

Revised Final Report

**Incidence of Taxes and Levies on
Telecom Sector in India**

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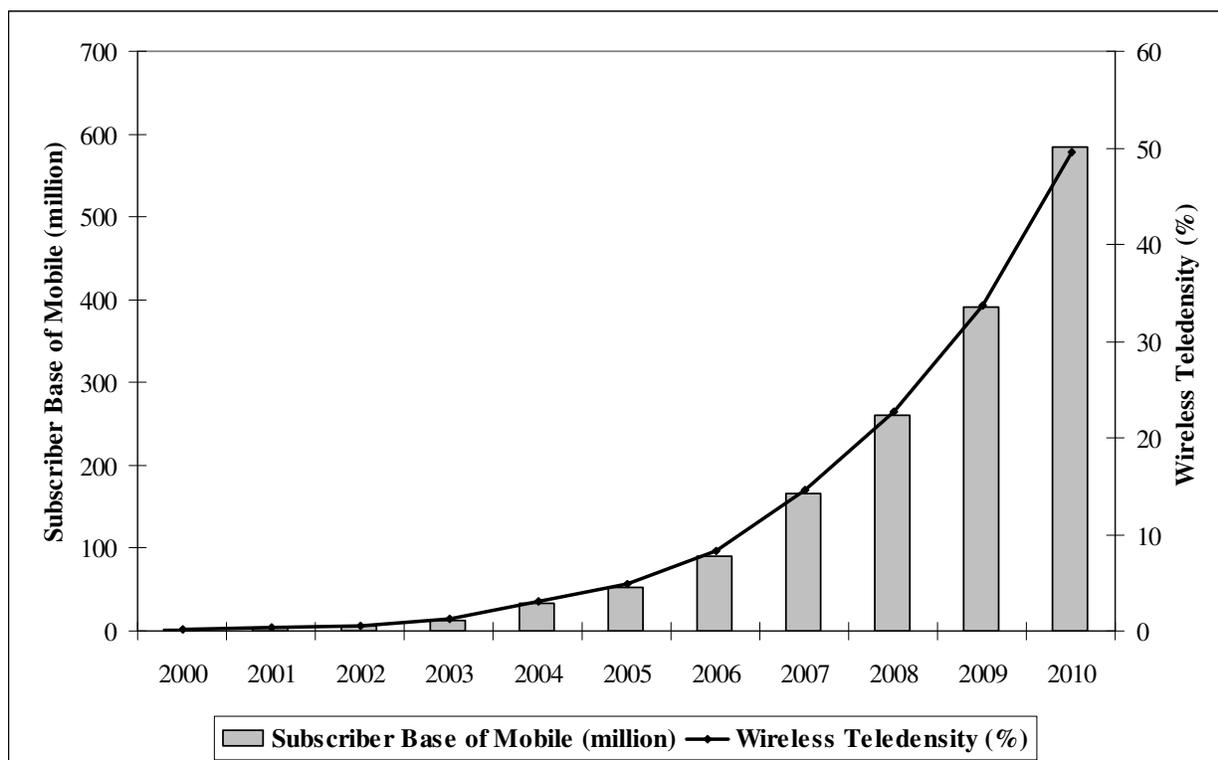
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1. Introduction to the sector

The telecom sector in India is one of the fastest growing sectors in the country. From 28.55 million subscribers in the year 2000, the subscriber base of telecom (fixed line and mobile) has gone up to 621.28 million in 2010. The combined tele-density of fixed line and wireless has gone up from 2.81 per cent in 2000 to 52.74 per cent in 2010. The subscriber base of mobile services alone has gone up from 1.9 million in 2000 to 584.32 million in 2010, showing a Compounded Annual Growth Rate of 79.8 per cent. With 584.32 million subscribers, the mobile services have now achieved a tele-density of 49.6 per cent (see Figure 1 below).

Figure 1: Subscriber Base of Mobile Services and Tele-density of Wireless



Data Source: Compiled from TRAI's Quarterly Reports

One of the major drivers of such a rapid penetration of mobile service in India is the competitive telecom tariff. The average tariff has gone down from ` 1.02 per minute in Quarter Ending (QE) March 2005 to ` 0.30 per minute in QE September 2010 for GSM and from ` 1.00 per minute in QE March 2006 to ` 0.26 per minute in QE September 2010 for

CDMA. On the other hand, the average usage (measured in terms of average minutes of usage) has increased initially and then began declining. For GSM the decline begins from QE September 2008, while for CDMA, the decline begins much earlier in QE December 2007. These trends translate into a fairly consistent decline in the average revenue per user – an indicator often monitored and reported by the sector.

Table 1: Basic Statistics - Telecom Sector

Quarter Ending (QE)	Minutes of Usage (MOU) (minute)		Average Revenue per User (ARPU) (₹)		Telecom Tariff (₹ / Minute) (ARPU/MOU)	
	GSM	CDMA	GSM	CDMA	GSM	CDMA
QE MAR 05	394	N.A.	400	N.A.	1.02	N.A.
QE JUNE 05	358	N.A.	390	N.A.	1.09	N.A.
QE SEP 05	367	N.A.	375	N.A.	1.02	N.A.
QE DEC 05	393	462	370	N.A.	0.94	N.A.
QE MAR 06	366	256	366	256	1.00	1.00
QE JUNE 06	352	228	352	228	1.00	1.00
QE SEP 06	425	413	337	215	0.79	0.52
QE DEC 06	454	424	316	196	0.70	0.46
QE MAR 07	471	471	298	202	0.63	0.43
QE JUNE 07	476	462	297	206	0.62	0.45
QE SEP 07	462	413	275	173	0.60	0.42
QE DEC 07	464	375	261	176	0.56	0.47
QE MAR 08	493	364	264	159	0.54	0.44
QE JUNE 08	505	354	239	139	0.47	0.39
QE SEP 08	499	332	221	122	0.44	0.37
QE DEC 08	496	370	220	111	0.44	0.30
QE MAR 09	484	352	205	99	0.42	0.28
QE JUNE 09	454	342	185	92	0.41	0.27
QE SEP 09	423	308	164	89	0.39	0.29
QE DEC 09	411	318	144	82	0.35	0.26
QE MAR 10	410	307	131	76	0.32	0.25
QE JUNE 10	401	299	122	74	0.30	0.25
QE SEP 10	368	283	110	73	0.30	0.26

Note: N.A. – implies information not available

Source: Compiled from TRAI's Quarterly Reports

The estimated share of telephones (public and private sector together) under communication sector was 2.8 per cent of GDP in 2008-09. The estimated share of

telephones in GDP at factor cost (at 2004-05 prices), has gone up from 1.5 per cent in 2004-05 to 2.8 per cent in 2008-09.

