

Read: 1) Application dt.23/7/2007 from M/s. UFO India Ltd., holder of VAT R.C.
27540261939 under the Maharashtra Value Added Tax Act, 2002.
Heard: Smt. Sujata Rangnekar, C.A.

PROCEEDINGS

(Under section 56(1)(d) of the MVAT Act, 2002.)

NO.DDQ-11/2007/Adm-2/27/B-02

Mumbai, dt.26.06.08

An application for determination of disputed question was preferred by M/s.UFO India Ltd., having address as 101, Citi Point, J.B.Nagar, Andheri-Kurla Road, Andheri (east), Mumbai- 400 059, under the provision of section 56 of the Maharashtra Value Added Tax Act, 2002 whereby the following questions are posed for determination:-

1. Whether VAT is payable on such security deposits received by the applicant in view of Explanation III to definition of 'Sale price' given U/s.2 (25).
2. If VAT is applicable, what is the treatment at the time of refund of the said deposit after cancellation of leasing arrangement?
3. Can the applicant claim deduction in respect of VAT paid on the security deposits in the year when such deposits are refunded?

02. FACTS OF THE CASE

The applicant has submitted that they are engaged in leasing out 'Digital Cinema System' for film exhibition in Maharashtra. They provide digital infrastructure services by installing cinematographic equipments i.e. Projector, Cineblaster (Server), CDMA Phone, VSAT Antenna, UPS system etc. in the theatres to receive the movie content in digital form and subsequent software based decryption of the entire movie for every show. The applicants charge "digital cinema system rental charges" on usage basis from the theater owner. The said theater owner has to enter into "Equipment Leasing Rental Agreement" for approximately 10 years.

The cinematographic equipments required for the above business are purchased by the applicants either by way of import or local/inter state purchases. The applicants collect VAT at 12.5% on the lease rentals received from the theatre owner since it is in the nature of consideration received for transfer of right to use any goods for any purpose.

The said equipments are highly expensive and the applicant has to collect a refundable security deposit against such cinematographic equipment. The amount of security deposit is in the range of 15 to 25% of the total cost of the said equipment lying with the theatre owner. The said security deposits are collected to ensure safe custody of equipment. The applicant has the following questions in respect of the said security deposits.

- 1) Whether VAT is payable on such security deposits received by the applicant in view of Explanation III to definition of 'Sale price' given U/s.2 (25)?
- 2) If VAT is applicable, what is the treatment at the time of refund of the said deposit after cancellation of leasing arrangement?

- 3) Can the applicant claim deduction in respect of VAT paid on the security deposits in the year when such deposits are refunded?

03. HEARING

The case was fixed for hearing on 1.4.2008. Smt. Sujata Rangnekar, Chartered Accountant, attended on behalf of the applicant. She informed that the company is in the business of renting out leasing digital cinematographic equipment to cinema theatres. She informed that the company leases out cinema equipment and the equipment being expensive, the company also takes security deposit. The question therefore is whether such deposits form a part of the same price. She referred to the Explanation III to clause 2(25) of the MVAT Act which made 'deposits' a part of sale price. She informed that a similar explanation existed under the B.S.T. Act in the form of Explanation III which was added to the definition of 'Sale price' w.e.f 1.4.97. She referred to the Circular issued by the Commissioner (Circular 10 T of 1999 dt. 23.4.1999) explaining the scope of the amendment. She stated that as per the circular, deposits received on goods form a part of the sale price only when the ownership in the goods passes to the purchaser. She argued that in the instant case, there is no sale of digital equipment. Therefore, the deposit would not be a part of the sale price. She referred to the judgement given by the Tribunal in the case of M/s. Pamarox (Appeal No. 8 of 2002 dated 30.11.2002) in which the Tribunal had decided that the deposits received against returnable gas cylinders cannot be treated as part of sale price.

04. DECISION

I have gone through the submissions made by the applicant in the application. It is seen that the applicant provides digital infrastructure services by installing cinematographic equipments i.e. Projector, Cineblaster (Server), CDMA Phone etc in the theatres to receive the movie content in digital form. The applicant charges' digital cinema system rental 'charges on usage basis from the theatre owner. The said theatre owner has to enter into 'equipment leasing rental agreement for approximately 10 years. The applicants have collected VAT @ 12.5% on the lease rentals received from the theatre owner. The equipments are highly expensive and therefore the applicant has collected refundable security deposit against such cinematographic equipment.

It would be necessary to look into the relevant clauses of the agreement made by the applicants with their customers in order to decide the issues. A copy of the agreement made by the applicant with Jayashree Talkies is submitted by the applicant. Some of the relevant of agreement clauses are reproduced here for the sake of clarity.

