prasar Bharti with 31 own channels⁹ and other 27 channels⁹ on DTH service (DD Direct Plus) platform is the largest broadcaster.

The Industrial status

1.8 Until 1990s, film making was not even recognised as manufacturing activity. It was for the first time in March 1991 that the Bombay High Court ruled that the production of film amounts to manufacture of goods¹⁰, which

⁵ Of these 251 were news channels and 264 other than news channels. These do not include 31 channels of Doordarshan.

⁶ Back in the Spotlight-FICCI & KPMG Indian Media & Entertainment Industry Report -2010

⁷ Source: Indian Entertainment and Media Outlook 2010 by Price Waterhouse Coopers

⁸ Formed under Prasar Bharti (Broadcasting Corporation of India) Act, 1990 which came into force with effect from 15th September, 1997

⁹ Annual Report of Ministry of Information & Broadcasting for 2009-10

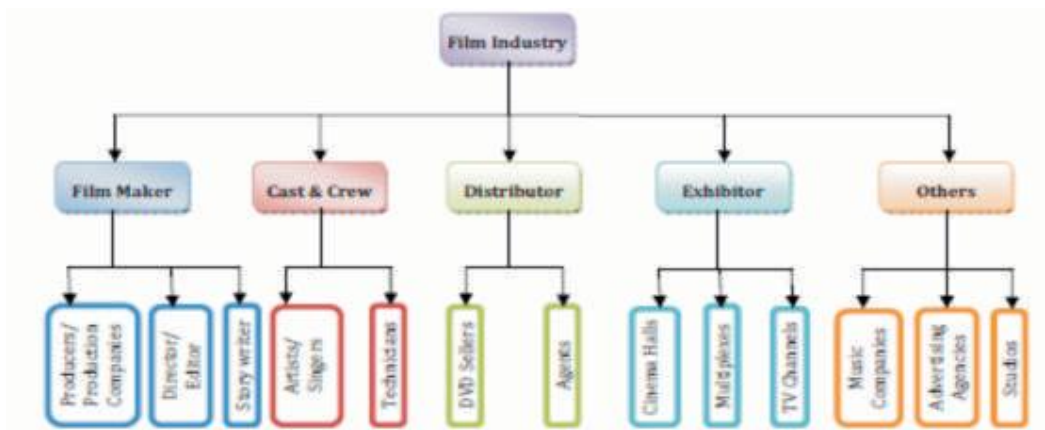
¹⁰ CIT Vs D. K. Kondke (192 ITR 128) & CIT Vs. Uttam Chitra (261 ITR 263)

was reaffirmed in 2003. In May 1998, the Information & Broadcasting Ministry accorded “industry” status to the film industry and the Finance Ministry announced that the entertainment industry would be recognised as an approved activity under industrial concern section of the Industrial Development Bank of India Act, 1964. Since then, the Government of India has taken several initiatives to liberalize the exchange control regulations for film production and financing.

Main players

1.9 The film industry consists of the technological and commercial institutions of filmmaking, artists and allied service providers. The main players in this industry may be categorised as under:

Chart 3: Main players of the film industry



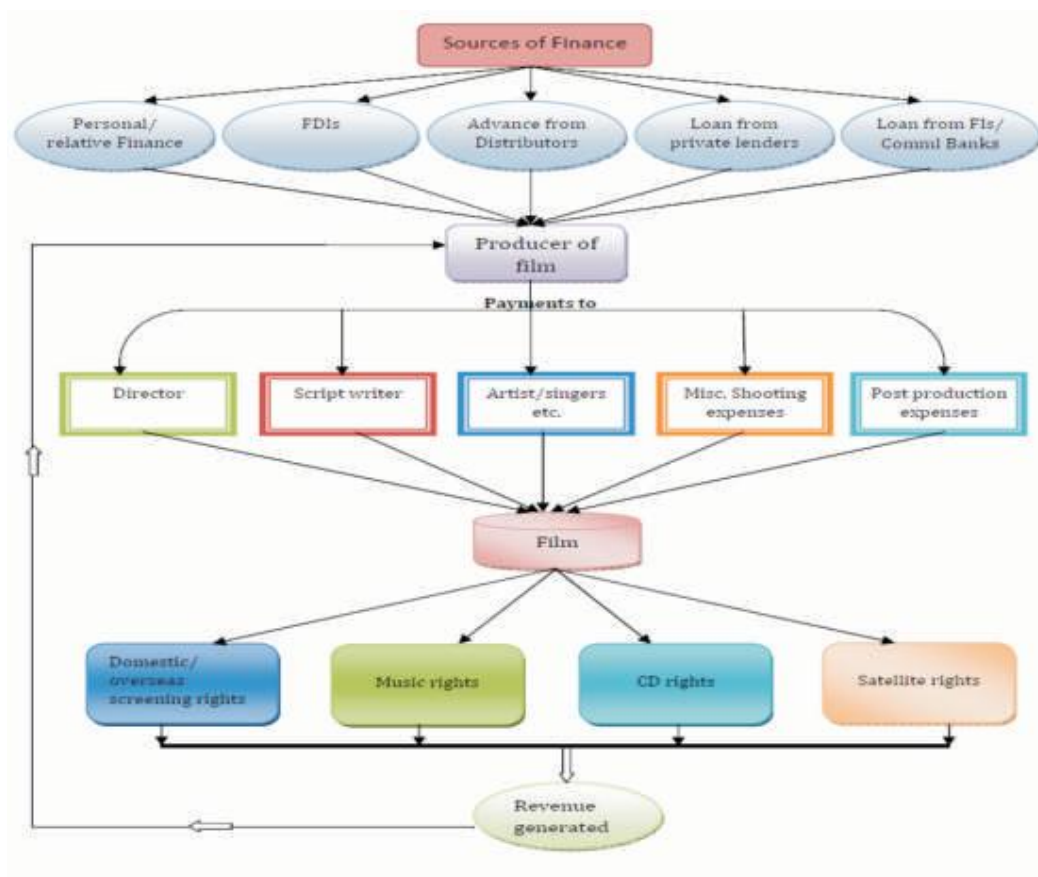
1.10 While the key groups of players in the Television industry engaged in production and processing activities are the same as in the film industry, the distribution network substantially differs from the film industry which includes

- Providers of uplinking and downlinking facilities;
- Persons involved in telecasting of programmes; and
- Distributors of signals through various modes like cable connection network, direct-to home (DTH) services, IPTV, etc.

Sources of funding

1.11 Basically, film making is a work of art and all films may not achieve commercial success. The risk of failure and unorganized functioning of film industry is hampered by limited availability of finances for film making. Previously film industry was mainly financed with funds coming from producer’s own capital, advance from distributors, interest free loans from close relatives and interest bearing loans from sundry creditors/conventional money lenders etc. After the Film sector was accorded the status of ‘Industry’, banks have been extending support to the Indian Film Industry. In

Chart 4 : Flow of funds in a film



addition, NFDC and State Film Development Corporations promoted by many state Governments also provide financial support to the film producers in the form of loan and subsidy, etc.

International funding

1.12 Apart from improvement in domestic options available for film financing, foreign participation has also been encouraging in the recent past. The provision of 100 *per cent* foreign direct investment¹¹ has made the Indian film market attractive for foreign enterprises. International enterprises viz 20th Century Fox, Sony Pictures and Warner Bros. have come up with production and distribution proposals for Indian films in association with Indian enterprises such as Zee, UTV and Adlabs. Reliance ADA Group has entered into a production deal with DreamWorks Studios to produce films with an initial funding of US\$ 825 million for first three years.

Why we chose the topic?

1.13 We had conducted a performance evaluation on working of film circles. Results were included in the Report of the Comptroller & Auditor General of

¹¹ The Government allowed 100 *per cent* FDI in film industry by Press Note No. 2 of 11 February 2000.

India for the year 1997-98 (Report No. 12 of 1999-Direct Taxes). We found that:

- some of the deficiencies which were pointed out in the earlier performance evaluation¹² of the Film Circle, Bombay (Mumbai) like absence of monitoring mechanism for filing of Form 52A, incorrect amortisation of cost of production, etc were still persisting;
- recommendation of the Public Accounts Committee (PAC) to devise a fool-proof system of maintaining records of incomplete/abandoned films was not complied with;
- the objective of bringing about improvement in quality of assessment of film related personalities by creating Film Circles was not achieved.

1.14 In addition, with passage of time

the film and TV industry has expanded a lot. The film and TV industry which generated revenue of ₹ 22,700 crore in 2005 had grown at an annual rate of 14.7 *per cent* and reached to ₹ 36,050 crore in 2009. The industry is expected to grow¹³ at 16.5 *per cent* per annum in next five years to reach ₹ 65,850 crore by 2014.