Table 2: Share of Telecom Sector in Gross Domestic Product (GDP) at factor cost (at 2004-05 prices) (` Crore)

Year	Telephones	All Sectors
2004-05	45,650 (1.5)	2,967,599
2005-06	56,872 (1.8)	3,249,130
2006-07	71,850 (2.0)	3,564,627
2007-08	92,720 (2.4)	3,893,457
2008-09	117,249 (2.8)	4,154,973

Note: Figure in the parenthesis shows the percentage share in GDP

Source: Computed from Central Statistical Office (2010), "National Accounts Statistics 2010", MoS&PI, GoI, New Delhi.

Discussions on the sector often suggest that this is a capital intensive sector – the Tenth Plan Document indicates a capital output ratio of over 7 for this sector as compared to less than 4 for the economy as a whole. The capital costs include what is referred to as passive infrastructure in the form of towers as well as active infrastructure.¹ In the initial years, the telecom companies themselves had captive towers with only a few pure infrastructure operators like GTL Infrastructure. India reportedly, has around 330,000 towers and it is anticipated that another 130,000 towers will be required during the next 3 years. With a view to unlocking value and reduce cost of operations, many mobile operators have hived off their tower infrastructure, which in the industry parlance is known as ‘passive infrastructure’. The demerged units have then formed Joint venture as in the case of Indus Towers Ltd., which is a joint venture of Bharti Airtel, Idea, and Vodafone.²

¹ Active infrastructure includes goods like Base tower station, Microwave radio equipment, Switches, Antennas, Transceivers for signal processing and transmission, etc.

² Vodafone’s effort to demerge its infrastructure activities has come unstuck because of the Gujarat High Court turning down its request, inter alia, on the ground of alleged tax avoidance. However, recently, the Delhi High Court on identical facts has upheld the scheme without making any reference to the Gujarat High Court’s decision.

In India, the share of subscribers across telecom service providers is skewed and as on November 2010, a group of six companies (Bharti Airtel, Reliance, Vodafone, BSNL, Tata and Idea) accounted for 87.9 per cent of the total subscriber base. However, with the introduction of Mobile Number Portability (MPN) throughout the country from January 2011, it is expected that the share of the different players might undergo change.

Table 3: Market Shares of Major Telecom Companies

Company	Circles	Subscribers (million)	Market Share (%)
Bharti Airtel	Pan India	149	20.6
Reliance Communications	Pan India	122	16.9
Vodafone	Pan India	121	16.8
BSNL	20 Circles	83	11.5
Tata	Pan India	82	11.4
Idea	Pan India	78	10.8
Aircel	Pan India	48	6.6
MTNL	Delhi, Mumbai	5	0.7
Uninor	Pan India	16	2.2
Sistema	Pan India	7	1.0
Videocon	Pan India	6	0.8
Loop	Pan India	3	0.4
Stel	6 Circles	2	0.3
Etisalat	15 Circles	0.1	0.0
Total		722.1	

Source: The Times of India, New Delhi, January 31, 2011

While the sector has made considerable progress, the penetration of telecommunication in rural areas is still low at only 24.29 per cent in 2010. The penetration of broadband in India is even lower – 10.31 million subscribers as on September 30, 2010. Compared internationally, we have a lot of ground to cover. The National Broadband Policy, 2004 proposed a plan to implement an increase in broadband coverage to 20 million connections by 2010 (TRAI, 2010).³ TRAI has proposed revised targets of 75 million by 2012 and 160 million by 2014.

³ Telecom Regulatory Authority of India (TRAI) (2010), "Recommendations on National Broadband Plan", December 8, 2010. Available at:

Further, to achieve hundred per cent tele-density through mobile service alone, the sector needs to add another 593.7 million subscribers. To achieve these targets, the service providers need to concentrate on the rural sector. In order to help the sector to achieve these targets, an assessment of the fiscal environment faced by the sector is called for. Needless to say, a conducive fiscal environment can stimulate the growth of the sector. With this aim in view, the Telecom Regulatory Authority of India (TRAI) has commissioned a study to the National Institute of Public Finance and Policy (NIPFP) to examine these issues and suggest measures to address the potential concerns that have been identified.

2. Terms of reference for the study

The National Institute of Public Finance and Policy has been requested by the Telecom Regulatory Authority of India, to undertake a study on the Incidence of taxes, levies and fees on the Indian Telecom Sector. The issues to be covered in the study are:

1. Various types of taxes applicable to the telecom sector in India including direct and indirect taxes, etc., the rates and basis of charging, quantum of taxes collected from the sector
2. Various types of charges and levies applicable to the telecom sector in India, the rates and basis of charging, the total quantum of payout by the Industry on this account, etc.
3. Comparative analysis of the system and the practices followed in imposition of taxes, charges and levies on the telecom sector in other parts of the world particularly in developing countries, highlighting international best practices
4. Role of regulatory in this regard in the other parts of the world
5. Recommendations for restructuring of the tax structure applicable to the telecom sector in India

In taking up this study, the TRAI agreed to coordinate the collection of information from the service providers. With a view to capture data on the revenues and liabilities on account of various taxes, through the TRAI, the Institute circulated a proforma to the telecom companies. Eighteen companies responded to the request for data and provided completed forms. A number of such companies were, however, new companies with very little revenue from the telecom services. Further, inconsistencies were also found within the data provided. For instance, in the case of some companies, it was found that the amount of service tax (as given in the proforma) was greater than what would be payable at the statutory rates of taxes. While numerous attempts were made to get clarifications or cleaner data, so far, the team has been able to get some worthwhile data from only three companies (see Annexure 1 for the details of meetings conducted with TRAI and Telecom Companies). It was reported that the companies found it difficult to collate data on the

various heads of expenditures as required by the study team. For instance, it was indicated that unless there is an option for claiming input tax credit, most companies do not keep track of expenditure on indirect taxes explicitly/ separately. If a telecom company were to pay charges to a local body for setting up towers, the information is not captured in its information system since for the company, these would be a sunk cost. In the process, companies reported their inability to cull out figures for various levies such as Value Added Tax, Entry Tax and Central Sales Tax, which are paid to states on inputs purchased as well as Customs Duties paid on imported inputs. It may be mentioned here that even the annual reports of these companies do not contain the details of these taxes.

