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TAX FLASH NEWS

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Digital content developed by an animation company is a copyrighted intangible asset and not a computer software. Therefore, eligible for depreciation at the rate of 25 per cent and not 60 per cent

Recently, the Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Pentamedia Graphics Ltd.[1] (the taxpayer) dealt with an issue of rate of depreciation on 'digital content' developed by the taxpayer for utilisation in the production of films. The Tribunal held that the digital content is a copyrighted intangible asset and not a computer software. Therefore, the taxpayer is eligible for depreciation at the rate of 25 per cent and not 60 per cent.

Facts of the case

The taxpayer is an animation and special effects company using computer as camera. The taxpayer had produced animation films and visual/special effects for more than 500 Indian and international films. These animations of special effects are produced using computer software and specially prepared software for the characters, backgrounds and properties. These are called 'digital content' which is available in hard disk/drive of the computer. The taxpayer is a 100 per cent Export Oriented Unit (EOU) status under Electronic Hardware Technology Park (EHTP) scheme engaged in development of 'Digital Content'/ 'Animation Software' for utilisation in the production of films. The taxpayer claimed that these are customised software and was eligible for depreciation at higher rate of 60 per cent. The taxpayer contended that animation software developed by it satisfies the definition of computer software, being a programme, recorded and stored in an information storage device and utilised in the business of the taxpayer.

The Assessing Officer (AO) rejected the claim of the taxpayer and held that the taxpayer was entitled for deprecation at the of 25 per cent on 'Digital Content' as the same was intangible asset and not computer software. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Tribunal's decision

As per Rule 5 of Income-tax Rules 1962, (the Rules) the depreciation in respect of block of assets shall be calculated at percentages specified in Appendix 1 to the Rules on written down value of such block of assets. In Appendix 1, it is specified that computers including computer software shall be eligible for depreciation at the rate of 60 per cent. The said clause also defines 'computer software' as any computer program recorded on any disc, tape, perforated media or other information storage device.

However, Appendix 1 also specifies 'Intangible Assets' which include know-how, patents, copy rights, trademarks, licenses, franchise or any other business or commercial rights of similar nature which shall entitle the taxpayer for depreciation at the rate of 25 per cent.

Computer software has been given restricted coverage to 'computer program' vis-a-vis customs notifications referred by the Supreme Court in the taxpayer's own case[2], wherein the said custom notifications referred to 'Information Technology software' means any representation of instructions, data, sound or image[3]. The coverage under the customs law was very wide.

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[1] Pentamedia Graphics Ltd. v. DCIT- [ITA No. 1406 & 1407/Chny/2015, AY-2007-08 & 2009-10]- Taxsutra.com

[2] Commissioner of Customs v. Pentamedia Graphics Ltd (Civil Appeal No. 2576 of 2001, dated 09 May 2006)

[3] Including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of an automatic data processing machine to be covered by the term 'Information Technology Software'

Under the Income-tax Act, 1961 (the Act), the coverage of the term ‘computer software’ is restrictive to computer program which is recorded in any disc, tape, perforated media or other information storage device. The taxpayer had developed digital content which was held as an asset and was used in various films after being manipulated. This cannot be equated with a computer program but what was held by taxpayer was a digital content which was used by the taxpayer in various films, etc.

The computer animation and special effects were digital content which were stored in the hard disc of the computer. This digital content developed by the taxpayer was utilised in the multimedia and entertainment industry and at best was a copyrighted intangible asset owned by the taxpayer which was manipulated by the taxpayer to be used in various films. Considering it as a computer software would be far-fetched as it was not a computer program. If the language in the statute is clear and unambiguous then strict interpretation had to be done and it was well settled that there was no equity in taxing statute. Once the definition is given in the statute itself, then there was no need to refer to other statute and restrictive definition as given in the Act read with the Rules shall apply. Thus, the taxpayer was eligible for the depreciation at the rate of 25 per cent and not 60 per cent.

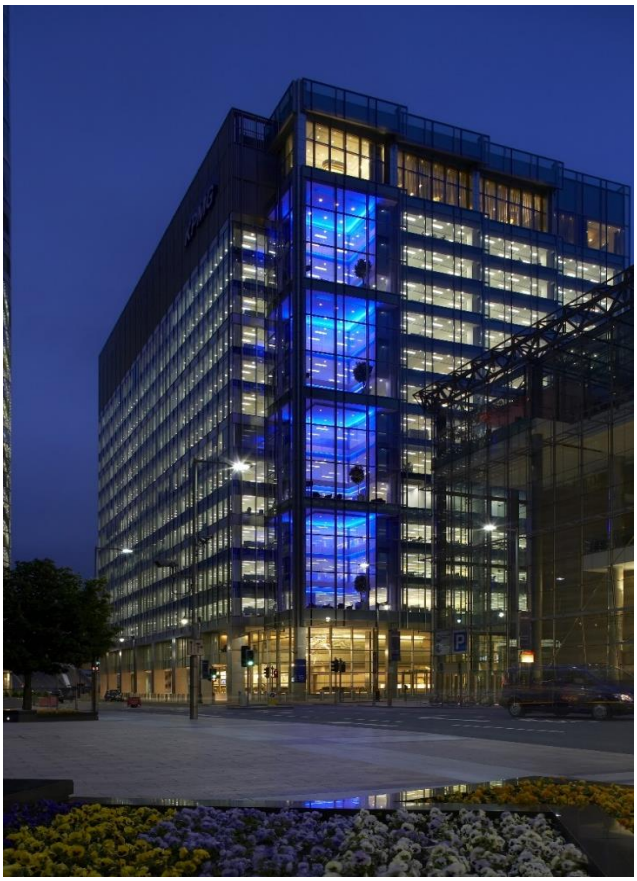
Our comments

The issue with respect to the eligibility of higher rate of depreciation on certain electronic devices, parts of computer, computer software, etc. has been a subject matter of debate before the Courts.

The Mumbai Tribunal in the case of Cine tech Entertainment India (P.) Ltd.[4] held that any machine or equipment cannot be described as computer if its principal output or function is the result of some sort of ‘computer functions’ in conjunction with some non-computer functions. Hence, the film projector cannot be said to be computer entitled to depreciation at the higher rate of 60 per cent.

However, the Special Bench of the Mumbai Tribunal in the case of Data Craft India Ltd.[5] held that routers and switches are to be included in block of 'computer' entitled to depreciation at the rate of 60 per cent as they can be classified as a computer hardware when they are used along with a computer and when their functions are integrated with a 'computer'.

The Tribunal in the present case has held that the digital content is a copyrighted intangible asset and not a computer program. Therefore, the taxpayer is eligible for depreciation at the rate of 25 per cent and not 60 per cent.



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[4] **Cine tech Entertainment India (P.) Ltd. v. ITO (**ITA No. 4971 (MUM.) Of 2017)

[5] DCIT v. Data Craft India Ltd. (2010) TIOL 473 ITAT MUM(SB) DCIT v. Data Craft India Limited [2010] 40 SOT 295 (Mum) (SB)

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