Chart 5: Revenue generated by Film and TV industry

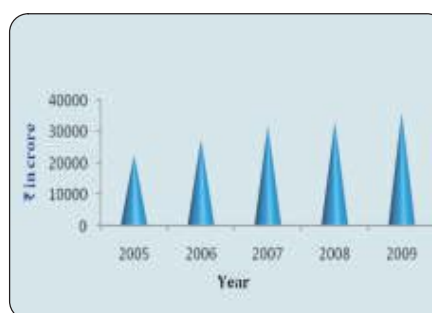
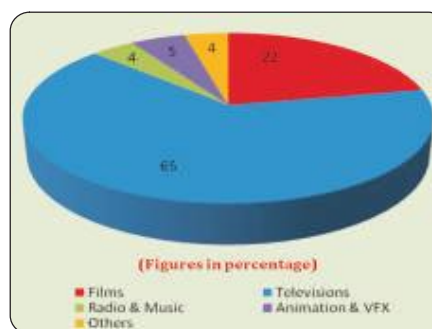


Chart 6: Entertainment industry in 2009



1.15 The Film and TV industry contributed approximately 87 *per cent*¹⁴ to the entire entertainment pie during the year 2009.

1.16 As a follow up of our earlier Report and considering the growth of the industry in the last decade, we felt it appropriate to select this topic for performance evaluation.

Objectives of audit

1.17 The objectives of our audit were to ascertain whether:

- ❖ the Department had broadened its tax base vis-à-vis film related personalities to increase tax collection commensurate with the growth of the industry;
- ❖ systems and procedures were sufficient and in place to ensure compliance with the provisions of the Act/Rules;

¹² Reported in Paragraph 3.26 in the Report of the Comptroller & Auditor General of India for the year 1982-83, Union Government (Civil) Revenue Receipts, Volume II, Direct Taxes, which was discussed by the PAC which gave recommendations in its 71st Report (8th Lok Sabha)-1986-87. The PAC gave its recommendations on action taken by the Government on the above Report, in its 175th Report (8th Lok Sabha)-1989-90.

¹³ Source: Indian Entertainment and Media outlook 2010 by Price Waterhouse Coopers

¹⁴ Source: Study on Indian E&M Industry, 2009 by FICCI and KPMG

- ❖ mandatory information as required under the provisions of the Act as due from the assesseees related to the film and TV sector were being received regularly in time;
- ❖ there was a system to utilize the information for assessment, available with the Department in Income Tax Returns of film/TV related assesseees and in mandatory statements filed by the producers;
- ❖ there was a proper co-ordination between the Department and outside agencies for gathering information to detect undisclosed or incorrect information with a view to widen and deepen the tax base;
- ❖ the deficiencies noticed in earlier performance appraisals were addressed by the Department;
- ❖ the Department had taken action on the recommendations of the PAC.

Scope of audit

1.18 This audit covered assessments completed in nine states¹⁵ during the financial years 2006-07 to 2009-10. Wherever required past records were linked for conducting a meaningful examination in audit.

Sample size

1.19 All the assesseees in film circles of Mumbai, Chennai, Hyderabad and Bengaluru were identified for the purpose of this audit. In addition, assesseees being assessed in other commissionerates of selected states were identified by correlation of assessment records, old local audit reports, data received from Doordarshan Centres, list of major advertising agencies and cable operators and information provided by the Income Tax Department.

1.20 After the identification of assesseees, a two tier sampling based on risk assessment was followed. In tier-I sampling, those assessment units were selected which were assessing the film/TV related assesseees. In tier-II selection, the assessment records were selected for audit. In respect of assesseees other than individuals, all scrutiny assessment cases including block assessment cases were selected for examination. The number of scrutiny cases of individual assesseees was restricted to top 100 cases per year in a unit. In respect of summary cases, five *per cent* of companies and firms; and 50 *per cent* of individual assesseees were selected on random basis. During the course of this audit, 17,601 cases (details in **Appendix-I**) were selected for detailed examination with regard to compliance with laws and procedures.

Constraints

1.21 We faced the following constraints during the course of our audit:

- In absence of any database of assesseees related to Film and TV industry with the Department, assesseees who are being assessed outside film circles were identified to the extent possible by

¹⁵ Andhra Pradesh, , Delhi, Karnataka, Kerala, Maharashtra, Orissa, Tamil Nadu, Uttar Pradesh and West Bengal

correlation of assessment records, old local audit reports and third party sources. However, all the assessees could not be identified as full details/PAN details of assessees were not available.

- The Department failed to provide 5,760 assessment records which were about 32.72 *per cent* of records called for.
- A 360 degree analysis of assessments of different players involved in specific films could not be done in totality due to non availability of complete details of expenditure and revenue receipts in the assessment records of film producers. PAN details of many assessees were not available. This hampered the selection of the assessment records.

Legal provisions

1.22 Apart from other general sections/provisions applicable to income from business/profession and deduction of TDS¹⁶ and assessment of Fringe Benefit Tax and Wealth Tax, following provisions of the Income Tax Act, 1961 are specific to the Film and TV industry:

- section 44AA(3) read with Rule 6F relating to maintenance of accounts by film artists;
- section 80(IB)(7A) read with Rule 18DB relating to deduction to multiplex theatres;
- section 285B read with Rule 121A relating to filing of particulars of payments in Form No. 52A by the producer of a film;
- section 272A relating to penalty for non filing of Form No. 52A within prescribed time;
- Rule 9A and 9B relating to deduction of cost of production of feature film or cost of acquisition of distribution rights of a feature film;
- CBDT circular No. 742 dated 02 May 1996 and circular No. 6/2001 dated 05 March 2001 on taxation of foreign telecasting companies.

Acknowledgement

1.23 We acknowledge the cooperation of the Income Tax Department in providing the necessary records and information in connection with the conduct of this performance audit. However, they failed to provide some of the records requisitioned by us. An entry conference was held with CBDT in March 2010. The audit objectives, scope of audit and the main areas of audit examination were explained in the meeting.

1.24 The exit conference was held (February 2011) with the Ministry/Board wherein the Report was discussed. The views expressed by the Ministry/Board in the exit conference have been suitably incorporated in this Report.

¹⁶ Tax deducted at source

CHAPTER 2

Oversight and linkages

Role of the Ministry of Information and Broadcasting

Linkages with advertising sector

Coordination between Income Tax Department and State Revenue Departments

Correlation of assessee's returns with information available from other sources

The International interface

Recommendations

CHAPTER 2

Oversight and linkages

Advertising sector registered a growth of 16.5 *per cent* during the last five years 2005-2009. No tax is deducted or collected at source on sale of time slots or telecast fees though nearly 40 *per cent* of the total revenue of the advertising sector is associated with the TV industry. Production of feature films by and large is in the hands of private sector. NFDC and Film Development Corporations/companies promoted by State Governments provide financial assistance and other support to the film producers. The Department has no mechanism to obtain information on subsidy/grants etc. granted by these development corporations to the film producers. The Department has no coordination with other Government Departments or the States' Revenue Department to identify the probable assesseees with a view to widen the tax base.

Role of the Ministry of Information and Broadcasting

2.1 The Ministry of Information and Broadcasting is the apex body for formulation and administration of the rules and regulations and guidelines relating to films, uplinking and downlinking of TV channels, quality of contents of TV programmes and advertisement.

2.2 Production of feature films in the country is by and large in the hands of the private sector. The title of the films is required to be registered with film associations before start of the production of films, however, there is no mechanism to ascertain as to how many films have been completed and how many films are incomplete or have been abandoned mid way.

2.3 The PAC in para 1.8 of its 175th Report of 8th Lok Sabha (1989-90) desired that the Department of Revenue should pursue vigorously with the Ministry of Information and Broadcasting to devise a foolproof system of maintaining records as regards the incomplete/abandoned films. We did not find any system in the Department to maintain records of incomplete/abandoned films.

2.4 The Government exercised its control on uplinking and downlinking of TV channels through "Uplinking and Downlinking Guidelines"¹⁷. For regulating cable operators and DTH operators, etc. necessary legislations¹⁸ have been enacted.

¹⁷ Guidelines for uplinking from India dated 2nd December 2005 and policy guidelines for downlinking of television channels dated 11th November 2005

¹⁸ The Telecommunication (Broadcasting and Cable Services) Interconnection Regulation 2004 & The Cable Television Networks (Regulation) Act 1995

The Central Board of Film Certification

2.5 The Central Board of Film Certification (CBFC), popularly known as the Censor Board set up under the Cinematograph Act, 1952, is mainly responsible for certification of feature films for release and also the contents of television shows, television advertisement and promotional material meant for public exhibition through its nine regional offices¹⁹ having its Headquarters at Mumbai. During the period January to December, 2009 the Board had issued total 13,488 certificates (3,521 for celluloid²⁰ films and 9,967 for video films).