In the process, while representatives of companies were quite keen to discuss the nature of levies on the sector, the study team has been able to obtain some corresponding data for only three companies – Bharti Airtel, BSNL and Vodafone. However, considering the fact that it was not possible to cross-check the data provided to ensure that these are mutually comparable across the three companies, as also given the fact that there was considerable unease amongst the companies in divulging data on their actual operations, the study team has opted to largely utilize the data available in the public domain. In the absence of such data, it has not been possible to examine the impact of such levies on the bottomline of the companies operating in this sector. To the extent the discussion could be supplemented by the figures available from the annual reports of the companies, the same have been duly incorporated.

The report is organized as follows. The next section presents a brief discussion of the levies that this sector faces. This is followed by a discussion of the impact of these taxes on the revenues or profits of this sector (section 4). The following section presents an assessment of the sensitivity of revenues of the telecom sector to changes in prices. If the demand for a service or good provided by an industry/ sector is very sensitive to changes in prices, changes in taxes can have significant impact on the demand for the service. If price elasticities are higher than one, a change in price would induce a more than proportionate change in revenues, whereas if the elasticity is less than unity, the change in revenues would

be less than proportionate (section 5). Section 6 discusses some of the critical issues that the sector faces in terms of taxation and the possible options for change available within the present regime. Since there is a proposal to replace a number of the existing indirect taxes with a comprehensive Goods and Services Tax (GST), section 7 provides an assessment of how this can impact the sector and identifies some critical issues that need to be spelt out in how GST would apply to this sector. Since any concern of excessive tax liability can be assessed either in comparison with other sectors within the country or with the same sector internationally, such a comparison is attempted in section 8. Section 9 provides a comparative discussion of the role of the regulators internationally, in determining or influencing tax policy for the sector. The last section summarizes the conclusions and recommendations of the study.

3. Description of the nature of levies on the sector

The telecom sector, like most other sectors in the economy, faces a number of government levies. While some of these are in the nature of user charges or fees for getting access to scarce spectrum resources, the others are in the form of taxes on the inputs used by this sector as well on the services provided by this sector. Further, in the face of the emerging nature of the sector – where the services provided are expanding at a rapid pace – there is a continuously evolving scheme of taxation as well. Various levels of government are exploring the potential of bringing some or all of the activities connected with this sector within the ambit of their respective power of taxation. Today therefore, the services component of the sector faces the following taxes:

- **Income tax liabilities** - Corporate tax rate at present for companies including those from the telecom sector is 33.99%.⁴ The Direct Taxes Code proposes to bring this down to 30% by abolishing surcharge and cess. While the current Minimum Alternate Tax (MAT) rate of 18% is proposed to be increased to 20%, the period of carry forward of MAT credit has been proposed to be increased to 15 years. Currently, business loss is allowed to be carried forward for 8 years. Under the proposed DTC, depreciation and loss can be carried forward infinitely.

The Telecommunication sector has been getting liberal benefits for quite some time. Starting from 1997, telecom companies are getting benefit in respect of their profit under Section 80IA of the Income Tax Act. In the year 2000, the benefit was due to expire but this has progressively been extended from time to time. However, in the same year, a sub-section (2A) was introduced and the quantum of benefit to the companies in the sector was reduced and the deduction is now available to telecom companies in respect of 100% of their profits for the first five years followed by 30% of the profits for the next 5 years as compared to 100% of the profits for 10 years which

⁴ Assuming that the taxable income of the companies exceed ` 10 million, otherwise the same is 30.9%

is available to other infrastructure companies. The benefit is available to companies that commence business before 2005. Of course, the taxpayer has the choice of selecting the years from out of the 15 years.

Two further issues within the purview of income tax that have been flagged by the telecom companies as an issue of concern, are

- **Issue of Tax deduction at source in the context of inter-connect charges:** In the case of *Commissioner of Income Tax vs Bharti Cellular Limited*, the issue of tax deduction at source in respect of interconnect charges was examined by the Supreme Court of India.⁵ In this case, Bharti had entered into interconnect agreement with BSNL/MTNL. The Income Tax Department took the view that the port services using sophisticated technology qualify as technical services in terms of Explanation 2 to Clause (vii) of Section 9(1) of the Income Tax Act, 1961 (ITA) and hence tax should have been deducted at source u/s 194J of the ITA. When the matter reached the Supreme Court, it wanted the tax department to examine through expert evidence as to whether at any stage of the process any human intervention takes place. The Court had given the Assessing Officer (TDS) four weeks to examine a technical expert from the side of the Department and then decide the matter within four months. It is gathered that the Department has examined some experts and has taken the view that there indeed was human intervention. It is also learnt that the taxpayer proposes to challenge the finding in appeal.
- **Amortization of one time spectrum fees:** Telecom companies have to pay a one-time fee to the regulator, especially in the case of auctioning of spectrum rights. Under section 35ABB of the Income Tax Act, any capital expenditure incurred for acquiring right to operate telecom even before the commencement of the business would be amortized over the life of the license. No depreciation can however be claimed. The companies make a case for treatment of this cost as a deductible expense. While both the treatments return the capital invested to the company, since the time profile is different, the company bears the cost of financing this expense.