- The Equipment Provider is inter alia engaged in the business of leasing Digital Cinema equipment to theatres wherein the equipment is used to project images on to the cinema screen. The Digital Cinema equipment includes (a) digital projector; (b) digital server; (c) computer Equipment (including monitors, mouse, key boards etc., (d) UPS; (e) CDMA telephone; (f) cables; (e) digital cinema software embedded in the digital server. All the equipments mentioned hereinafter collectively referred to as the **(Digital Cinema Equipment)**
- The Renting Party is desirous of leasing the Digital Cinema Equipment for installation at its theatre as defined in greater detail in Schedule A to this agreement (Theatre), from the Equipment Provider has agreed to lease to the

Renting Party the Digital Cinema Equipment on the terms and conditions set out in this Agreement.

1. SCOPE OF THE AGREEMENT

A) The Equipment Provider hereby agrees to provide and the Renting Party hereby accepts the Digital Cinema Equipment on lease basis at its Theatre for the Term (as defined hereinafter) and for any further term renewed in accordance with the provisions of this Agreement.

2. TERM

The Agreement shall come into effect from the date of execution hereof and shall remain in force for a period of ten (10) years from the date of execution ("Term") , unless terminated earlier by the Equipment Provider in accordance with the provisions of this Agreement. This Agreement may be renewed by the Parties based on mutual agreement in writing.

3. RENT/SECURITY DEPOSIT

A) The Renting Party shall be required to pay a refundable deposit for every set of the Digital Cinema Equipment leased ("Security Deposit"). In addition to this the Renting Party shall pay Rent to the Equipment Provider for the lease of the Digital Cinema Equipment ("Rent") all such payments shall be in terms of schedule B of this agreement.

B) The parties of the agreement acknowledge the fact that there is a sizeable investment which the Equipment Provider has made in the Digital Cinema Equipment leased to the Renting Party and that ideally the consideration for lease should be in the form of fixed monthly rentals. However, this being a new concept the success of which is uncertain, the Equipment Provider has agreed to provide the Digital Cinema Equipment to the Renting Party on a usage basis, wherein in the Renting Party shall be required to pay the Rent for the equipment on actual Usage. Other models of charging rent including fixed rental charges shall be explored by the Equipment Provider in the future in mutual consultation with the Renting Party. It is therefore agreed between the parties that the Equipment Provider shall recover the lease rental on a usage basis, wherein the Equipment Provider recovers the lease rental based on the number of shows run during the specified period. To optimize the utilization of the Digital Cinema Equipment, the Equipment Provider shall incentivise the Renting Party to use Digital Cinema Equipment by charging lower lease rentals in the case of films which have already been released and have a lower revenue potential as compared to new releases. The actual prevailing lease rental rates to be charged are set out in Schedule B to this agreement.

C) For operational convenience, different categories of per show lease rental charges which the Equipment Provider shall recover from the Renting Party shall be converted into a common unit of nature which shall be referred to as 'Show Units'. The periodic Lease Invoices raised by the prevailing rate of lease rental charge per Show Unit is Rs.Five. Renting Party acknowledges

that the Service Provider may vary this per Show Unit Lease Rental charge any time by giving one months notice.

D) The Security Deposit shall be refundable upon the expiry / termination of this Agreement subject to any deductions on account of any monies that may be owed by the Renting Party to the Equipment Provider at the time of such termination. Such Security Deposit shall be refunded by the Equipment Provider to the Renting Party only after delivery of the Digital Cinema Equipment by the Renting Party to the Equipment Provider in good working condition subject to normal ware and tear.

E) The Renting Party shall not be entitled to deduct any taxes from the Rent amount due to the Equipment Provider. All applicable taxes payable in relation to the Digital Cinema Equipment to the Rent will be payable by the Renting Party, unless agreed to the contrary by the Equipment Provider.

F) The Renting Party shall pay the rent on a weekly basis on the basis of usage and if the Renting Party delays in the payment of rent the Equipment Provider shall have right to discontinue the Renting Parties right to use the equipment.

G) The Rent charged by the Equipment Provider is subject to change and shall be at the prevailing rates as indicated by the Equipment Provider from time to time.

H) If the Renting Party does not make adequate use of the Digital Cinema Equipment (if a minimum of 50% utilization), the same shall constitute an additional ground for termination of this agreement.