Film Development Boards/Corporations

2.6 With a view to promote and organize an integrated development of the Indian Film Industry and to foster excellence in cinema, National Film Development Corporation Ltd. (NFDC) was established in 1975. NFDC in addition to producing feature films provides film finance and essential pre-production, production and post production technical infrastructure support to the film industry. It provides a ready-made platform to producers of Indian films to promote their films globally. The NFDC (and its predecessor the Film Finance Corporation) has so far funded/produced over 300 films.

2.7 States²¹ have also formed film development corporations/companies for promoting, providing technical and infrastructure support and finance to the regional cinema.

2.8 The Department has no mechanism to obtain information to ensure that all such persons who got money from the Government/corporations by way of subsidy, contribution or loan, file their returns.

Orissa Film Development Corporation, Cuttack released subsidy of ₹ 67.49 lakh to 25 film producers during the financial year 2008-09. We found that none of the producers to whom subsidy was released, filed their returns with the concerned jurisdictional assessing officer. As a result, subsidy amount and income from the film to which subsidy was released escaped assessment.

Linkages with advertising sector

2.9 Advertising refers to any sponsored offering of goods, services or ideas through any medium of public communication. This sector has seen a growth of 16.5 *per cent* during the period 2005-2009 with increase in revenue from ₹ 13,040 crore to ₹ 21,650²³ crore during the same period. Advertising

¹⁹ Bengaluru, Chennai, Cuttack, Hyderabad, Delhi, Guwahati, Kolkata, Mumbai and Thiruvananthapuram

²⁰ Celluloid films are produced on negative films and are shown in theatres with projectors whereas video films are produced on video tapes/video CDs, to be displayed through video players.

²¹ Except Delhi all the states selected for review have promoted companies/corporations for development of regional cinema.

²² ₹13.46 lakh to 8 producers under CIT, Bhubaneswar charge and ₹54.03 lakh to 17 producers under CIT, Cuttack charge

²³ Source: 'Indian Entertainment and Media Outlook 2010' by Price Waterhouse Coopers

provides revenue for the growth of satellite TV channels as nearly 40 per cent of the total revenue of the advertising sector is associated with the TV industry.

2.10 TV Channels sell time slots or receive telecast fees for telecasting serials/sponsored programmes. The purchasers of the time slots air their programmes along with advertisement during the purchased time slot and receive income from advertisement charges.

2.11 At present no tax is deducted or collected at source on the payment involved for sale of time slots or telecast fees.

2.12 Besides the traditional advertisements displayed in TV channels, the in-film placements of brand advertising and co-promotion has gained momentum as a marketing strategy in recent times.

Linkage with intellectual property and royalty payments

2.13 Royalty is the consideration (including any lump sum consideration) received for transfer of all or any rights in respect of any copyright, films or video tapes for use in connection with television or tapes for radio broadcasting, but does not include consideration for sale, distribution or exhibition of cinematographic films. The production houses, being the owners of films, hold several rights in the form of music rights, distribution rights, overseas rights, satellite rights, video rights, etc. They receive royalty for such rights.

2.14 Royalty payment is subject to tax deduction at source under the provisions of the Act.

As per section 40(a)(ia) of the Act, if any amount on which tax is deductible at source under chapter XVII-B, is paid without deducting tax or after deduction, tax has not been deposited during the previous year, then deduction of such amount is not allowable to the payer. We observed that the Department allowed royalty payment in three cases wherein TDS was not deducted, which have a tax effect of ₹ 4.21 crore. One case is illustrated below:

M/s Zee Entertainment Enterprises Ltd.²⁴ paid ₹ 2.73 crore to M/s B R Films for purchase of satellite rights of films without deduction of TDS. However, this amount had been allowed. This has resulted in underassessment of income having a tax effect of ₹ 1.45 crore.

Doordarshan Kendra, Bhubaneswar paid royalty of ₹ 57.17 lakh to two assesseees²⁵ during 2005-06 to 2008-09 but realization of tax on this amount could not be confirmed as both the assesseees had not filed their returns.

²⁴ Charge: CIT 11, Mumbai, AY 2005-06

²⁵ M/s HAS communications, Bhubaneswar-₹ 56.85 lakh, Mihir Kant Tripathy, Berhampur ₹ 32000

Coordination between Income Tax Department and State Revenue Departments

2.15 The Commercial Taxes Department of the State Governments regulate fixation and collection of Entertainment Tax from cinema halls and cable operators. The CBDT has issued instructions²⁶ from time to time for proper coordination of information from assessment proceedings of commercial taxes, which has bearing on Income Tax assessments in order to improve the quality of assessment and examine evasion of tax, if any. We found that there was no coordination between the Income Tax Department and Revenue Departments of the states.

In CIT, Cuttack we observed that the assessing officer considered total receipt from sale of tickets as ₹ 8.04 lakh, as declared by the assessee M/s. Mahendra Pradhan Movies (P) Ltd., Cuttack²⁷. On correlating the Entertainment Tax assessment order²⁸ of the assessee, we found that receipt from sale of tickets was assessed at ₹ 19.70 lakh²⁹. This resulted in underassessment of income by ₹ 11.66 lakh involving tax effect of ₹ 5.16 lakh (positive tax ₹ 4.98 lakh + potential tax ₹ 0.18 lakh) (including interest).

We noticed that after a survey in Mumbai City, Mumbai Suburban and Thane districts between May and December 2006, Maharashtra State Revenue Department found non/under reporting of 10.24 lakh cable connections by 3,804 cable operators and 889 unregistered cable operators. This practice of under reporting was prevailing since 2001. The Department adjudicated 2,115 cases upto December 2009 and levied entertainment duty of ₹ 21.15 crore and penalty of ₹ 34.51 crore. We observed that in absence of any established system, such vital information was not known to the Income Tax Department even though it had a bearing on the determination of taxable income of relevant financial year of the concerned assessee.

Considering that under reporting continued between April 2004 to March 2008, the actual revenue loss would be substantial. The same could not be ascertained.

Correlation of assessee's returns with information available from other sources

2.16 We noticed that the information available with industry sources was rarely used by the assessing officers during scrutiny assessment.

2.17 We could not identify the assessments of 314 producers who produced feature films during 2005-06 to 2007-08 after linking the information collected from Central Board of Film Certification (CBFC), Chennai relating to

²⁶ Instructions issued in November 1974 and on 11 April 1979

²⁷ Charge: ACIT, Circle-2(2), Cuttack AY- 2006-07

²⁸ Additional Commissioner of Sales Tax, Central Circle, Cuttack

²⁹ Computed by compounding Entertainment Tax at 20 per cent of sales value of tickets - ₹ 393960 X (100/20)

films certified and producers thereof with the Blue Book³⁰ maintained in Media Range, Chennai.

2.18 In six cases we observed that the persons earned income from films but did not declare this income. One such case is illustrated below:

Sri Shivaji Raju³¹ acted in eight films during financial year 2004-05 and 2005-06 but did not disclose income in respect of five films.

The International interface

2.19 Bollywood films as also regional language films are highly acclaimed and immensely popular world wide largely on account of growing migration and settlement of Indians abroad. Income from screening Indian films abroad has increased steadily from ₹ 5.3 billion in 2005 to ₹ 9.77 billion³² in 2008. The Indian films shot in foreign locations have also promoted tourism in those countries. Some foreign governments have extended incentives to the Indian film producers to encourage tourism.

Recommendations

2.20 *We recommend that*

- *the Department maintain coordination with other Central Government Departments and States' Revenue Departments to identify the probable assessees with a view to widen the tax base and prevent tax evasion.*

While noting the recommendation, the CBDT stated (February 2011) that the Regional Economic Intelligence Committees under the respective DG'sIT/CC'sIT already exist to facilitate better coordination and flow of information/ intelligence between the various revenue departments of Central and State Governments. The CBDT further stated that amount of information is received electronically through Annual Information Return, TDS returns & FIU. The capacity of information gathering is also impacted by the capability of outside organizations such as State Governments to share the relevant information electronically and on a regular basis.

We are of the opinion that the CBDT should strengthen the mechanism of Regional Economic Intelligence Committees for collecting the information from various sources.

³⁰ Maintained by the assessing officer, which contained names of assessees along with PANs, details of pending assessments and penalty proceedings, etc.

³¹ Chart: CIT I, Hyderabad, AY : 2005-06 and 2006-07

³² Source: Study on Indian E&M Industry, 2009 by FICCI and KMPG

- *provisions for TDS on sale of time slots and on telecast fees should be incorporated in the Act;*

The CBDT noted (February 2011) the recommendation for consideration.

- *a mechanism may be developed to obtain information of such persons who got assistance from the Government/Government corporations by way of subsidy and grant, etc. on a regular prescribed interval.*

The CBDT stated (February 2011) that subsidy/government assistance is given to various categories of persons/entities and is not limited to film & television industry. Further, the subsidy given to the film sector is very small. However, feasibility for tracking the same would be analysed.

