



Cellular Operators Association of India

**Pre-Budget submission;
Key finance & taxation issues
of the Telecom Sector**

November 2009



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I. Financing for Telecom Projects

The Honorable President of India, in her address to the first session of both Houses of Parliament after the elections to the 15th Lok Sabha had emphasized on the need to **infuse massive resources into infrastructure development so as to enable economic growth**. The Honorable President had stated

“Infrastructure is a fundamental enabler for a modern economy and infrastructure development will be a key focus area for the next five years. Public investment in infrastructure is of paramount importance. Bottlenecks and delays in implementation of infrastructure projects because of policies and procedures, especially in railways, power, highways, ports, airports and rural telecom will be systematically removed.”

*- Address by the Hon'ble President of India to the Parliament
New Delhi, 4th June, 2009*

Accordingly, in the Union Budget 2009-2010, a special thrust has been given by the Honorable Finance Minister to promote funding of infrastructure sector through India Infrastructure Finance Company Limited (IIFCL). **This is a welcome step as it will encourage investment in the infrastructure sector.**

So as to make more funds available for infrastructure sector, the Government has introduced “takeout financing” scheme which shall be evolved by IIFCL and the Government has also decided that IIFCL will refinance 60% of the commercial bank loans for PPP projects in critical sectors.

The Honorable Finance Minister in his budget speech has noted that as a result of the above initiatives, total investment to the tune of Rs 100 thousand crore would be made available for infrastructure projects.

However, we understand that ‘Telecom’ does not fall within the purview of the definition of Infrastructure projects so as to qualify for the above funding from IIFCL. This has been an area of concern earlier as well.

Telecom has been defined as infrastructure sector by various circulars and notifications issued by the RBI and Planning Commission and hence should be treated at par with other infrastructure sectors.

We therefore request that the funding from Indian Infrastructure Finance Company Ltd. (IIFCL) be equally extended to all infrastructure projects, including telecom projects, whether, fixed line, wireless, broadband, Independent Infrastructure Providers (IP-1) etc., for both private as well as public sector projects. And accordingly clear guidelines should be issued so as to facilitate funding for telecom projects from IIFCL. The same will be in line with the stated objectives of the government, including greater penetration of telecom service to rural areas.



II. Uniform Licence Fee Rates

COAI has consistently been representing to the Government that there should be a uniform levy across various telecom licences as the same will not only reduce administrative problems, but also eliminate all concerns regarding arbitrage and enforcement. – thereby protecting revenues to the Government.

At present the revenue share licence fee is prescribed at below:

- at 6% to 10% of AGR for Access Services depending on the category of service area,
- at 6% of AGR for National Long Distance/International Long Distance (NLD/ILD) services, and
- at 6% of AGR for Internet Service Providers for revenues accruing from Internet Telephony Service.

It may be noted that the above license fee is inclusive of a 5% levy for Universal Service Obligation (USO).

It may be appreciated that as service providers increasingly become integrated and with the onset of convergence, the imposition of differential license fee across various telecom services, such as Access, Internet, NLD/ILD etc. is leading to complications and problems in administering, thereby causing concerns regarding possible opportunity for arbitrage or misreporting of revenues

There also exists an anomaly wherein the burden of licence fee is higher on the more capital intensive Access Service, whereas the same is lower at 6% for NLD/ILD services.

The **need for having a uniform Licence Fee has also been recognized and advocated by TRAI as well.** The Authority in its Recommendations on components of Adjusted Gross Revenue (AGR) dated 13th September, 2006, has seen merit in having a uniform license fee across different licences.

“The Authority observed that many service providers are now integrated operators and provide all telecom services. Since licence fee on number of services is charged at different rates, it is possible for the service providers to book revenues in such a manner that licence fee liabilities are minimized. The Authority noted that recently DoT has brought a few services at par for payment of licence fee. **The Authority therefore observed perhaps a uniform rate licence fee regime could obviate the recourse of diverting revenue from one service and booking it to another where incidence of licence fee is lower.**”

*-TRAI Recommendations on components of AGR
dated 13th September, 2006*

- **RELIEF SOUGHT BY COAI:**

In light of the above, we would like to submit that the revenue share licence fee should be prescribed at a uniform rate of 1% of AGR and the same should NOT include the USO levy. The aspect of USO levy should be de-linked from the revenue share licence fee and should be dealt with separately.