⁵ *M/S Bharti Airtel Ltd Vs State of Karnataka & ors*[2009-TIOL-36-SC-VAT]

- **Service tax on services provided:** The Central Government levies a tax on services provided by this sector. The rate of tax currently is 10 per cent with an education cess of 3 per cent. It has been brought down from a higher level of 12 per cent as a part of the stimulus package introduced in response to the 2008 global slowdown.
 - a. Limitations in tax credit rules: The law provides for exemption of services provided to certain users. The tax credit rules make it costly to provide such services – the service provider is required to maintain separate accounts for inputs used for exempt and taxable services, in order to avail tax credit for taxable supplies. Since the service providers in this sector tend to provide both taxable and exempt services, they would be able to avail credit for taxes paid on capital goods. However, for all other inputs, either in the form of goods or services, if the service provider fails to maintain separate accounts, they have to pay 5 per cent of value of the exempted services and get the credit (see section 6 of this report for details)
 - b. Since the central service tax does not apply to the state of Jammu and Kashmir, the state government has decided to levy a service tax which covers telecom services along with a few other services (all together 14 services). The rate of tax is 10% and surcharge is 5%.⁶ Discussions with the telecom operators suggest that there is considerable litigation about this levy, since the service providers have not collected the tax and hence cannot remit it to the state government. In this case, as well as in some other levies discussed here, there is an apprehension that the tax would be collected with retrospective effect and this can seriously undermine the finances of the companies.
- **Customs duty/ excise duty** on goods purchased and used for the provision of these services: while the bulk of the goods imported by this sector face low or no basic customs duty (BCD),⁷ the countervailing duty (CVD) in the form of additional customs duty and Special Additional Duty (SAD) continues to apply.
 - a. While there is tax credit available for the excise duty component of the tax and for the additional customs duty, there is no mechanism of credit or setoff for the primary customs duty (if applicable) or for the SAD. Since no country

⁶ Notification No. SRO 117, dated March 30, 2007, Government of Jammu & Kashmir.

⁷ Capital goods for telecom sector generally attract zero basic customs duty under the Information Technology Agreement of WTO.

provides tax credit for basic customs duty, the telecom sector in India would fare comparably with that in most other countries on this count. As regards additional duty to counterbalance states taxes, it was imposed to ensure that while domestic goods attract VAT, imported goods also should be subjected to some corresponding duty. Since VAT credit is allowed against sale of goods but not for supply of services, the SAD is also given the same treatment. Credit is allowed against excise duty but not for supply of services, which is a stranded cost for the telecom companies.

- b. The extent of credit available for input used for setting up towers however is being disputed – the issues relates to whether towers are movable or immovable property and on whether setting up a tower is a process of manufacture.⁸
- **VAT or entry tax** on the inputs used by this sector: since the services in this sector require the presence of transmission towers and other equipments in varied locations, the states expect to derive some revenue from such procurements. Often, in order to avoid higher local taxes, companies resort to procuring out of the state and paying only CST. However at the point of entry into the state, a number of states seek to impose and recover entry taxes. Since telecom services per say, are not taxable under state VAT, it appears that there is no way to recover these taxes, through the input tax credit mechanism.
 - **VAT or entry tax on the SIM cards and the recharge coupon vouchers** sold by the service providers: since these transactions take the form of a “good” – (SIM card or a piece of paper) in return for a consideration, States have taken a view that these should be taxed on the full value they command in the market. However, since the inputs used to provide these “goods” are not related to the inputs used by the sector, there is no tax credit mechanism for recovering the input taxes suffered by the sector.

⁸ The Base Transceiver Station Towers are not covered under the definition of “capital goods” as given in the Cenvat Credit Rules, 2004. Consequently, telecommunication service providers are not eligible for Cenvat credit under the Cenvat Credit Rules, 2004 while discharging Service Tax liability on telephone services provided by them (COAI: <http://www.coai.com/docs/Budget%20-BTS%20towers%20representation.pdf>, Dated: December 10, 2004).

- **Tax on “broadband services”** provided by the companies: Karnataka initiated the process of charging a VAT on the value of services provided as broadband services. While the other states too are emulating this approach, it is still being contested in the courts of law. Apart from conceptual issues of whether such a supply should be taxable within the ambit of taxation of goods, the operational issue is that since these taxes have not been collected by the companies, it could severely undermine their bottom lines, particularly if implemented with retrospective effect.
- For the services provided in the form of Value Added Services (VAS), the potential of attracting **entertainment tax** is arising. Once again, since this would be a separate levy, taxes paid on the vouchers can remain independent of the tax on services accessed through the vouchers. This would result in double taxation of the same transactions.
- Since the infrastructure supporting the telecom services has to be located in local bodies, the latter are now devising ways of taxing the installation of these infrastructure units, be it the laying of fibre optic cables or setting up of transmission towers. These charges are determined separately by each of the local body concerned and therefore there is no basis or reason for uniformity or convergence. For instance, while Kolkata charges ` 1 lakh per new tower, Delhi charges ` 5 lakh per new tower, and Jaipur charges only ` 25,000 per tower for new towers and the same as rent for old towers. Further, since these levies are not related to the levies by other levels of government, they tend to become sunk costs for the operators. In addition, any advertising may face **charges for billboards** etc.
- Further, with the location of a tower, the **property tax** status of a property could be turned into part commercial, in which event the liability of property tax could be higher. It would, however, depend on the nature of the lease contract, and on whether the liability is passed forward or retained by the lessor.

It may be noted that of the levies described above, most would also be borne by units functioning in any of the other sectors. All other services would be subject to service tax but not sales tax. Manufacturing sectors would be liable to central excise and sales tax. So far as

levies by local bodies are concerned, levies relating to property tax, advertising and fees relating to shops and establishments would be applicable to all other sectors. However, where the telecom sector differs from the others is in the following areas:

- 1) **The evolving nature of levies on this sector:** Given that this is a relatively new and rapidly growing sector, the issues of taxation for this sector are not yet settled. All levels of government are exploring ways of bringing in this sector within the ambit of taxation. It would be fair to argue that this contributes to an unstable tax environment for this sector.
- 2) Since the form of service delivery in the sector requires the establishment of a wide network of service points (transmission towers, fibre optic network, etc.) this sector, unlike a number of other sectors, cannot undertake a strategic location of its business. As a result, the sector has to face and comply with wide variations in the levies imposed at the sub-national level. Whether these add substantially to the cost or otherwise, it is clear that these levies could impose significant compliance costs, more so if they change very frequently.

