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Digital content/ animation software is intangible asset, eligible for depreciation at 25%

The Chennai Bench of the Indian Income-tax Appellate Tribunal (ITAT) gave its decision that digital content/animation software is an intangible asset and not computer software, and is eligible for depreciation at the rate of 25%

Facts of the case:

- Pentamedia Graphics Limited (the taxpayer)[1] is in the business of production of animation films. The animation of special effects are produced using computer software. The characters, backgrounds and properties are made specially and merged using multiple computer processers to create visual shots. These are called digital content', which is available in the hard disk / drive of the computer.
- The taxpayer developed the animation software/ digital content and claimed depreciation on the same at 60%, as applicable to computer software during the Financial Years (FY) 2006-07 and 2008-09, corresponding to Assessment Years (AY) 2007-08 and 2009-10.
- During the course of audit by the Assessing Officer, the key contentions of the taxpayer with regard to claiming the depreciation at 60%, were as follows:
  - The digital content was utilised in the production of the films;
  - The taxpayer had engaged software programmers who wrote necessary codes for the software, which was stored on an information storage device like hard disk;
  - The digital content qualified as computer software under Explanation 2 to section 10B of the Income-tax Act, 1961 (ITA), being a programme, recorded and stored in an information storage device and utilised in the business of the assessee;
  - In the context of Customs law, the Supreme Court in the taxpayer's own case[2], had held that the 'motion capture animation films' qualified as information technology software.
- The key observations / findings of the Assessing Officer (AO) were as follows:
  - The ruling of the Supreme Court in the taxpayer's own case[2] was in a different context and had not examined relevance under the ITA, and hence is not relevant;
  - The digital content had a longer and enduring life period;
- The taxpayer did not develop and sell the digital content. It held the rights and generated revenue, which were in the nature of intellectual rights.

[1] Pentamedia Graphics Limited v. DCIT [2020] (116 taxmann.com 564) (Chennai – Trib.)

[2] Commissioner of Customs v. Pentamedia Graphics Ltd Civil Appeal No. 2576 of 2001

- AO rejected the taxpayer's contentions and held that the digital content was in the nature of an intangible asset, eligible for depreciation at 25%. The Commissioner of Income-tax Appeals [CIT(A)] gave the following additional findings and upheld the AO's order:
  - The 60% rate for depreciation was stipulated for:
    i. computer software acquired off the shelf;
    ii. operational software that controlled hardware;
    iii. cases where the software was an integral part of the related hardware etc.
  - As per Accounting Standard 26, where the software was not an integral part of the related hardware, then the computer software was considered an intangible asset.
- Aggrieved by the CIT(A)'s order, the taxpayer filed an appeal with the Chennai Bench of Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT held that the analogy laid down by the Supreme Court in the taxpayer's own case[3], could not be followed for the following reasons:
  - The ruling was rendered in the context of Customs law, which had a very wide coverage of the term 'Information Technology Software'.
  - The meaning of computer software under the Appendix I to the Income-tax Rules, 1962 (Rules), which prescribed the depreciation rates, was restrictive vis-à-vis the definition under the Customs law.
  - Since the definition of computer software was provided under the ITA read with the Rules, there was no need to refer to any other statute.
- The ITAT held that the digital content developed by the taxpayer was a copyrighted material, which was stored in a computer. It was manipulated by the taxpayer to be used in different films and thus, retained the character of copyrighted material, being intangible asset, and could not be categorised as computer program.
- In view of the above, the ITAT held that the digital content developed by the taxpayer was an intangible asset, eligible for depreciation at the rate of 25%.

Comments:

- The ruling based on facts of the case has held that the digital content was a copyrighted material, which qualified as an intangible asset and not as a computer program.

[3] Commissioner of Customs v. Pentamedia Graphics Ltd Civil Appeal No. 2576 of 2001

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