

# **CHAPTER 1**

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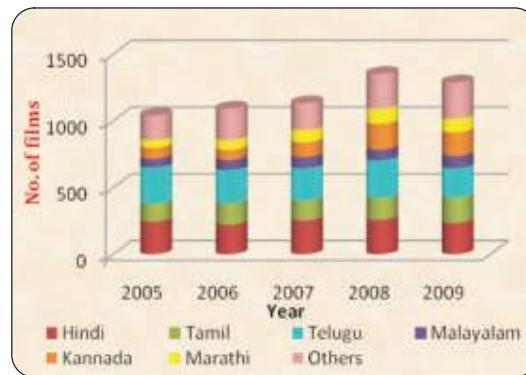
**Acknowledgement**

**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’<sup>1</sup> in Telugu and ‘Kalidas’<sup>2</sup> 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 films<sup>3</sup> 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.

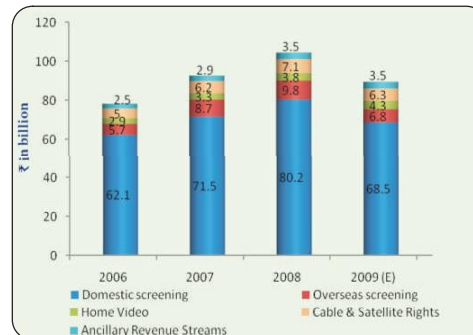
**Chart 1: No. of feature films certified for release**



**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 crore<sup>4</sup> 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**



<sup>1</sup> Produced and directed by Shri H. M. Reddy

<sup>2</sup> Produced by Shri Ardeshir Irani and directed by Shri H. M. Reddy

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

<sup>4</sup> Source: Indian Entertainment and Media Outlook 2010 by Price Waterhouse Coopers

**1.4** People of India were introduced to television on 15<sup>th</sup> 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 crore<sup>6</sup> 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 crore<sup>7</sup> 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)<sup>8</sup>. Prasar Bharti with 31 own channels<sup>9</sup> and other 27 channels<sup>9</sup> 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 goods<sup>10</sup>, which

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

<sup>6</sup> Back in the Spotlight-FICCI & KPMG Indian Media & Entertainment Industry Report -2010

<sup>7</sup> Source: Indian Entertainment and Media Outlook 2010 by Price Waterhouse Coopers

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

<sup>9</sup> Annual Report of Ministry of Information & Broadcasting for 2009-10

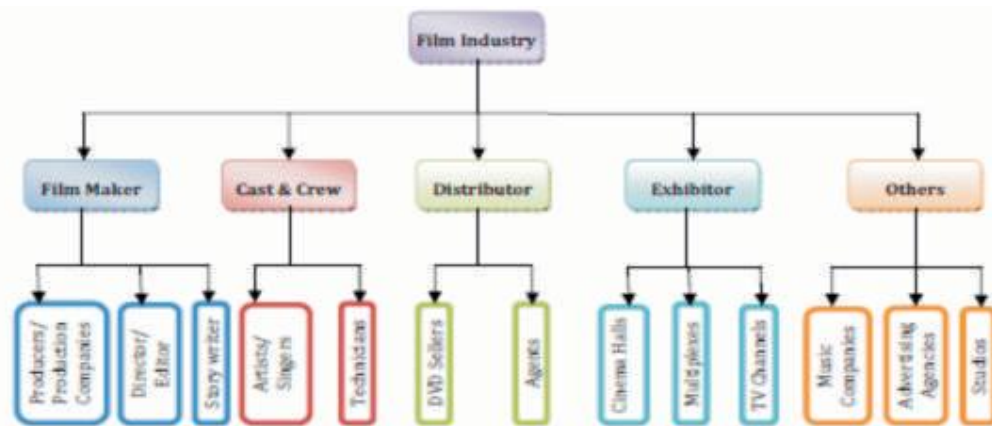
<sup>10</sup> CIT Vs D. K. Kondke (192 ITR 128) & CIT Vs. Uttam Chitra (261 ITR 263)