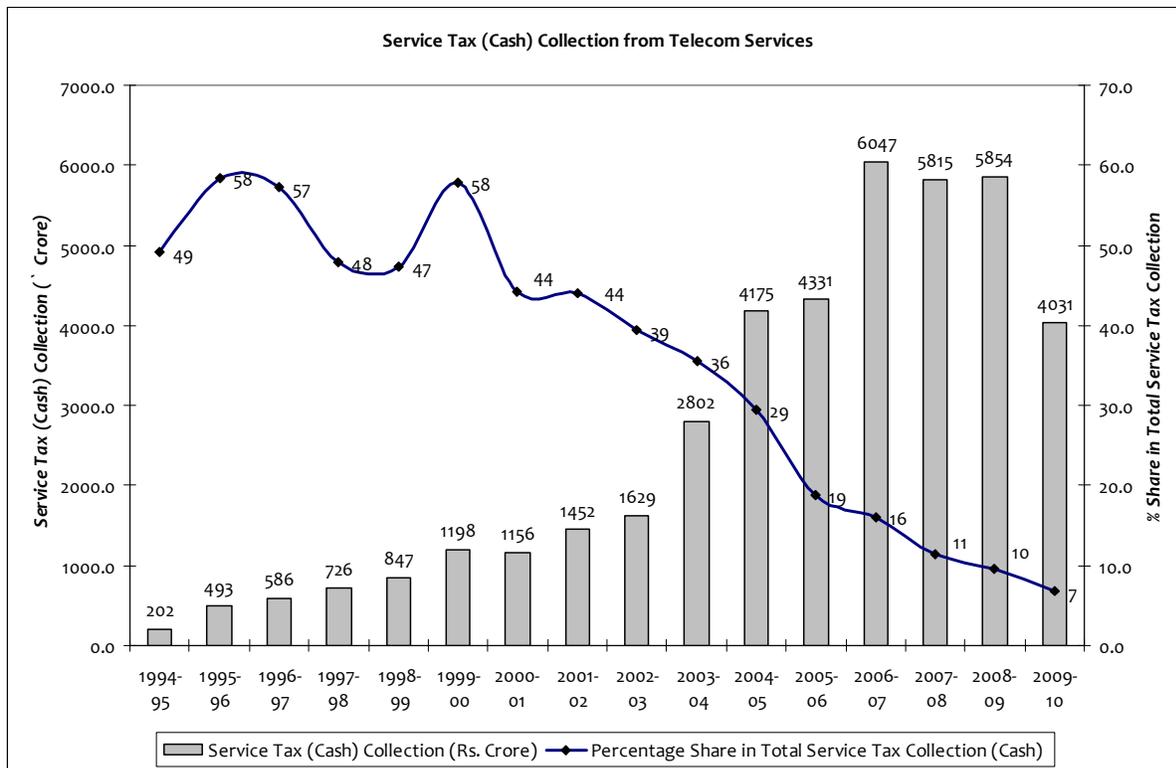
As discussed above, some of these levies tend to add to the cost of service delivery. It is therefore important to understand the dimensions of the extent of blocked taxes. Using data that is available in the public domain as well as data made available by some of the companies in the sector, the following section summarizes the impact of taxes on the companies in this sector.

4. Impact of taxes on the telecom companies

Service Tax

Telecom service is one which attracted service tax right from the introduction of service tax in India in 1994-95.⁹ The telecom service sector comprises basic telephone service (both wireline and wireless), pager services, telegraph services, telex services, facsimile and leased circuit services. The rate of service tax was increased from 5 per cent when initially introduced to 8 per cent in 2003-04 and subsequently to 10 per cent in 2004 and to 12 per cent in 2006. As a part of the fiscal stimulus package introduced in response to the global economic crisis, the rate was reduced to 10 per cent in 2009. Currently, this tax is topped up by 2 per cent education cess and a further 1 per cent secondary education cess.

Figure 2: Service Tax (Cash) Collection from Telecom Services



Data Source: DGST (2006, 2011) and TRU (2008)¹⁰

⁹ The number of services covered under the service tax has gone up from 3 in 1994-95 to 117 in 2009-10.

¹⁰ Directorate General of Service Tax (2006), "Annual Performance Report 2005-06", DGST, Mumbai.

Under the CENVAT Credit Rules, 2004, CENVAT credit is available for telecom companies for utilization across goods and services and therefore, the net service tax payment for a telecom company depends on the availability of CENVAT credit. Since CENVAT credit is available on capital goods purchased as well, the cash component of the tax paid, i.e., the net tax liability is expected to be relatively high for older companies when compared to new entrants in the sector. Since telecom sector is capital intensive, the CENVAT credit component will be high in years following substantial capital procurement.

Total cash disbursement (net payment of service tax) for the telecom sector has gone up from ` 202 crore in 1994-95 to ` 4,031 crore in 2009-10. The highest collection of service tax from the telecom service sector was ` 6,047 crore in 2006-07 (see Figure 2). The share of service tax collection from this sector has, however, gone down since 1999-00 due to inclusion of large number of services under the tax net to expand the base of service tax – net service tax collection has gone up from ` 410.6 crore in 1994-95 to ` 58,454 crore in 2009-10.

The payment of service tax through utilisation of CENVAT credit is considered to be substantial. Information on utilisation of CENVAT credit by the telecom service providers is not available in the public domain. Given that the extent of credit available to different companies would be different, the information provided by the telecom companies cannot be generalised to the entire sector. However, in order to understand the extent of credit available and estimate a range of CENVAT credit component of total service tax payment by the telecom companies, we construct three scenarios, based on our discussion with telecom companies and information provided by two telecom companies. In scenario I, the service tax liability met through CENVAT credit is taken as 45 per cent (this is the approximate level reflected in the information provided by one of the oldest service providers in the sector, for the year 2009-10). In scenario II, the service tax payment through CENVAT credit is 62 per

Directorate General of Service Tax (2010), "Annual Performance Report 2009-10", DGST, Mumbai.
Tax Research Unit (2008), "Indirect Taxes: Statistical Data", CBEC, Dept. of Revenue, MoF, GoI, New Delhi.

cent for 2009-10 and 59 per cent for 2008-09 (based on actual information for an established player in the sector). In scenario III, we assume that the service tax payment through CENVAT credit lies between 70 to 75 per cent (this figure relates to a company which has expanded operations in recent times, reflecting the higher levels of CENVAT credit availability). The variations of CENVAT credit component in total service tax payable across telecom companies are large and the three scenarios considered here adequately captured the range of this variation. For telecom companies, CENVAT credit pool will vary depending on their procurement of taxable goods and services (including capital goods) (subject to payment of excise duty and service tax) and import of goods (subject to payment of additional customs duty). Corresponding to the three alternative scenarios, we estimate the payment of service tax through utilization of CENVAT credit. The actual collection of service tax through CENVAT credit will vary depending on the structure and composition of the service sector, in terms of existing and new investments. The bifurcation of the CENVAT credit component into two baskets – a) CENVAT credit corresponding to capital goods procurement and b) CENVAT credit against procurement of goods and services other than capital goods and services – is not possible within the present state of information available in the public domain on service tax, or on the operations of the service providers.