CHAPTER 3

Controls on assessments

Failure of the concept of Film Circle

Lack of coordination within the Department

Mandatory information – Form 52A

Absence of TDS provisions for film distribution rights

Search & Seizure, Surveys

Recommendations

CHAPTER 3

System Issues

Controls on assessments

Despite special Film Circles being created in four cities with a view to assess all the assessees involved in film and TV related activities at one unit, cases were being assessed in other units also. Form 52A is deficient to the extent that it does not require the PAN of the person to whom payment has been made. There was no system in the Department to monitor the receipt of mandatory information in Form 52A for monitoring the expenditure on films. No penal action was taken in most of the cases for non/late filing of Form 52A. Information furnished in Form 52A was rarely verified or used. Expenditure on the films was allowed without receipt of Form 52A. Provisions of section of 285B regarding filing of Form 52A were not made applicable to the producers of TV serials. There is no provision in the Act for deducting TDS on revenue from sale of distribution rights of the films. In absence of clear provisions and instructions for assessment of income of foreign telecast companies huge sums had been blocked in litigation. Huge demands were outstanding at the end of 31 March 2010.

Failure of the concept of Film Circle

3.1 With a view to having an overall control on the assessments and to achieve greater co-ordination and effective handling of the assessments of assessees related to the Film industry, special Film Circles have been created in Mumbai³³, Chennai³⁴, Hyderabad³⁵ and Bengaluru³⁶, where maximum number of films are produced.

3.2 As a natural corollary to this, the Department should have ensured that all film and television related assessees are assessed in the Film Circles. We, however, noticed that 465 assessees³⁷ related to film and television industry were being assessed outside Film Circles. Thus, the purpose of creation of Film Circles to assess all film related assessees at one place is not fully served.

3.3 On this being pointed out by us, CCIT-I, Mumbai issued instructions (April 2010) to all CCsIT in Mumbai to transfer all cases relating to Film and TV industry to Film Circle.

3.4 We also found that assessment jurisdiction of persons associated with television and audio/video production activities had been excluded from the purview of Hyderabad Film Circle. Thus, the very purpose of creating a film

³³ Range 11(1) of CIT, 11

³⁴ CIT IV, Media range

³⁵ Range 13 (1) of CIT Hyderabad-I

³⁶ DCIT 7(2), Bengaluru

³⁷ 140 assessees in Mumbai, 23 assessees in Chennai and 302 assessees in Hyderabad

circle is defeated as the persons who are holding audio and video rights, satellite rights of films would be assessed outside the Film Circle, thereby negating the possibility of their income tax returns being correlated with others.

Difference between number of film personalities and those actually assessed

3.5 The Department is not maintaining any database of film and TV related personalities. Even though the AST³⁸ provides for codes for business and profession, the Department did not have a category-wise data base as the filling up of the business/profession code column in the income tax returns is never insisted upon. As a result there was no mechanism available with the Department to ensure that all film and TV related personalities have been filing their returns regularly. The Department has made no efforts to reconcile the figures of film personalities available with other organisations, cultural directories etc. and to ensure that all the film related assessee file their return of income (ROI) to broaden the tax base.

3.6 As per the information collected from producers/artists council, Andhra Pradesh Film Chamber of Commerce and other agencies, there were 2,463 film related personalities in Hyderabad. Of which only 881 persons filed their returns in Film Circle, Hyderabad whereas 364 assessee³⁹ filed their returns either in other than Film Circle or out of Andhra Pradesh.

3.7 We observed that of the 5,364 assessee registered with the Media Range, Chennai, 3,770 assessee (70 *per cent*) did not file their returns in 2009-10 where as it was 56 *per cent* in 2006-07.

Lack of coordination within the Department

3.8 The provisions of TDS under chapter XVII-B of the Act specifies that tax is required to be deducted at source by the payer on specified sums. The tax is to be deducted either at the time of actual payment or giving credit to the payee in the books, which ever is earlier.

3.9 Under the provisions of section 40(a)(i) of the Act, any assessee paying specified sums which are chargeable under the Act and payable outside India or in India to non-resident or foreign company shall not be allowed as deduction unless tax is deducted at source under chapter XVII-B or after deduction has been paid to the Government account within the time prescribed under section 200(1).

3.10 These provisions further enable the Department to get automatic compliance with TDS provisions and disclosure of income by the payees on

³⁸ One of the module of ITD applications software used for assessment of income tax returns of assessee. The process starts with entering the returns received from assessee into the system.

³⁹ Of the 35 ranges specifically addressed to furnish the information regarding the number of assessee related to film and television activities assessed under their respective jurisdiction we have received information only from 19 Ranges.

behalf of whom tax is deducted. To ensure the compliance of these provisions, coordination among the assessing officers within the Department is required. We observed 13 cases involving tax effect of ₹ 81.56 crore in which non compliance of TDS provisions was not communicated to the concerned jurisdictional officer by the other assessing officer. One case is illustrated below:

The Department charged distribution revenue⁴⁰ of ₹ 8.05 crore received by M/s. MTV Asia LDC (a non-resident) from the assessee - M/s. Viacom 18 Media Pvt. Ltd.⁴¹ (formerly known as M/s. MTV India Pvt. Ltd.), its Indian agent, as royalty. The assessing officer of M/s. MTV Asia LDC did not communicate the fact that the Indian agent (the assessee) had not deducted TDS on royalty to the concerned jurisdictional officer of the Indian agent (the assessee). Due to this, royalty payment by the assessee was incorrectly allowed, resulting in under assessment of income having a tax effect of ₹ 4.66 crore (including interest)

Mandatory information – Form 52A

3.11 Section 285B was introduced in 1976 with an object, as clarified by CBDT vide circular No. 204 issued in July 1976, to check inflation of expenditure by the film producers and enable the Department to get information about the recipients of payment for necessary action. Under this section, every person carrying on production of cinematograph film is required to furnish a Statement in Form 52A providing particulars of all payments of over ₹ 50,000 in aggregate, made by him or due from him to the persons engaged by him in the production, for each financial year or part of it, till completion of production, within 30 days from the date of completion of production or within 30 days from the end of the financial year, whichever is earlier. In case of default, penalty u/s 272A(2)(c) is leviable which is ₹ 100 for every day during which the failure continued.

Deficiency in Form 52A

3.12 A review of Form 52A revealed that Form 52A does not require the PAN of the person to whom payment has been made. In absence of this it would be difficult to trace the person to whom payment has been made. The very purpose of Form 52A towards getting information about the recipient is defeated.

Furnishing of information in Form 52A by TV serial producers

3.13 Provisions of section 285B were not made applicable to the TV serial producer since the Department interpreted 'cinematograph film' as a feature film.

⁴⁰ Revenue collected from distributors of satellite signals

⁴¹ Charge: CIT11, Mumbai; AYs-2005-06 & 2006-07

3.14 The term 'cinematograph' as per Cinematograph Act, 1952 includes any apparatus for representation of moving pictures or series of pictures and the term 'film' means a cinematograph film. Thus as per the definitions, TV serial would also fall within the purview of cinematograph film and therefore, the provisions of section 285B of the Act would be applicable to the producers of TV serials and may be required to file the required information in Form 52A.

No system to monitor filing of Form 52A

3.15 For compliance to the provisions of the Act, it is necessary that the Department should have information about the films under production. In absence of information on number of films under production during the year, the Department may not be in a position to ascertain how many Forms 52A were required to be filed and how many had not been filed. The Department had not devised any system to monitor filing of Form 52A by the producers as neither record regarding receipt of Form 52A was being maintained nor the information regarding films under production was available with the Department.

3.16 The PAC in their recommendation in Para No.103 of 71st Report (8th Lok Sabha)-1986-87 has observed that the CIT, Madras had admitted that in the absence of source register, the correct number of statements actually received could not be given and that the suitable instructions had been issued to the concerned Inspecting Assistant Commissioners to maintain a register and record of cases of producers. We observed that despite assurance given to the PAC, the Department has not been able to maintain necessary register/records for monitoring Form 52A even after lapse of more than two decades.

Non filing/late filing of Form 52A

3.17 By comparing the number of films certified by the Censor Board with the number of Forms 52A received by the Department, we observed that during the period 2006-07 to 2009-10, Form 52A was not filed by the producers in 1,770 cases (detailed in Table 1). Particularly in Orissa, Form 52A was not filed even in a single case, whereas in Kerala Form 52A was filed only in 3 cases.

Table 1 : Cases where Form 52A were not filed

State	No. of cases
Andhra Pradesh	514
Kerala	191
Karnataka	500
Tamil Nadu	440
Delhi	36
Orissa	86
West Bengal	2
Uttar Pradesh	1

3.18 We observed that Form 52A was filed late in 302 cases⁴² and this delay ranged from 3 days to 4 years.

Non levy of penalty

3.19 The Department had not taken any action in most of the cases under section 272A(2)(c) to levy penalty for non-filing and late filing of Form 52A. The penalty for non-filing and late filing of Form 52A comes to ₹ 18 crore in respect of 2,072 films⁴³.