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**



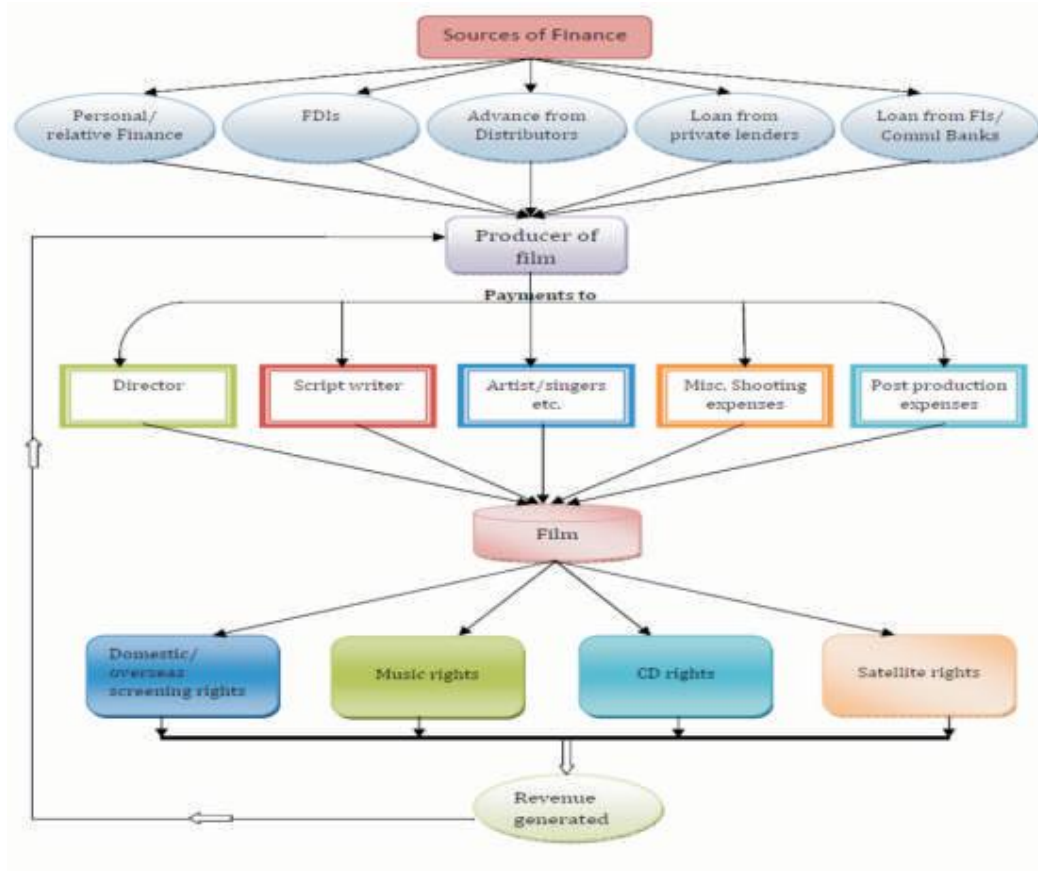
**1.10** While the key groups of players in the Television industry engaged in production and processing activities are the same as in the film industry, the distribution network substantially differs from the film industry which includes

- 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 investment<sup>11</sup> 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

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

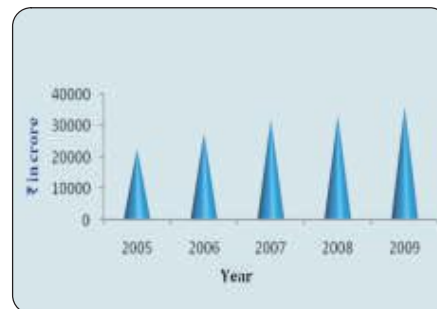
India for the year 1997-98 (Report No. 12 of 1999-Direct Taxes). We found that:

- some of the deficiencies which were pointed out in the earlier performance evaluation<sup>12</sup> 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

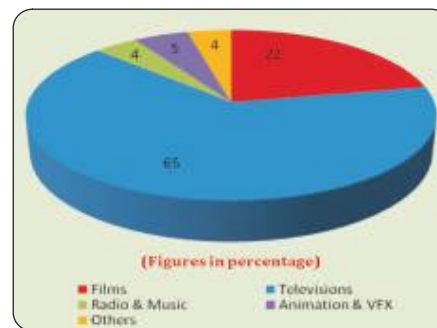
the film and TV industry has expanded a lot. The film and TV industry which generated revenue of ₹ 22,700 crore in 2005 had grown at an annual rate of 14.7 *per cent* and reached to ₹ 36,050 crore in 2009. The industry is expected to grow<sup>13</sup> at 16.5 *per cent* per annum in next five years to reach ₹ 65,850 crore by 2014.

**Chart 5: Revenue generated by Film and TV industry**



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

**Chart 6: Entertainment industry in 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;

<sup>12</sup> 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 71<sup>st</sup> Report (8<sup>th</sup> Lok Sabha)-1986-87. The PAC gave its recommendations on action taken by the Government on the above Report, in its 175<sup>th</sup> Report (8<sup>th</sup> Lok Sabha)-1989-90.

<sup>13</sup> Source: Indian Entertainment and Media outlook 2010 by Price Waterhouse Coopers

<sup>14</sup> 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 states<sup>15</sup> 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

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<sup>15</sup> 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 TDS<sup>16</sup> 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.

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<sup>16</sup> Tax deducted at source