

IS A MUSIC CD AN ELECTRONIC MACHINE? – VALUE ADDED SALES TAX AND INDIA'S PIRACY BESET MUSIC INDUSTRY

**By: Shakeel Kudrolli, Majmudar & Co., International Lawyers,
Bombay, India (shakeel@majmudarindia.com)**

After much delay, the Value Added Taxation system for sales tax is likely to be introduced in 2005. This system will require the classification of various products, for taxation at differential rates. Chapter 85.24 of the EXIM (Export Import) Policy categorizes pre-recorded audiocassettes and music CDs as Electrical Machinery and Equipment, and the music industry is concerned about the potential sales tax implications of this classification. Electrical Machinery and Equipment will be taxed at the revenue neutral rate (about 12.5% in most states) under the proposed sales tax regime. This rate of sales tax is higher than the present rate of roughly 10%.

Profit margins in India's music industry have suffered due to the mushrooming piracy industry with losses of around Rs.18 billion in the past three years due to illegal copying and sales of music cassettes and CDs. Even the large drop in prices has not arrested the fall in volumes, and anti-piracy steps have so far had no real effect.

The Indian Music Industry (IMI) therefore feels that the imposition of the revenue neutral rate VAT rate upon music CDs and audiocassettes would be the final straw for the beleaguered music industry. The imposition of a 12.5% VAT translates into a 17-20% effective VAT rate for the music industry, which will further reduce margins by an estimated 12%.

According to the IMI, music CDs and audiocassettes are not in the nature of Electrical Machinery and Equipment since music falls under the Copyright Act, 1957 definition of 'musical work' in S. 2(p) and is therefore intangible intellectual property. The IMI suggests that the sound recording industry be viewed in the same light as the publishing industry and be taxed similarly. The tax rate applicable to analogous products of the publishing industry in the EXIM policy is currently nil.

The IMI proposal has merit. Perhaps, as the IMI suggests, sound recordings were considered luxury items at one point of time, and therefore taxed at high rates, along with electrical machinery and equipment. If so, the situation has clearly changed, and the law has lagged behind. It is apparent that much of the value of

the final product, being the finished CD or audiocassette, comes from the information inscribed upon the medium rather than from the medium itself. To illustrate, the cost of a blank CD varies from Rs. 10 to Rs. 20. Once music is recorded onto it, its value rises to Rs. 125. Thus, for all practical purposes, about 90% of the value of the final music CD arises from the musical work recorded onto it. So whereas blank CDs or audiocassettes may well be electrical and electronic machinery, the final product is more in the nature of a sound recording under S. 2(xx) of the Copyright Act, 1957, and thus would be better described by the term 'publication'. Further, the cost structures of the sound recording industry and the publishing industry are similar as both largely consist of intellectual property, either as sound recordings or as literary works. Presently however, there is no separate classification for publications (the chapter in the EXIM policy dealing with books etc is limited to paper products), and thus one may have to be created.

In conclusion, the argument for treating music CDs and audiocassettes as similar to publications rather than Electrical Machinery and Equipment throws up several important questions. The government should consider these questions very seriously, especially in the light of the decline in the music industry's fortunes due to piracy.