3.20 We also observed in one case⁴⁴ that the assessing officers completed assessment after scrutiny in 2009-10 but no penalty proceedings were carried out against him for non compliance of provision of section 285B.

3.21 In one case the director of the assessee company⁴⁵ admitted in a statement recorded under section 131, that they had not filed Form 52A in respect of ongoing films namely FAREBI, NAHLE PE DEHLA, BACHELOR and one untitled production. However, no penalty proceedings were initiated for non filing of Form 52A. This omission resulted in non-levy of penalty aggregating to ₹ 12.43 lakh.

Allowance of expenditure without receipt of Form 52A

3.22 Section 285B requires that Form 52A should be filed within 30 days from the date of completion of the feature film or end of the relevant financial year, whichever is earlier. It means that Form 52A should be received in the Department before completion of the relevant assessment. However, there is no enabling provision in the Act which disallows the expenditure on the film if required Form 52A is not filed within time.

3.23 We observed that in absence of such enabling provision, expenditure of ₹ 145.36 crore on 23 films was allowed in Andhra Pradesh without receipt of Form 52A.

3.24 We also observed in four cases⁴⁶ that the assessing officers finalized the assessment after scrutiny without ascertaining the reasons for huge differences between the expenses declared in Form 52A and the cost of production as per their Profit and Loss account.

⁴² Karnataka-128 cases, Tamil Nadu-171 cases, Kerala-3 cases

⁴³ AP-514, Kerala-194, Karnataka-628, Orissa-86, TN-611, Delhi-36, UP-1, West Bengal-2

⁴⁴ Sri Niranjan Rana - assessment years 2004-05 to 2009-10-assessed by ACIT, Circle -1(2), Bhubaneswar

⁴⁵ Charge: CIT-11, Mumbai, Assessee- M/s Dhariwal Films Pvt Ltd., AY 2003-04 to 2005-06

⁴⁶ M/s Madras Talkies, CIT IV, Chennai, AY 2007-08; M J Antony, CIT IV, Chennai, AY 2006-07; S.P. Bala Subramanian, CIT IV, Chennai, AY 2006-07; Sri N. Srinivasa Reddy, Hyderabad

Non correlation of information in Form No. 52A with the assessment records of concerned assesseees

3.25 Form 52A is one of the important tools available with the assessing officers to ensure that all film related personalities engaged in the production of a film disclose correct particulars of income.

3.26 We observed that producers of films have filed Form 52A in the office of the Additional Commissioner of Income Tax Range 11(1), Mumbai. However, there was no system to forward Form 52A by Additional Commissioner of Income Tax Range 11(1), Mumbai to the Assessing officers concerned for correlation. The same were more or less used for levy of penalty under section 272A(2)(c) in case of late filing rather than its actual purpose of correlation during scrutiny assessment. Out of 110 cases of film producers made available, our efforts to correlate expenditure aggregating to ₹ 214.75 crore allowed to 20 film producers did not yield result due to non production of Form 52A. Thus, due to non availability of a system for passing Form 52A to the concerned assessing officer, Department had failed to utilize the information made available by film producers for detection of non-disclosure or incorrect disclosure of income during scrutiny assessment.

Absence of TDS provisions for film distribution rights

3.27 Income derived from sale of satellite rights and music rights for further use in telecast for televisions and radio broadcast is subject to TDS provisions. However, the income derived by producers/distributors from sale/lease of distribution rights of a film is not liable to TDS. Similarly, TDS provisions are not applicable⁴⁷ on sharing of proceeds from film exhibition between film producers/distributors and a film exhibitor owning cinema theatre/multiplexes. TDS provisions need to be broadened to cover activities like distribution of rights of films and sharing of proceeds from film exhibition to avoid tax evasion and broaden the tax base.

Demand, collection and arrears of tax

3.28 Our study revealed that outstanding demand in respect of Mumbai film Circle has increased by 60 *per cent* during the period from 2006-07 to 2009-10 whereas in Chennai Film circle it increased by 161 *per cent* during 2007-08 to 2009-10. Details are given in Table 2 below. The Department should consider appropriate action to reduce the outstanding demands.

⁴⁷ CBDT's clarification vide circular No. 736 dated 13.02.1996

(₹ in crore)

Table 2: Position of demands raised, collected and outstanding in Film Circles							
Film Circles	Financial Year	Demand outstanding as on 1st April	Addition due to transfer in from other Circles, wards	Demand made during the year	Total demand due	Amount realized during the year	Demand outstanding as on 31st March
1	2	3	4	5	6	7	8
Mumbai	2006-07	362.03	0	440.67	802.70	411.83	390.87
	2007-08	390.88	0.01	94.25	485.14	178.43	306.71
	2008-09	306.71	1.31	370.71	678.73	257.09	421.64
	2009-10	421.64	0	439.98	861.62	234.84	626.78
Hyderabad	2006-07	NA	NA	NA	NA	NA	NA
	2007-08	12.88	0	6.40	19.28	6.49	12.79
	2008-09	12.79	0	4.62	17.41	5.57	11.84
	2009-10	11.84	0.26	2.07	14.17	8.03	6.14
Chennai	2006-07	NA	NA	NA	NA	NA	NA
	2007-08	63.18	3.60	33.98	100.76	25.67	75.09
	2008-09	75.09	2.62	40.98	118.69	40.10	78.59
	2009-10 (upto 12/2010)	78.59	10.83	167.41	256.83	60.64	196.19

Search & seizure

3.29 Section 132 of the Act provides for unearthing undisclosed income and detects evasion of tax. Section 132 empowers the Department to conduct search for unproduced books of accounts/documents or undisclosed income and seize the same. This is significant considering the media reports on investment of money in films from the underworld. We observed that during the period under review, 19 searches⁴⁸ were conducted on films related assesses in which additions to income of ₹ 72.54 crore⁴⁹ were made.

Surveys

3.30 Sections 133A and 133B empower the Income Tax authorities to conduct surveys. Surveys enable the Department not only to gather information relating to financial transactions of the existing assesseees, but also to identify new assesseees. Surveys also help in checking the veracity of the statements filed by the assesseees and detecting tax evasion. We found that though a separate Range was created exclusively for Media industry in Tamil Nadu as the industry requires close monitoring and correlation of information, surveys were not given the importance they deserve. Five surveys were conducted in the Media Range, Chennai during the period from 2006-07 to 2009-10.

⁴⁸ Tamil Nadu-5, Andhra Pradesh-6, Karnataka-3, Maharashtra-5

⁴⁹ Tamil Nadu-NIL, Andhra Pradesh-₹ 13.79 crore, Karnataka-NIL, Maharashtra-₹ 58.75 crore

Assessment of foreign telecast companies

3.31 Under the provisions of the Act, payment for uplinking and use of transponders and satellite charges to foreign satellite companies are subject to withholding tax⁵⁰. Similarly, the income received by the foreign satellite companies is taxable in India subject to issues relating to permanent establishment and provisions of Double Taxation Avoidance Agreement (DTAA).

3.32 Foreign Telecast Companies (FTCs) started their operations around 1992 in Indian sub-continent by uplinking signals from abroad. Their main source of income was advertisement revenue from sale of air time and subscription revenue for their pay channels. Their activity is continuously carried out in India with the help of an Indian agent who canvasses for space selling for advertisements, establishing the distribution network and delivering the programmes to Indian viewers.

3.33 In absence of specific provisions in the Act with regard to taxation of FTCs, the taxation of FTCs has been a vexatious issue as no uniform basis had been adopted by the assessing officers for taxation of income of FTCs from their operations in India. Keeping this in view, the CBDT through circular No. 742 of May 1996 clarified that profits of FTCs not having any branch office or permanent establishment in India or those not maintaining country-wise accounts, shall be determined by adopting a presumptive profit rate of 10 *per cent* of the gross receipts meant for remittance abroad or the income returned by such companies, whichever is higher. This circular was in respect of advertisement revenue. However, the issue of taxation of subscription revenue was not dealt with and no clarification in this regard was issued.

3.34 The aforesaid circular was subsequently withdrawn and revised instructions were issued (circular No. 6 of March 2001) providing for determination of taxable profits in accordance with the provisions of the Act. It was further clarified that where accounts for Indian operations are not available, the provisions of Rule 10 of the Income-Tax Rules, 1962 shall be invoked and in case the FTC is a resident of a country with whom India has the Double Taxation Avoidance Agreement, its business income (including receipts from advertisement) can be taxed only if it has a permanent establishment in India. As regards taxation of FTCs who are residents of countries with whom India does not have a Double Taxation Avoidance Agreement, the same was to be dealt with as per the provisions of section 5 read with section 9 of the Act.