Table 4: Estimation of Service Tax Collection from Telecom Companies through Cenvat Credit

Alternative Scenarios	Service Tax Payment Through CENVAT Credit (%)		Service Tax Collection from Telecom Companies (` Crore)					
			Cash (actual)		CENVAT Credit (estimated)		Total (estimated)	
	2009-10	2008-09	2009-10	2008-09	2009-10	2008-09	2009-10	2008-09
Scenario I	45 [*]	45 [#]	4,031	5,854	1,475	9,168	7,329	10,644
Scenario II	62 [*]	59 [*]	4,031	5,854	4,754	9,524	10,608	14,278
Scenario III	75 [#]	70 [#]	4,031	5,854	10,270	9,243	16,124	19,513

Notes: *-implies based on information provided by the telecom companies and #-implies assumed

Data Source: DGST (2006; 2011) and data provided by telecom companies

Direct Taxes

Like other companies, telecom companies are subject to corporate income tax and the rate of tax is the same for all. The effective tax rate (ETR) for direct tax is presented in Table 5. The ETR for companies under public sector is higher than their private counterparts and for service providers the ETR is higher than the manufacturing companies.

Table 5: Effective Tax Rate* of a Sample of Companies under Public and Private Sectors:
2008-09 and 2009-10

	Effective Tax Rate (in % of PBT)	Effective Tax Rate (in % of PBT)
Sector	2008-09	2009-10
Public	27.14	25.36
Private	21.56	23.03
Total	22.77	23.58
Manufacturing	21.97	23.40
Service	23.53	23.77
Total	22.77	23.58

Note: *- Effective tax rate is inclusive of surcharge and education cess

Source: Table 3 and 4, *Revenue forgone under the Central Tax System: Financial Years 2008-09 and 2009-10 and 2009-10 and 2010-11* (<http://indiabudget.nic.in>)

In order to understand the effective impact of taxes on the companies in this sector, Table 6 summarizes the relevant information from the annual reports of five of the major telecom service providers. The provision for direct taxes - considered a proxy for the actual tax liability of the company - when viewed as a percentage of profit before taxes, shows considerable variation across companies. In fact there are two companies for which the ratio is greater than the statutory rate of tax. This could be the result of some back taxes being

provided for. For the other companies, the effective rate of tax is considerably lower than the statutory rate of tax of 35 per cent. Alternatively, if provisions for current tax are viewed as a percentage of service revenue, the figures range from about 1 per cent to over 5 per cent. Given that telecom service providers had access to tax concessions in the form of section 80IA, the actual liability of companies in the sector is expected to be lower than the statutory liability. This incentive however is now coming to an end, and the liabilities are therefore expected to increase somewhat over time.

Table 6: Tax Liabilities reflected in Annual Reports of the Telecom Companies

Description	Unit	Year	Reliance Comm.	TATA Comm.	Bharti Airtel	BSNL	IDEA Cellular
Service Revenue	(` Crore)	2008-09	22250.5	9963.2	37232.8	30169.4	10116.9
		2009-10	21496.4	11025.6	41729.5	27913.4	12365.0
Profit Before Tax (PBT)	(` Crore)	2008-09	6196.7	422.8	8591.0	1271.6	939.1
		2009-10	5222.8	-681.2	10895.4	-2197.5	1075.4
Provision for Current Tax	(` Crore)	2008-09	32.8	179.4	1040.0	1323.2	127.3
		2009-10	344.3	92.9	2128.5	0.0	216.7
	(% of PBT)	2008-09	0.5	42.4	12.1	104.1	13.6
		2009-10	6.6	-13.6	19.5	0.0	20.2
	(% of Service Revenue)	2008-09	0.1	1.8	2.8	4.4	1.3
		2009-10	1.6	0.8	5.1	0.0	1.8
Power and Fuel Expenses	(` Crore)	2008-09	841.9	174.0	2724.3	1780.0	555.7
		2009-10	1509.4	207.8	3597.4	2030.6	1009.1
	(% of Service Revenue)	2008-09	3.8	1.7	7.3	5.9	5.5
		2009-10	7.0	1.9	8.6	7.3	8.2

Data Source: Annual Report of the Respective Company

Customs Duty

In addition to the above, the sector also has some liabilities in the form of customs duties on all goods imported for the provision of services. While the tariffs have been reduced considerably in recent times on items specific to the sector, there still remain some liabilities on this count. While the annual reports of the companies do not provide information on the amount of liability, unless the liability is disputed, some information made available by a few of the companies indicate that **customs duties as a percentage of service revenue is between 0.5 and 4 per cent**. Since the companies can get tax credit for apart of the customs duty paid as additional customs duty, the extent of unrecovered taxes would be lower. Since the basic customs duty for most capital goods imported for the telecom sector is zero (under Information Technology Agreement of WTO) apart from additional due to counter balance excise, the customs duty payments by these companies would largely include additional duty to counterbalance state taxes, which are levied at a maximum rate of 4 percent. With the average excise duty at 10 percent, the unrecovered taxes in customs duty would be in the range of 28 percent of the amount paid. As a percentage of revenue, this would be between 0.1 and 1 percent of revenue. Even taking a more moderate assumption that 50 percent of the duties paid are sunk costs for the telecom companies (for which no input tax credit is available), customs duties as a percentage of service revenue will be 0.25 to 2 per cent. It may be mentioned that where a company is expanding operations, the scale of investment would be larger and hence its imports and accordingly the corresponding liabilities for customs duties would be larger, especially since the revenue stream from the investments will not yet be reflected in the services revenue of the company. For a company that has stabilised its scale of operation, the corresponding ratios would be correspondingly smaller. In the Table 7, Company A represents a mature company while Company B represents an expanding company. For the completely new entrants without any significant user base, the ratio can be even higher, but as the user base expands and the company stabilizes, the ratio is expected to reduce.