III. DIRECT TAXES

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1. Tax Holiday under Section 80-IA

- **Present Scenario:**

Under existing provision, to avail this exemption, services should commence before 01.04.2005.

Present clause (ii) of sub-section 4 of section 80IA states 'any undertaking which has started or starts providing telecommunication services..... on or before the 31st day of March, 2005'

- **COAI RECOMMENDATIONS:**

For the new licences issued after 31st March 2005, this period should be extended upto 01.04.2011.

Proposed clause (ii) of sub-section 4 of section 80IA should therefore state that any undertaking which has started or starts providing telecommunication services... on or before the 31st day of March, 2011.

- **PROPOSAL BY COAI:**

To replace the ending words in Clause (ii) of sub-section 4 of section 80 I A.

“on or before the 31st day of March, 2005”
with
“on or before the 31st day of March, 2011”

- **Rationale/ Benefits:**

- **With the slowdown in economy, the new operators are finding it difficult to achieve financial closure in the absence of this benefit, especially when a corresponding incentives under section 10(23G) was available sometime back directly to the Financial Institutions and the same has been withdrawn since 01.04.2007.**
- This would greatly enhance viability of cellular projects and would thus go a long way in enabling companies to achieve financial closure.
- It will help in providing level playing field for all telecom operators who have been issued licenses by the Government at different times from 1994 onwards till date.
- As the projects become viable and the cellular industry grows, the **Government would not only derive benefits from higher tax revenues but also from the resultant economic growth.**



2. Tax benefit under section 80-IA not available to companies undergoing amalgamation or demerger after 31.03.2007

- **Present Scenario:**

The existing provisions of section 80-IA provide for 100% deduction for ten years in respect of profits and gains of certain undertakings or enterprises engaged in the business of development, operation and maintenance of infrastructure facility, industrial parks and special economic zones or generation, distribution or transmission of power, and similar benefit is proposed for laying and operating a cross-country natural gas distribution network, including gas pipelines and storage facilities being an integral part of the network, etc.

Sub-section (12) of the said section 80-IA, inter-alia, provides that in cases where any undertaking of an Indian company which is entitled to the deduction under the said section is transferred before the expiry of the period specified therein, to another Indian company in a scheme of amalgamation or demerger, the provisions of the said section 80-IA shall apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the amalgamation or demerger had not taken place.

However, the Union Budget of 2007 -2008, inserted a new sub-section (12A) in section 80-IA so as to provide that the **provisions of sub-section (12) shall NOT apply to any undertaking or enterprise which is transferred in a scheme of amalgamation or demerger after 31.03.2007.**

This amendment is effective from 1st April, 2008 and will, accordingly, apply in relation to the assessment year 2008-2009 and subsequent years.

- **Adverse Impact**

- The above step could **result in confusion and disputes** on reorganization of telecom companies in the future.
- Because of the above step, the expansion by the telecom operators by way of acquisitions is likely to become tax inefficient.
- **It cannot be denied in any way that the Government has not been benefitted whether directly or indirectly by the mergers and amalgamations that have taken place in the Industry. Inserting a sun-set clause to the provision would act as a retrograde step in which even the benefit that would have accrued to the Government would also be deprived.**

- **RELIEF SOUGHT BY COAI:**

Tax holiday benefits in case of mergers/ amalgamations should be continued and

The provision should suitably be amended to provide that the benefit of the tax holiday would continue to be available to the undertaking as it would have been available had the amalgamation or demerger not taken place.

Alternatively, Government could bring in the effective provisions to prevent misuse instead of doing away with the provisions altogether.



3. Deduction in respect of Section 80-IA; 100% exemption for successive 10 years out of the 20 years.

- **Present Scenario:**

As per Sub section 2A of Section 80 IA, a telecom operator is entitled to 100% exemption on taxable profits for 5 years and thereafter 30% exemption on profits of next 5 years during the initial 15 years from the date of commencement of commercial operation.

However, for **other infrastructure** sectors as defined under section 80 IA exemption is available to the extent of 100% for the full term of 10 years in succession and these 10 years can be opted from the block of 20 years.

- **RELIEF SOUGHT BY COAI:**

Compared to other infrastructure sectors such as power, the telecom sector has been growing at a much faster pace and has significantly contributed to the economic growth.

Therefore, telecom sector should be given equal importance and should be treated at par with other infrastructure sectors such as power. Benefits applicable to power should be extended to telecom as well.