3.35 The revised instructions restored the pre May 1996 status. In cases where there was absence of country wise accounts⁵¹, the assessing officers estimated the profits at rates varying from 10 *per cent* to 30 *per cent*.

⁵⁰ Withholding tax refers to deduction of tax at source (TDS) by the payers from the payment made to the recipient.

⁵¹ Multinational companies are supposed to prepare their accounts showing country wise transactions.

Similarly, in some cases the subscription revenue was considered as royalty. This led to protracted litigations pending with various judicial fora. The controversy still persists despite the FTCs continuing their operations over two decades and huge revenues being remitted abroad. As a result, revenue of ₹ 972.98 crore has been locked up in litigation from four to ten years. Cases of two assesseees are illustrated below:

In the case of Star Group including channel companies like i) M/s. Star TV Entertainment Ltd (broadcasting channels Star Plus, Star World), ii) M/s. Star Asian Movies Ltd (broadcasting Star Gold), iii) M/s. Star International Movies Ltd (broadcasting Star Movies), iv) M/s. Channel V Music Networks Ltd, (broadcasting Channel V music), and conduit companies like Star Ltd and Asian Broadcasting FZ LLC⁵², income was assessed in the hands of ultimate beneficiaries i.e. channel companies. Some part of the same income was also assessed in the hands of conduit companies like Star Ltd and Asian Broadcasting FZ LLC. Star group approached Settlement Commission (March 2007) self declaring income of ₹ 1,500 crore for assessment years 2000-01 to 2006-07 and the Commission prima facie accepted the application. However, the Department filed a writ in the Mumbai High Court in December 2007 against the very acceptance by the Commission. As a result amount of ₹ 880.68 crore⁵³ has been locked up in the litigation.

In the case of M/s. MTV Asia LDC, Singapore⁵⁴, (Telecasting MTV channel), the assessing officer had taxed 30 *per cent* of the entire revenue as business income. On the appeal of the assessee, the CIT (A) ordered to assess 10 *per cent* of the income as revenue. Against this the Department has gone into appeal in May 2007 which is pending. As a result amount of ₹ 2.93 crore⁵⁵ has been locked up.

Wealth not assessed due to non-correlation of Income Tax assessment records

3.36 The Board has issued instructions⁵⁶ to the Assessing Officers for ensuring proper co-ordination amongst assessment records pertaining to different direct taxes and for simultaneous disposal of income tax and wealth tax assessment cases so that there is no evasion of tax as also regulate unaccounted wealth. We observed that in 18 cases the assesseees either had not filed their Wealth Tax returns or did not account for their total wealth and the Department failed to initiate assessment proceedings for assessing the wealth on the basis of information available with them. Two cases are illustrated below:

⁵² Assessment years 2000-01 to 2006-07

⁵³ Revenue locked up is gathered from the dossiers

⁵⁴ Assessment year 2004-05

⁵⁵ Tax locked up shown as per the scrutiny report of AO before filing 2nd appeal

⁵⁶ November 1973, April 1979 and September 1984

M/s. Yashraj Films Pvt. Ltd.⁵⁷ had not filed returns of wealth though the assessee had the wealth of ₹ 8.88 crore in the form of bungalow and vehicles. The Department had also not initiated any proceedings for wealth tax on the basis of information available from Income Tax assessment.

An actor⁵⁸ was having a flat and motor cars which were chargeable to wealth tax. However neither did she file her return of net wealth nor did the Department initiate any wealth tax proceedings resulting in escapement of taxable wealth aggregating to ₹ 2.39 crore.

Recommendations

3.37 We recommend that

- *the Department may put a system in place to ensure that all assessees related to the film and television industry are assessed in the specially created Film Circles and that case records of those assessees who file their returns outside Film Circles are migrated to Film Circles;*

While appreciating the issue, the CBDT stated (February 2011) that as computerization and e-filing evolves, focus on professional codes, completeness of returns, etc. can be made.

- *provisions for deduction of TDS on sale of distribution rights and sharing of proceeds from exhibition of films may be introduced;*

The CBDT stated (February 2011) that the issue has been addressed in Direct Tax Code Bill, 2010.

- *a suitable system may be devised to collect the information about the films which are under production;*

The CBDT agreed (February 2011) to look into the suggestion.

- *in respect of Form 52A we recommend that*
 - ◆ *receipt of Form may be suitably monitored;*

The CBDT agreed (February 2011) to look into the suggestion.

- ◆ *suitable provisions be made in the Act to disallow the expenditure on the films if Form is not received before filing of income tax return;*

The CBDT stated (February 2011) that disallowance of expenditure is made only in cases where substantive law expressly provides for a specific mode of payment and is not

⁵⁷ Charge: CIT-11, Mumbai, AYs- 2004-05 to 2007-08

⁵⁸ Charge: CIT-11, Mumbai, AYs-2005-06 to 2007-08

complied with and not for non-submission of information. Hence disallowance of expenditure on non-filing of return would be harsh on the tax payer and therefore, the recommendation may not be practicable. However, the issue of monitoring the submission of forms is being looked into. The CBDT further stated that amount of penalty for late submission of Form 52A may be considered for increase.

- ◆ *Form be amended to include PAN of the person to whom payment is being made;*

The CBDT accepted (February 2011) the recommendation.

- ◆ *submission of Form may be made mandatory to the producers of TV programmes.*

The CBDT noted (February 2011) the recommendation for consideration.

CHAPTER 4

360 degree analysis

Lakshmi

Desamuduru

Chandhramukhi

Thirupatchi

Classmates

Recommendation

Chapter 4

360 Degree Analysis

The Department rarely used information given by an assessee during his assessment to cross verify the correctness of the information furnished by another assessee (who had transacted with the former) during the assessment.

4.1 Creation of separate film circles was expected to facilitate the correlation of assessments of related assesses towards arresting tax evasion as all the industry related assesseees are to be assessed in one unit.

4.2 We attempted to correlate the information collected from assessment records with the assessment of related assesseees and found escapement of income having tax effect of ₹ 1.64 crore in 11 cases whereas in one case tax effect could not be quantified as the income escaped from assessment was not ascertainable. We observed that

- Shri B. V. S. N. Prasad, proprietor of Sri Venkateswara Cine Chitra⁵⁹ offered income of ₹ 25 lakh from sale of satellite rights of film 'Chatrapati' to 'MAA TV'. We observed that 'MAA TV' purchased satellite rights of this film for ₹ 81 lakh, thus there was understatement of income by ₹ 56 lakh having a tax effect of ₹ 21.11 lakh.
- Shri M. L. Kumar Chowdary, proprietor of M/s. Shree Keerthi Creations⁶⁰ disclosed income of ₹ 65 lakh from sale of satellite rights of his film 'Vikramarkudu' to 'MAA TV'. However, as per records of 'MAA TV', they paid ₹ 81 lakh for acquiring satellite rights. This resulted in escapement of income of ₹ 16 lakh leading to short levy of tax of ₹ 7.17 lakh.

The Department replied that the amount received by the assessee from 'MAA TV' was only ₹ 65 lakh and the balance ₹ 16 lakh were paid to third party on his behalf for hiring camera. The reply is not tenable as ₹ 16 lakh paid to third party for hiring of camera was part of the total consideration for satellite rights. This should have been treated as expenditure, if it has not been charged already in accounts.

- M/s. Turner Broadcasting System Asia Pacific⁶¹ included ₹ 2.32 crore in its total income for assessment year 2007-08 as royalty received from M/s. Global Broadcast News Pvt. Ltd. whereas the assessment records of M/s. Global Broadcast News Pvt. Ltd. for the assessment year 2007-08 disclosed that ₹ 4.57 crore was paid to M/s. Turner Broadcasting System Asia Pacific towards royalty. This resulted in underassessment of income by ₹ 2.25 crore involving short levy of tax of ₹ 31.31 lakh (including interest).

⁵⁹ Assessment charge: Film Circle, Hyderabad, AY-2006-07

⁶⁰ Assessment charge: CIT, Central, Hyderabad, AY-2007-08

⁶¹ Charge: DIT (IT), Delhi.

360 Degree Analysis of select films

4.3 We selected nine films in four regions with a view to examine assessments of all the persons involved in production, distribution and exhibition of these films.