Table 7: Impact of State Taxes, Local Government Taxes and Custom Duty on Telecom Companies

Description	Year	Company A	Company B
Service Revenue (` Crore)	2008-09	32,061	20726.3
	2009-10	37,349	23385.8
State Taxes Paid (` Crore)	2008-09	134	384.8
	2009-10	68	349.9
State Taxes Paid (% of Service Revenue)	2008-09	0.42	1.86
	2009-10	0.18	1.50
Local Government Taxes Paid (` Crore)	2008-09	47	N.A.
	2009-10	52	108.4
Local Government Taxes Paid (% of Service Revenue)	2008-09	0.001	--
	2009-10	0.001	0.005
Custom duty (BCD) & others	2008-09	211	285.3
	2009-10	182	864.2
Custom duty (BCD) & others (% of Service Revenue)	2008-09	0.66	1.38
	2009-10	0.49	3.70
State Taxes, Local Government Taxes and Customs Duty Paid (` Crore)	2008-09	392	670
	2009-10	301	1,323
State Taxes, Local Government Taxes and Customs Duty Paid (% of Service Revenue)	2008-09	1.22	3.23
	2009-10	0.81	5.66

Data Source: Data Provided by the Telecom Companies

State Taxes

Apart from the central taxes discussed above, State governments collect VAT on a variety of purchases made by the companies as well as on some supplies by the companies. In terms of supplies, VAT would normally be applicable on all goods supplied by the company. In some of the states, there is a levy applicable on SIM cards and Recharge Coupon Vouchers (RCVs). Further, on all goods purchased by the companies, there would be a liability of VAT/ Sales tax. In some states there is an additional levy of entry tax on all goods brought for use into the state as well. Since the services provided by these companies are not subject to tax under state VATs, there is no possibility for availing input tax credit in respect of the taxes

paid on such expenses. Hence these costs become a part of the sunk cost for the companies. The annual accounts of companies do not provide information on any of the indirect taxes paid by them. Hence, the only source of information on the extent of liability on this account is that provided by the companies. In providing this information, the companies have mentioned that since the data is not separately captured in the information systems of the companies, the information provided is at best an approximation of the actual liability. This information is captured in the Table 7. As reflected in the table, **state taxes as a percentage of total service revenue vary between 0.2 per cent and 2 per cent.** This difference could result either from differences in the way the approximation was obtained, or as a result of differences in the capital expenses as a proportion to revenues in any given year. If purchases of capital goods are higher, the VAT liability too would be higher. Here, it should also be mentioned that, these numbers reflect only the actual taxes paid by companies. Wherever there is a dispute in the nature or amount of liability, those amounts are not reflected in these figures.

An alternative approximation of the state taxes on telecom companies can be obtained by looking at the head of expenditure called “power and fuel” expenses. The taxes on this head of expenditure are once again a sunk cost for the companies, and should be included in any assessment of the total sales tax/ VAT liability of the company. The figures provided in Table 6 suggest that for most of the companies, expenses on “power and fuel” account for 7-8 per cent of total service revenue. If the tax is assumed to be 12 per cent, then the tax liability would be close to one per cent of service revenue. This alone suggests that the figures reported in Annual Report by one of the companies (see Table 6), is possibly an underestimate.

To sum up, the numbers suggest that the liability on account of state taxes is not large, especially when compared to the central taxes. However, as would be discussed in following sections, there is a significant degree of uncertainty in the extent of liability, and the emerging picture might involve higher liabilities, if some or all of the issues are settled in favour of the state governments.

Municipal Taxes

Entry tax, octroi, right of way charges and tower charges are some of the charges that local governments collect from the telecom companies. Entry tax and octroi if applied on goods purchased for service delivery, as well as right of way charges and tower charges are in the nature of one time levies. This would mean that in years in which any given company undertakes large scale expansion, the company would bear a liability on this account. In years with relatively small expansion, the correspondingly liability will be lower. The information in the annual accounts for any individual company for a single year would therefore not be a good reflection of the extent of liabilities on this account.

The information on the above charges is not available from annual reports of the telecom companies. Since, these charges are one time payment to local governments and cannot be set off against other taxes (input tax credit is not permissible), information on these charges is not maintained by the telecom companies. With the outsourcing of tower infrastructure to other companies or telecom infrastructure providers, the extent of levies explicitly borne by primary service providers is undergoing some change as well. From the information for the two companies for which some data is available, the share of **local government charges as percentage of service revenue constitutes a miniscule portion - between .001 and .005 per cent of service revenue** (see Table 7).

For an overall summary of the impact of the taxes, for the companies for which some data was available, the average impact can be summarized as follows: direct taxes account for somewhere between 1 and 5 per cent of total revenues, while indirect taxes account for somewhere between 14 to 19 per cent. Of this amount, the extent of cascading taxes, as reflected in the data for the two companies for which more details are available, is between 1 and 2 per cent of total revenues. In addition disputed taxes account for 1 to 2 per cent of total revenue of these firms. However, the levies on account of license fee and spectrum charges are considerably higher than those on account of these taxes.

5. Elasticities of telecom demand

The concerns of a sector in terms of taxation are often related to the sensitivity of the demand to variations in prices. For services or goods which have a relatively inelastic demand, any change in the price would not result in proportionate change in the revenues earned. However, if the demand is elastic, i.e., elasticity is greater than one, then for a percentage point change in revenue, the fall in demand is expected to be large enough to induce a net reduction in the revenues earned by the company. In sectors faced with very volatile and sensitive demand, the sector could potentially articulate a case for rationalization or lowering of taxes and tariffs in the interest of the consumer as well as the government. Corresponding to every level of elasticity, it can be shown that there is a rate of tax, which optimizes revenues. Higher the elasticity, lower is the corresponding level of optimal tax.