It is clear from the agreement that the Equipment Provider i.e. the applicant has agreed to provide the Digital Cinema Equipment on lease basis. The lease is to operate for a period of 10 years from the date of execution as is common with lease agreements. The customer or the Renting Party shall pay lease rent to the equipment for the lease of the Digital Cinema Equipment. However, in addition to the lease rent the agreement also provide that the Renting Party shall pay a refundable deposit to the applicant. It is seen from clause 3 of the agreement that the Security Deposit is a refundable deposit subject to any deductions on any account of money i.e. payable by the Renting Party.

The question raised by the applicant is whether the Security Deposit received by the applicant, which is in the range of 15 to 25% of the total cost of the equipments lying with the theatre owner, is part of sale price under explanation III of clause (2) of Section (2) of the MVAT Act. The section under question is as under:-

(25) "Sale Price" means the amount of valuable consideration paid or payable to a dealer for any sale made including any sum charged for anything done by the seller in respect of the goods at the time of or before delivery thereof, other than the cost of insurance for transit of installation, when such cost is separately charged.

Explanation 1 :- The amount of duties levied or leviable on goods under the Central Excise Act, 1944 (I of 1944) or the Customs Act, 1962 (52 of 1962) or the

Bombay Prohibition Act, 1949 (Bom. XXV of 1949) shall be deemed to be part of the sale price of such goods, whether such duties are paid or payable by or on behalf of the seller or the purchaser or any other person.

Explanation II :- Sale price shall not include tax paid or payable to a [seller] in respect of such sale.

Explanation III :- Sale price shall include the amount received by the seller by way of deposit, whether refundable or not, which has been received whether by way of a separate agreement or not, in connection with or incidental or ancillary to, the said sale of goods;

The Explanation III is clear in its import. It says that sale price shall include amount received by the seller by way of deposit whether, refundable or not, which has been received whether by way of separate agreement or not in connection with or incidental to the said sale of goods. It is the contention of the applicant that irrespective of the aforesaid provision, where deposits have been made a part of sale price, the deposits received by them would not be a part of sale price. In support of the contention, the applicant has relied on the Circular issued by the Commissioner No. Cir. No. 10T of 1999 dt. 23rd April, 1999. The applicant has also referred the judgement of the MSTT in the case of M/s. Pamarox Private Limited V/s. State of Maharashtra (App. No. 8 of 2002 dt. 30.11.2002).

The Tribunal decided in the case of M/s. Pamarox Pvt Ltd. that, irrespective of the deeming fiction in the form of Explanation III making deposits a part of sale price, deposits received against refundable gas cylinder cannot be treated a part of sale price. This conclusion was arrived at by the Tribunal by relying upon the Trade Circular as also the judgement of the Supreme Court in the case of M/s United Breweries (105 STC 177). In the case of M/s United Breweries ,United Breweries sold beer in bottles and crates to the customers. The supplies were made to selling agent when he deposited a certain sum as security for the bottles and the crates. These deposits were returned to the selling agent when the bottles and the crates were returned. The Supreme Court observed that that in this case the appellant was anxious not to lose the bottles and crates and the deposits were charged by the appellant with the intention of getting back the bottles from the consumers. This was not a case where the appellant was selling bottles and washing his hands off them thereafter. He wanted to use the bottles. There was clear intention not to sell the bottles and the deposit could not be considered as the price of the bottles. The crates and the bottles were not sold along with the beer and the deposits could not be treated as the price of the bottles and crates. The Court concluded that the intention of the appellant was to get the bottles back from the customers as it wanted to use the empty bottles. Therefore, there being no intention to sell the bottles,, the deposits received for them is not a part of sale price.

By following the aforesaid judgement, the MSTT impliedly concluded that sale of gas cylinders does not entail sale of cylinders. Therefore, deposits received for cylinders not being received in connection with sale does not form of sale price. In coming to this conclusion, the MSTT relied on the following observations made in the Circular :

“Secondly nothing in the amendment applies or is intended to apply to the deposits received in the ordinary course of business and not in connection of any sale. It may also be clarified that the present amendment will have application only when the deposit is obtained in connection with or incidental or ancillary to a sale. In other words, obtaining a deposit should be relatable to a sale of goods. The amendment will have no impact on receipt of any other type of goods.”

What can be gathered from the above is that in the case of M/s United Breweries, the Supreme Court had categorically held that in sale of beer, there is no sale of beer bottles. This was a case of deciding whether sale of goods entails sale of returnable packing material. The Apex Court concluded that in this particular type of sale there is no intention of selling the bottles and therefore deposits received for them would not be a part of the sale price. The tribunal applied the observations in the case of M/s Pamarox and held that in sale of gas cylinders, there is no sale of cylinders and therefore the deposits would not be a part of sale price, irrespective of the deeming fiction introduced which made deposits a part of sale price.