4.3.1 Two films⁶² in Andhra Pradesh were selected for detailed examination. Out of the 178 assesseees identified, records of only 59 assesseees were made available. Whereas 42 assesseees were being assessed in other states, PAN of 27 assesseees were not available. During examination we observed that both the films were commercially successful but the producers declared income of ₹ 20.16 lakh and ₹ 32.91 lakh from these two films. Further details are as under:

Film 'Lakshmi'

- There was a wide variation between the expenditure of the film as declared in Form 52A (₹ 5.56 crore) and as reflected in profit & loss account and allowed in assessment (₹ 11.13 crore). The Department made no efforts to reconcile this wide variation.
- As per Form 52A, Ms Surdeep Kaur Uppal alias 'Charmee', an artist was paid ₹ 10 lakh whereas she offered ₹ 25 lakh from this film. This indicates that either the assessee did not declare full expenditure or the recipient Ms. Surdeep Kaur has income from undisclosed sources.
- Two distributors⁶³ of this film did not disclose transactions on expenditure incurred on acquisition of distribution rights of this film and income from the screening of the film whereas two other distributors⁶⁴ did not file their returns for AY 2006-07 though they purchased distribution rights for ₹ 81.40 lakh and ₹ 91.70 lakh respectively.
- One assessee (costume designer), Ms. Surjit Kaur Uppal⁶⁵ did not offer remuneration of ₹ 7.50 lakh received from this film for assessment.

Film 'Desamuduru'

- The assessee did not file Form 52A. No penalty u/s 272A was imposed.
- Against receipt of ₹ 23.60 lakh from M/s. Aditya Music (P) Ltd. for audio rights, the assessee offered ₹ 20 lakh as income.
- Two distributors⁶⁶ who purchased distribution rights for ₹ 1.23 crore and ₹ 63.03 lakh did not file their returns for 2007-08.

⁶² Film 'Lakshmi' produced by Shri Nallamalapu Srinivasa Reddy, AY-2006-07 and film 'Desamuduru' produced by Sri D. V. V. Daniah, AY- 2007-08

⁶³ Sri N. Rama Krishna Reddy proprietor of M/s Kranti Krishna Pictures under CIT, Visakhapatnam and M/s Sri Lakshmi Devi Films under CIT, Vijayawada

⁶⁴ M/s Jayalakshmi Film Distributors for East Godavari area, under CIT, Rajahmundry and M/s D S Movements for Guntur area under CIT, Vijayawada

⁶⁵ Assessing charge : CIT Central Hyderabad, AY : 2006-07

⁶⁶ Sri A Mallikaarjuna proprietor of M/s Asha Film Distributors under CIT, Tirupati and M/s Sri Venkateshwara Creations, Guntur under CIT, Vijayawada

4.3.2 Three films⁶⁷ in Maharashtra were selected for detailed examination. Out of identified case records of 103 assessees, records of only 66 assessees were made available.

In the case of film Umrao Jaan⁶⁸ we noticed that the producer received ₹ 2.50 crore for satellite rights of the film from M/s. Adlabs Films Ltd., however, this amount was not offered for tax. This resulted in short levy of tax by ₹ 1.12 crore (including interest).

4.3.3 Two films⁶⁹ in Tamil Nadu were selected for detailed examination. The film ‘Chandhramukhi’ was released for exhibition in April 2005 and the total realization from the film was ₹ 25.53 crore. The film ‘Thirupatchi’ was released in January 2005 through distributors both under “minimum guarantee” and “outright sale” basis.

Film ‘Chandhramukhi’

Though the assessment of the producer of the film for 2006-07 was selected for scrutiny under section 143 (3) under the orders of CCIT, we observed that some of the following aspects were not examined in detail:

- Four distributors could not be identified with their PAN.
- Telugu rights of feature film were sold for ₹ 4 crore. However, the assessee declared only ₹ 2.27 crore. This resulted in underassessment of income with short levy of tax amounting to ₹ 77.83 lakh.
- Sale value of overseas rights⁷⁰ was understated by ₹ 17 lakh involving a tax effect of ₹ 7.61 lakh.
- Products of M/s. TATA Indicom were displayed as in-film advertisement in the film. This extended benefit should have been assessed under section 28(iv).
- Similarly, income earned by displaying Sunfeast biscuit as in-film advertisement was not offered for tax.
- The producer celebrated 200th day function of the film spending ₹ 20.52 lakh which was telecast on satellite channel-Sun TV. Income earned from sale of satellite rights was not offered for assessment.

Film ‘Thirupatchi’

- Seven distributors to whom distribution rights were sold for ₹ 3.05 crore could not be identified with the information available in the records of the producers.
- Entire cost of acquisition of distribution rights by M/s. Jothimurugan Films⁷¹, Salem ₹ 50 lakh was allowed under Rule 9B though the film was not released for 90 days in the year and the collection was only

⁶⁷ Umrao Jaan by Shri J P Dutta, Salam Namaste by M/s Yashraj Films Pvt Ltd and Apaharan by Shri Prakash Jha

⁶⁸ Produced by Shri Jyoti Prakash Dutta (J P Dutta) under CIT-11, Mumbai charge, AY 2007-08

⁶⁹ Chandhramukhi by M/s Sivaji Productions under CIT-IV, Chennai charge, AY 2006-07 and Thirupatchi by M/s Super Good Films (Pvt) Ltd. under CIT-IV, Chennai charge, AY-2005-06

⁷⁰ Overseas rights sold to M/s Sanjai Wadhva

⁷¹ Assessment charge: CIT, Salem, AY- 2005-06

₹ 24.35 lakh. Allowance should have been restricted to the amount of collection under Rule 9B (3). This has resulted in short levy of tax by ₹ 10.94 lakh (including interest).

- The producer paid ₹ 1.60 crore without deducting TDS under section 194J for acquiring story rights of the films. This amount was not disallowed u/s 40(a)(ia) having a tax effect of ₹ 83.23 lakh (including interest). Non deduction of TDS also attracts interest of ₹ 12.87 lakh u/s 201(1A) and penalty u/s 271C.

The Department's reply that provisions of section 194J are not applicable on 'story rights' is not acceptable since as per explanation (c) to Rule 6F, 'film artists' include 'story writers'.

4.3.4 Two⁷² films in Kerala were selected for detailed examination. Out of identified 42 case records, records of 16 cases were made available whereas PAN details and assessing charge in respect of 23 cases could not be ascertained. Our examination revealed the following:

Film 'Classmates'

- Director of the film Shri Lal Jose declared only ₹ 18.35 lakh as against payment of ₹ 31.49 lakh as declared by the assessee (producer) in Form 52A. There was a short levy of tax of ₹ 5.53 lakh.
- Story writer of the film Shri James Albert declared ₹ 19.57 lakh receipt from the film whereas in Form 52A payment of only ₹ 1.95 lakh was declared.
- Actress Kavya Madhavan was paid ₹ 2.1 lakh (as per Form 52A) for acting in the film, however, she declared only ₹ 1.11 lakh. There was a short levy of tax of ₹ 0.34 lakh.

Film 'Madhuchandralekha'

- Form 52A was not filed. No penalty was levied.
- Payment made to singers was not debited in P&L account.

Recommendation

4.4 *We recommend that the Department should develop a system which may ensure that the information furnished by an assessee is used to cross verify the correctness of the information given by other assesseees having transactions with the former, to avoid the evasion of tax by way of furnishing incorrect information.*

While noting the suggestion the CBDT stated (February 2011) that the Department has already put in place a system by which transactions of tax payers are captured electronically through AIR, CIB, ITS, TDS etc. The entire drive for computerization, in a way, aims to facilitate cross verification of information. While the first of objective of information capture has been met largely, the matching and dissemination of CIB information received without PAN is the challenge at the next level.

⁷² Classmates produced by M/s Arya Films Classmates under CIT, Kottayam charge, AY- 2007-08 and Madhuchandralekha produced by Shri Abdul Samad under CIT, Kozhikode charge, AY- 2006-07

CHAPTER 5

Mistakes in assessments

**Allowance of cost of production/
acquisition of distribution rights of
films**

Other mistakes in assessment

Recommendation

CHAPTER 5

Mistakes in assessments

There were 257 cases of errors in assessment involving ₹ 350.81 crore due to wrong application of provisions of the Act.

The provisions of the Income Tax Act regarding allowance of cost of production of films and acquisition of distribution rights of films were not being invoked properly. There were also errors in assessment involving other provisions of the Act.

I Allowance of cost of production/acquisition of distribution rights of films

Rule 9A of the Income Tax Rules, 1962 regulates deduction of expenditure on production of a film and Rule 9B, expenditure on acquisition of distribution rights of the film. We found mistakes in 32 cases involving tax impact of ₹ 22.32 crore. Few cases are illustrated below:

5.1 Irregularities in allowance of cost of production of film

Charge: CIT-11, Mumbai, Maharashtra; AY 2006-07

Assessee: Ms. Smitha Thackeray

Rule 9A (5) provides that deduction for cost of production of a feature film, certified for release by the Censor Board shall be allowed when the producer exhibits the film on commercial basis or sells rights of exhibition; and the realization from it is credited in his books of accounts.