The period during which 80 IA can be claimed by the telecom operators should be extended to 20 years in place of existing 15 years.

Telecom operators have incurred heavy business losses and significant tax depreciation on account of capitalization in its initial years due to which 80IA benefits have not been triggered by many operators till now.

- **Rationale/Benefits:**

- This step will **result in higher disposable funds for reinvestment in expansion of service.**
- **Any measure that enables expansion of service will also result in much higher tax revenues for the Government.**



4. Deduction of upfront charges paid for 3G / BWA Spectrum

- **Present Scenario:**

Currently any expenditure incurred for acquiring any right to operate telecommunication services (to obtain a licence for rendering such services) is allowed deduction as amortized over the period of the licence as the same is in consonance with the Matching Cost Concept.

Due to varied interpretations adopted at the field level the deduction U/S 35ABB is denied in certain cases on the above allowance.

In the light that the 3G / Broadband Wireless Access (BWA) auctions which are slated to take place during the current financial year, which will involve huge capital outlay, the industry will have to invest huge amounts as upfront spectrum charges and for establishing 3G / BWA networks.

- **PROPOSAL BY COAI:**

To settle this confusion it is recommended that the explanation to Section 35ABB **should include a new sub clause (iv) stating as below:**

“Clause (iv): Licence means to include upfront fee paid for acquiring licence and/ or upfront fee paid for acquiring spectrum”

Rationale/ Benefits

- The grant of deduction u/s 35ABB for the upfront fee paid will be in consonance with the Matching Cost Concept and of amortization of one time expenses over the period of the License.
- Further, the said clarification will also ensure the uniformity in treatment of the said expenditure by both the Tax Authorities and the Industry and will help in mitigating unnecessary litigation on this account.



5. Requirement of PAN/ Form 60/61

- **Present Scenario:**

The total number of telephone connections in the country has reached 442 million as on end April 2009. Out of which, the wireless segment forms almost 91% of the market share and the total wireless subscriber base is over 400 mn subscribers and is targeted to cross 600 million by the year 2010.

Mobile tele-density has increased exponentially and today almost one in every third Indian has access to a telephone.

The affordability of mobile phone has helped in spreading mobile services rapidly across all the strata of the society. The maximum gainers have been the small businessmen and vendors like, vegetable vendors, barbers, electricians, plumbers, etc., who have witnessed significant rise in their businesses owing to the availability of very affordable mobile service.

Further, low tariffs, micro-prepaid, low cost handsets and lifetime packages have lead to an increase in the usage of mobile phones, especially in the rural areas.

Rationale/ Benefits

Many of these low end subscribers and subscribers in the rural areas do not have a PAN number and the same acts as a hindrance towards spread of service.

In this regard, it is pertinent to note that many of these low-end subscribers like, electrician, plumbers, vegetable vendors are NOT income tax assesses. **The requirement of quoting PAN number or the need to submit a declaration in Form 60/61 as per the rule 114 B of the Income Tax Act becomes an inhibitor/hurdle for spread of service to these strata of the society.**

This also creates administrative problems for the service providers and in certain cases it **may lead to these low-end and rural subscribers from being deprived of affordable mobile telecom services.**

- **RELIEF SOUGHT BY COAI:**

In light of the above, the requirement of quoting the PAN number at the time of taking a mobile connection, as per the Rule 114 B of the Income Tax Act has become redundant and should be dropped.

- **PROPOSAL BY COAI:**

To delete clause (g) in 114B of the Income Tax rules.



6. Income Tax Incentives to Independent Infrastructure Providers (IP-1s)

Tax incentives should be provided to Independent Infrastructure Providers so as to ensure that the service provided by them is attractive. The Tax benefits which are available to Access Service Providers should be extended to Independent Infrastructure Providers. The following measures are proposed:

- i. To extend Income Tax benefits under Section 80-IA to Independent Infrastructure Providers.*
- ii. Granting Infrastructure status to Independent Telecom Infrastructure Providers as a separate entry under Section 80-I A (4).*

The Income Tax Act under Sec. 80-I A (4) extends Income Tax benefits to the telecom operators who are developing their own telecom infrastructure. This benefit should also be extended to the Independent Infrastructure Providers as well. **Moreover, this benefit is available to developers of other infrastructure like roads, ports highways, water supply projects.** The above incentives shall lower the cost of services offered by Independent Infrastructure Providers and would thus help in achieving the Government's goal of providing affordable telephony.