However, with due regard to the authorities cited, I am of the opinion that the judgements do not apply to the present case at all. In the present case, the applicant has leased the cinema equipment and pays tax on the principle that the right to use of the equipment is transferred. The Lease Act was repealed w.e.f.1.4.2005 and was made a part of the MVAT Act, 2002. Therefore, the definition of 'Sale' as prevailing under the MVAT also includes lease. In the instant case, unlike the duality of beer/ bottles and gas/ gas cylinders, the deposit is to be received for the very product that is leased. In the case of United Breweries the sale was of beer and the deposit was received for beer bottle. In the case of Pamarox, the sale was of gas and the deposit was received for gas cylinders. *In the instant case, the lease is of digital equipment and the deposit is received for digital equipment itself.* In the case of United Breweries, the Apex Court felt that there is no intention to sell the beer bottle. In Pamarox, the MSTT followed suit and impliedly held that there was no intention to sell the gas cylinders. *But in the instant case, there is every intention of the applicant to lease the equipment as the application says in very clear terms.* The security deposit is nothing but an additional consideration for the lease of digital equipment. It is not a case in which the fact whether sale has taken place or not is disputed. In the present case, the fact that the applicant intended to lease the equipment is uncontroverted and lease is included in the definition of 'sale' under the MVAT Act. The deposit was received in addition to the lease rent received for the lease of digital equipment and are received in connection with the lease. The link is direct and inextricable. The deposit is charged by the applicant to provide as a guarantee that the equipment is used carefully by the lessee. Clause D of para No. 3 of the Agreement provides that the deposit shall be refundable after deducting from it any payment owed by the lessee to the lessor. Thus, the security deposit is taken for the lease of the equipment itself. The Explanation III to the definition of sale price includes such 'deposits' in the definition of sale price and therefore the deposits received for the lease of the equipment is a part of sale price.

Therefore, the description in the circular is not applicable for the following two reasons:-

1. This is not a case of sale of returnable packing material. This is a sale / lease of Digital Equipment and the lease deposit is received on the lease of Digital Equipment itself. Therefore, the issue of whether there is sale of packing material or does not arise in the present case.
2. As per the Circular, the amendment was not intended to apply to the deposits received in the ordinary course of business but only to the deposits received in connection with sale. In the present case, the deposits are received in connection to the sale and are not incidental.

A useful reference should be made to the Supreme Court in the case of M/s Britannia Biscuits (96 STC 542) in which it was held that in the sale of biscuits in tins, the refundable deposits taken on 'tins' are a part of sale price. The judgement assumes significance given the fact that at the time of the judgement, the definition of 'sale price' did not even include 'deposits', as in the present case when the Explanation III considerably amplifies the scope of the definition by including 'deposits' in 'sale price' as a deeming fiction. This clinches the matter, so to say. The Explanation III also is the differing factor which does not allow a blind application of the United Breweries (cited supra) judgement- the AP Sales Tax Act did not have any explanation making 'deposits' a part of sale price.

The applicant has posed question No. 2 and 3 as to what would be the treatment at the time of refund of the said deposit after cancellation of leasing agreement and whether the applicant can claim deduction in respect of VAT paid on the security deposits in the year when such deposits are refunded. The Agreement placed before me for determination says in clause 2 under heading 'Term' that the lease shall be for a period of 10 years. Further, clause (D) of Clause 3 under heading 'Security deposit' says that the deposits are returnable at the termination of the agreement. Putting the two clauses together will show that the deposits are refundable after 10 years. Rule 3 of the Maharashtra Value Added Tax Rules, says that the period of refund of deposits for the purposes of clauses (32) and (33) of section 2 shall be six months from the date of the purchase or, as the case may be, the sale. Clause 32 and clause 33 deal with the Turnover of purchases and the Turnover of sales respectively. The deposits refunded by the seller to the purchaser in respect of goods sold by the seller would be reduced from the turnover of sales only if the deposits are refunded within six months of sale. The applicant would not be entitled to deduct the deposits from the turnover of sales as the deposits are refunded after a period of 10 years.

06. In the backdrop of the discussion held herein above, it is hereby ordered that,

ORDER

(Under section 56(1) (d) of the Maharashtra Value Added Tax Act, 2002)
NO.DDQ-11/2007/Adm-2/27/02 Mumbai, dt.26.06.08

1. The deposits received by the applicant in connection with the lease of digital cinema equipment are part of the sale price as per Explanation III to clause (25) of section (2) of the MVAT Act, 2002.
2. The applicant would not be entitled to deduct the deposits from the turnover of sales as the deposits are refunded after a period of 10 years.

SANJAY BHATIA
Commissioner of Sales Tax,
Maharashtra State, Mumbai.