The assessee had not commercially released the film 'Hum Do Hamara Ek/Double Trouble' and realization there from was not credited in the books of accounts. However, the Department allowed the cost of production of the film ₹ 4.39 crore, resulting in short levy of tax of ₹ 62.32 lakh (including interest) and potential tax impact of ₹ 96.24 lakh.

5.2 Irregularities in allowance of cost of acquisition of distribution rights

Charge: CIT-IV, Chennai, Tamil Nadu; AY 2004-05

Assessee: M/s. Allu Entertainment (P) Ltd.

Rule 9B (5) provides that deduction in respect of cost of acquisition of distribution rights of a feature film shall not be allowed unless the film distributor exhibits the film on commercial basis or sales rights of exhibition; and realization there from is credited in his books of accounts.

The assessee had not offered any income through exhibition and selling of distribution rights, but the Department allowed

deduction of ₹ 5.84 crore towards cost of film lease rights, cost of positive print and publicity for two feature films, resulting in short levy of tax of ₹ 2.55 crore.

Charge: CIT-IV, Chennai, Tamil Nadu; AY 2004-05
Assessee: M/s. Gemini Industries & Imaging Limited

The Department allowed entire cost of ₹ 4.55 crore on production of feature films. The Department further allowed expenditure of ₹ 2.33 crore under Rule 9B in the revision order, based on the revised return of the assessee. This ₹ 2.33 crore was already included in ₹ 4.55 crore, allowed during original assessment. The excess allowance of expenditure resulted in short levy of tax of ₹ 83.34 lakh.

II Other mistakes in assessments

We found mistakes in 225 cases having tax effect of ₹ 328.49 crore. Summarised position is given in Table 3 below.

Error category	No. of cases	Tax effect (₹ in crore)
Income not assessed or incorrect computation of business income	49	97.02
Incorrect carry forward and set off of losses	17	21.35
Mistake in allowing depreciation	6	4.10
Incorrect allowance of capital expenditure	4	6.51
Non levy of Fringe Benefit Tax	6	0.71
Others	143	198.80

Few cases are illustrated below:

5.3 Irregular allowance of bad debts

Charge: CIT-11, Mumbai, Maharashtra; AY 2006-07
Assessee: M/s. Zee Entertainment Enterprises Ltd.

As per section 36(1)(vii) read with section 36(2) of the Act, any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is an allowable deduction.

The assessee debited advances of ₹ 6.61 crore to the profit and loss account as bad debts. These were not written off from the books of accounts. The Department, however, allowed these advances as bad debts. This resulted in short levy of tax of ₹ 2.22 crore.

5.4 Income not assessed

Charge: CIT-11, Mumbai, Maharashtra; AY 2005-06

Assessee: M/s. B. R. Films

Under the mercantile system of accounting any income or expenditure is accounted for on accrual basis irrespective of the fact whether it is received or paid during the relevant previous year.

The assessee spread over the consideration of ₹ 2.28 crore, received for sale of satellite rights of old films for five years. Since the sale was finalised in the previous year relevant to the current assessment year, entire amount of consideration should have been assessed in the current assessment year. However, the assessing officer allowed the spreading over of income. This resulted in under assessment of income by ₹ 2.28 crore involving tax effect of ₹ 71.51 lakh.

5.5 Irregular allowance of capital expenditure

Charge: CIT-IV, Chennai, Tamil Nadu; AY 2003-04 to 2005-06

Assessee: M/s. Gemini TV Pvt. Ltd.

Expenditure of capital nature are not allowable under the provisions of section 37(1) of the Act while computing the taxable income chargeable under the head 'profit and gains of business or profession'.

The Department allowed expenditure of ₹ 6.42 crore on laying of cables for transmission of TV signals during assessment years 2003-04 to 2005-06 as deductions during these years. This has resulted in excess allowance of expenditure by ₹ 6.42 crore and short levy of tax of ₹ 2.92 crore.

After being pointed out by us, the Department rectified the assessments for assessment years 2003-04 and 2005-06 under section 147.

5.6 Non-capitalisation of intangible assets

Charge: CIT-IV, Chennai, Tamil Nadu; AY 2004-05 and 2005-06

Assessee: M/s. Sun TV Network Ltd.

Under section 32(1)(ii), intangible assets viz. know-how, patents, trade marks, copy rights, licences, franchises or any other business or commercial rights of similar nature should be capitalized and depreciation be allowed at 25 per cent under Part B of the Depreciation Schedule.

The assessee claimed and the Department allowed entire expenditure of ₹ 105.54 crore on purchase of rights of feature films and TV serials as deduction for the current assessment year, whereas it should have been capitalized and depreciation be allowed. Non-capitalizing of the intangible assets of feature films and TV serials rights resulted in short-levy of tax of ₹ 23.64 crore (including interest).

Reply of the Department that film rights do not fall under any of the categories of intangible assets is not tenable. Such rights are to be treated under Copyrights or Licences against Explanation 3 to Section 32(1).

5.7 Incorrect exemption under section 11

Charge: CIT, Kochi, Kerala; AY 2005-06 and 2007-08

Assessee: M/s KP Issac & Sons Charitable Trust

Under section 13(1), if any part of income or any property of the trust or the institution is applied or used directly or indirectly for the benefit of any person specified in section 13(3), income of such trust/institution will not be eligible for exemption u/s 11.

The assessee's only business is running three cinema theatres taken on lease owned by a firm -M/s. KP Issac & Sons, in which all the trustees are partners. The assessee claimed the entire excess of income over expenditure of ₹ 0.70 lakh and ₹ 27.50 lakh for AY 2005-06 and 2007-08 respectively as exempt u/s 11. We observed that ₹ 16.43 lakh and ₹ 40.39 lakh was due to the trust from the

Firm as on March 2005 and March 2007

respectively. As the income received by the trust was applied directly or indirectly for the benefit of persons referred to in Section 13(3), the assessee was not entitled to get exemption under section 11 and the status of the assessee should be considered as 'Association of Persons'.

Further, exemption allowed to the Firm – K P Issac & Sons for donation and charity to the Trust of ₹ 19.83 lakh and ₹ 3.97 lakh for AYs 2005-06 and 2007-08 respectively should have also been disallowed. This has tax effect of ₹ 9.21 lakh for AY 2005-06 and of ₹ 12.64 lakh for AY 2007-08.

5.8 Unexplained deposits not taxed as deemed income

Charge: CIT-11, Mumbai, Maharashtra AY 2006-07

Assessee: Shri Gautam Adhikari

Where any sum is found credited in the books of an assessee and no explanation/satisfactory explanation is offered to the assessing officer with regard to its nature or source, the same may be charged to income tax as the income of the assessee of that previous year under section 68.

The assessee during the relevant previous year 2005-06 purchased house property for consideration of ₹ 8.87 crore. In February 2006, the said property was let out to M/s. Rock Star Properties Ltd. for a deposit of ₹ 24.31 crore and rent of ₹ 48,000 per annum (all inclusive) which in turn had given it back to the assessee to occupy. We observed

that the amount of deposit was not recorded in the leave and licence agreement. The tax auditor in clause 24(a) of Form 3CD had categorically omitted to testify the aforesaid transaction. The assessee also failed to

furnish the documentary evidence to prove that the money was received through normal banking channels. Cognizance of such vital aspect was not taken into account while finalizing the assessment. The omission had resulted in unexplained deposit of ₹ 24.31 crore escaping assessment involving tax effect of ₹ 10.88 crore (including interest).

Recommendation

5.9 *We recommend that responsibility for material errors in assessment may be fixed to reduce their incidence.*

While noting the suggestion for consideration the CBDT stated (February 2011) that the new system of review of assessments by the CIT has been introduced in November 2008 for reducing such instances and responsibility is fixed in cases found appropriate.

**New Delhi
Dated**

**(MEENAKSHI GUPTA)
Director General (Direct Taxes)**

Countersigned

**New Delhi
Dated**

**(VINOD RAI)
Comptroller and Auditor General of India**

Appendix-I
(Refer Para No. 1.20)

Criteria for selection of cases

Scrutiny cases

Company/firms	100 per cent
Individual	100 per cent maximum of 100 cases per year

Summary cases

Company/firms	5 per cent
Individual	50 per cent

Position of cases selected for examination by audit

Office	Selected			Received			Cases not produced
	Scrutiny	Summary	Total	Scrutiny	Summary	Total	
Maharashtra	1615	7669	9284	1082	3392	4474	4810
West Bengal	302	446	748	251	283	534	214
Tamil Nadu	647	3065	3712	647	3065	3712	0
Andhra Pradesh	485	1111	1596	443	1111	1554	42
Orissa	24	525	549	18	65	83	466
Delhi	396	168	564	237	108	345	219
Karnataka	142	734	876	142	734	876	0
Kerala	65	183	248	56	183	239	9
Uttar Pradesh	12	12	24	12	12	24	0
Total			17601			11841	5760