Income Tax rules allow each operator to claim depreciation benefits on their capital expenditure. Common network on shared basis would reduce overall depreciation benefits claimed by the Service Providers.

Rationale/ Benefits

These proposals will give a thrust to Infrastructure Sharing in telecom sector and would thus go a long way in enabling faster roll-out of service in rural and remote areas.



IV. INDIRECT TAXES

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1. Levy of 4% Special Additional Duty of Customs (SAD)

- **Present Scenario:**

Presently SAD of 4% can be availed as credit against payment of excise duty on finished products. However, in light of **proviso 3 to sub-rule (4) of rule 3 of CENVAT Credit Rules, 2004**, an output service provider is not entitled to claim credit on SAD against the service tax liability.

While manufacturers are entitled to avail credit of this SAD for payment of excise duty on their finished goods, however, telecom operators being service providers are NOT eligible to avail credit of this 4% SAD. Hence, the 4% SAD is an added cost on the telecom service providers.

- **PROPOSAL BY COAI:**

To insert the following wordings in the above said proviso as stated below;

“.... except for the said proviso is not applicable in case of telecommunication service provider”

Rationale/ Benefits

- Telecom Services, inspite of being highly capital intensive industry, is not able to claim CENVAT Credit of SAD against the Service Tax liability on Output Services.
- We believe that the intention of the SAD is NOT to increase the cost of service, but to provide level playing field, which is why the facility of set-off has been provided.
- It is thus submitted that so as to ensure affordability of service, the SAD paid by telecom service providers should be allowed to be availed as credit against payment of service tax liability of cellular mobile service providers.
- It may be appreciated that Radio/Switching/Transmission Equipment, both backbone and access, is integral to Cellular Mobile Network and therefore increase in cost of these items would translate into an increased cost of service for the subscribers and hence go against the objective of speedy spread of affordable service.



2. Simplification of taxability of telecommunication services for its effective distribution

- **Present Scenario:**

Telecommunication industry offers business opportunity for millions of persons (known as distributors) across India. Telecom operators give certain amount of commissions; allow trade margins etc. to its distributors for doing business with them. Currently, the provisions of Service tax provides for:

- Individual registrations, charging, collection and payment of service tax by all these Distributors.
- It is administratively very difficult to ensure collection & payment of service tax by all these distributors on monthly basis.
- Also a very high percentage of these business persons are small time business units who don't even cross the annual threshold limit of Rs. 10 Lacs to get themselves registered under the Service tax provisions.

The telecom operators pay the service tax to the Government on the maximum service charge which includes all trade margins offered to the distribution channel resulting into payment of service tax on the entire telecom service offerings. **Thus, there is no revenue loss to the Government as the industry is already paying the service tax on the maximum service charge of its service offerings**

Relief Sought:

Appropriate changes should be made in the Finance Act, 1994 to allow the telecom industry to discharge service tax liability on distribution margins. Similar relief has been granted to the insurance industry which also involves a huge distribution force whereby the onus has been put on the insurance companies to discharge service tax on distributor/associate margins.

- **The above can also be achieved by issuing a letter similar to B-11/1/2000-TRU dated July 9, 2001 – Annexure VI.**
- **The relief sought is similar to the one provided to millions of insurance agents & the applicability of service tax on their income under the Insurance Auxiliary Service and will not have any revenue implication.**

Rationale/ Benefits

The above change is more beneficial for the Government from revenue perspective in following ways than the currently followed provisions:

1. Service tax is already being recovered by the Government on the full value and there is no loss to the exchequer.



2. A huge percentage of telecom products' distributors actually don't fall under the service tax charging category i.e, they don't cross the threshold limit of Rs. 10 Lacs / annum, thus don't pay any service tax to the Government.
3. Administratively it will become much easier for the Government to monitor, track & collect service tax from a very few business units, which is much easier to manage.
4. It shall help remove the cost of compliance for small self employed people in the distribution chain and encourage self employment without any fears.



3. Tax exemptions for contributions towards Universities and Centers of Excellence

So as to enable and encourage innovation, R&D and development of new applications, the industry should be encouraged to make contributions towards these initiatives taken by various Universities and Centers of Excellence based in India. It is thus requested that:

1. The contributions (from telecom operators, industry, others) made to various Universities and Centers of Excellence should be exempted from service tax.
2. Income tax deductions should be allowed to the corporates for making contributions to the Centers of Excellence and other such R&D initiatives undertaken by the Universities.