Service tax on distribution of films – centre poaching into states' territory – Mar 3, 2010

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WE already know that, the Central Government has been repeatedly poaching into the territory reserved for the States, in matters related to taxation. One classic example is the transfer of right to use software, which has been included under Sub Clause (vi) of Section 65(105)(zzzze) of the Finance Act, 1994 with effect from May 16, 2008, which is expressly recognized as a transaction involving 'goods'. Not content with this kind of transgressions, the Central Government has taken one more aggressive step in the area of taxing transactions involving goods under service tax, by proposing to levy service tax on services related to the transfer of cinematographic films and sound recording under Section 65(105)(zzzzt).

The relevant extracts from the TRU Circular D.O.F. No.334/1/2010-TRU dated 26-2-2010 is reproduced below:

7. Services related to two types of copyrights hitherto not covered under existing taxable service 'Intellectual Property Right (IPR)', namely, that on (a) cinematographic films and (b) sound recording.

7.1 The right to temporarily transfer or permit the use of Intellectual Property Rights (IPR), namely, trademarks, designs and patents was brought under tax net in 2004. However, one of the IPRs, i.e. copyright has been specifically kept out of the purview of the tax with an intent to encourage authors and artists, as it involves creative works, such as literary work, musical work and artistic work. In Budget 2008, Information Technology (IT) Software Service was also brought under tax net, which apart from involving development, upgradation, assistance etc. also covered the IPR aspect i.e. right to use the information technology.

- **7.2** The provisions of copyright are incorporated in the Indian Copyright Act, 1957. As per section 13 of the said Act, the copyright subsists in the following classes of work:
- (a) Original literary, dramatic, musical and artistic works;
- (b) Recording of cinematographic films;
- (c) Sound recordings.

7.3 The first category of copyright has been kept out of the tax net while the second and third categories of copyrights are being made taxable under this service. A cinematographic film means any work of visual recording on any medium (emphasis added) produced through a process from which a moving image may be produced. The same may be accompanied with sound reproduction also. Both the recording of the cinematographic film and the accompanying sound track are the property of the producer, who can temporarily transfer it or permit its use by another person for a consideration. It is this activity, which is being taxed under this service. It would have an impact on the royalty payments on both imported and indigenously produced films when the producer/right holder allows such use to another person, say the distributor.

7.4 Similarly, song, its music, lyrics and composition also enjoy the copyright protection to its owner who can commercially exploit it in the manner stated above.

Normally, the copyright of music vests in the composer and the copyright of music recorded vests in the producer of the sound recording. It is possible that a lyricist or a singer may hold copyright for the words of a song or the song itself. Merely allowing that song to be recorded is a copyright, which would fall under category (a) of section 13 of the Copyright Act and thus would not be subject to service tax. However, after the performer has transferred his rights to a sound recording company, the sound recording company acquires the copyright mentioned in category (c) of section 13 supra. It is the transfer or allowing use of this right, which would be subjected to tax under the new service.

7.5 As such, depending upon the nature and conditions of the contract, companies distributing music, owners of copyright of cinematographic films etc. would be prospective taxpayers. It may be noted that this taxable service will not cover individual artists, composers, performers etc. as their copyrights fall under clause (a) of Sec. 13 of the Copyright Act.
As we know, Intellectual Property service in terms of Section 65(55b) of the Finance Act, 1994 means (a) transferring temporarily; or (b) permitting the use or enjoyment of intellectual property right. Intellectual Property Right, in terms of Section 65(55a) means any right to intangible property, namely, trademarks, designs, patents, or any other similar intangible property, under any law for the time being in force but does not include copyright. In a nutshell, a transaction where a person is allowed to use an intellectual property right for consideration attracts service tax.

But, the fact remains, that the use of an intellectual property right is also a transaction involving sale of goods, attracting sales tax or VAT, as Intellectual Property is nothing but 'goods'. The Hon'ble Supreme Court, in Vikas Sales Corporation v. CCT (1996) 102 STC 106 (SC) has categorically held that corporatorial rights such as trademarks, patents and right in persona capable of transfer or transmission, such as debts, are also included within the ambit of "goods". In SPS Jayam & Co. V. Registrar, Tamil Nadu Taxation Special Tribunal and others (2004) 137 STC 117 (Mad), the Madras High Court has held that, a trade mark is an intangible good and that, giving permission to use a trade mark for a certain period is a transfer of right to use goods and not merely a right to enjoy and that, royalty for allowing the use of trade mark attracts sales tax. In fact, Entry 34 of the Third Schedule to the Karnataka Value Added Tax Act, 2003 includes DEPB Licenses, Copyrights, Patents and the like including the software licenses by whatever name called.

If the levy of service tax on Intellectual Property services was already controversial, the Government would seem to have become more aggressive by proposing to levy service tax on the transfer of cinematograph films, which will bring the a significant part of the film distribution industry under the service tax net. In A V Meiyappan v. Commissioner of Commercial Taxes, Board of Revenue, Madras and another reported in (1967) 020 STC 0115 , the Madras High Court had categorically held that, grant by way of lease of a cinematographic film amounts to a sale of goods, attracting the levy of sales tax. Now, the Central Government wants to levy service tax on distribution of films, a transaction which is already subjected to the levy of sales tax/VAT.

Is this not another aggressive attempt by the Centre to levy service tax on 'goods', a territory exclusively reserved for the States to tax?