In order to assess whether the demand for telecom sector is sensitive to prices, a pooled equation was estimated (see Table 8). The demand for telecom services and average telecom tariff is defined as follows:¹¹

$$\begin{aligned} (\text{Demand for Telecom})_{\text{GSM|CDMA}} &= (\text{MOU} \times \text{No of Subscriber})_{\text{GSM|CDMA}} \\ (\text{Telecom Tariff})_{\text{GSM|CDMA}} &= (\text{ARPU} \times \text{Subscriber}) / (\text{MOU} \times \text{Subscriber})_{\text{GSM|CDMA}} \\ &= (\text{ARPU} / \text{MOU})_{\text{GSM|CDMA}} \end{aligned}$$

Therefore, the price elasticity of Telecom Service is defined as:

Ratio of natural logarithm of $(\text{MOU} \times \text{No of Subscriber})_{\text{GSM|CDMA}}$ and natural logarithm of $(\text{ARPU} / \text{MOU})_{\text{GSM|CDMA}}$

We introduced two dummies with the following details:

Dummy = 1 for QE December 2007 and after
0 otherwise

Tech = 1 for CDMA
0 for GSM

¹¹ MOU – Minute of Usage; ARPU – Average Revenue per User

The equation is estimated using quarterly information on MOU, ARPU and number of subscribers both for GSM and CDMA, collected from the "The Indian Telecom Services Performance Indicators" released by the TRAI. For GSM, data on MOU, ARPU is available from QE March 2005 to QE September 2010. For CDMA, data on MOU and ARPU is available from QE December 2005 to QE September 2010. Data on subscriber, both for GSM and CDMA, is available from QE September 2006 to QE September 2010. For QE March 2005 to QE June 2006, data on total (both GSM and CDMA) subscribers is available and we have bifurcated the total subscribers into GSM and CDMA by using the ratio of the same for QE September 2006. Data on quarterly estimate of GDP at factor cost (at 2004-05 prices) is available from RBI and CSO.

The representation of the equation estimated is as follows:

$$\ln(\text{MOU} * \text{No. of Subscribers}) = \alpha + \beta_1 * \ln(\text{ARPU} * \text{MOU}) + \beta_2 * \text{GDP/GDP}(-1) + \beta_3 * \text{Dummy} + \beta_4 * \text{Tech} + \beta_5 * \text{Dummy} * \ln(\text{ARPU} * \text{MOU}) + \beta_7 * \text{Tech} * \ln(\text{ARPU} * \text{MOU}) + \beta_8 * \text{Tech} * \text{GDP/GDP}(-1) + \varepsilon$$

Where, ε is the error term and α, β s are coefficients

The results suggest that the demand for telecom services is sensitive to prices – the elasticity of demand for GSM services is 2.11, indicating that for every percentage point increase in the price of the service, the demand for the service would decline by 2.11 percentage points. Further, this also indicates that the revenue from this service would decline by more than one percentage point. On the other hand, the sensitivity of CDMA services is distinctly lower, at 1.36. Here too, the demand for the services would decline with an increase in the price, and the decline in revenue from a one percentage point increase in price is only about 0.36 percentage points. Further, while incomes are expected to play a role in determining the demand for this service – high growth in income should induce an expansion in the subscriber base, this variable does not seem to actually be of much importance, at least in the period being analyzed.

Table 8: Regression Results

Dependent Variable:	Ln(MOU*Subscribers)	Ln(MOU)	Ln(Subscribers)
Independent Variables	Coefficient	Coefficient	Coefficient
Constant	10.202 *** (0.275)	5.861 *** (0.131)	4.342 *** (0.296)
Ln(ARPU/MOU)	-2.113 *** (0.111)	-0.527 *** (0.043)	-1.586 *** (0.128)
GDP/(GDP(-1))	-0.235 (0.233)	0.048 (0.131)	-0.284 (0.247)
Dummy	0.629 *** (0.075)	0.607 *** (0.068)	0.022 (0.084)
Tech	-1.091 *** (0.068)	-0.405 *** (0.041)	-0.685 *** (0.093)
Dummy*Ln(ARPU/MOU)	0.692 *** (0.088)	0.98 *** (0.08)	-0.288 ** (0.109)
Tech*Ln(ARPU/MOU)	0.751 *** (0.077)	-0.192 *** (0.047)	0.943 *** (0.099)
Tech*GDP/(GDP(-1))	0.751 *** (0.077)	-0.192 *** (0.047)	0.943 *** (0.099)
Number of Observations	41	41	41
R2	0.991	0.924	0.985
Adjusted R2	0.989	0.91	0.982
Durbin-Watson Stat	0.817	1.573	1.037
F-Stat	591.508	68.802	362.51
Prob(F-stat)	0.000	0.000	0.000

Note: Figure in the parenthesis shows the estimated White-heteroscedasticity corrected standard errors. *** & ** - implies estimated t-stat is significant at 0.01 and 0.05 level respectively.

Table 9: Regression Results – Disaggregated across Technologies and Periods

Dependent Variable (1)	Period 1					
	Ln(MOU*Subscribers) (2)		Ln(MOU) (3)		Ln(Subscribers) (4)	
Technology	GSM	CDMA	GSM	CDMA	GSM	CDMA
Constant	10.202	9.111	5.861	5.456	4.342	3.657
Ln(ARPU/MOU)	-2.11	-1.36	-0.53	-0.72	-1.59	-0.64
GDP/GDP(-1)	-0.24	0.52	0.05	-0.14	-0.28	0.66
Period 2						
Constant	10.831	9.74	6.468	6.063	4.364	3.679
Ln(ARPU/MOU)	-1.42	-0.67	0.45	0.26	-1.87	-0.93
GDP/GDP(-1)	-0.24	0.52	0.05	-0.14	-0.28	0.66

Source: Derived from above regression results

Apart from the overall trend, since the trends in MOU suggest a decline in both CDMA and GSM services, in early 2008, it is important to know whether the underlying elasticities too changed during this change. In order to capture this effect, the second dummy (time dummy) variable was used. From the Table 9, it is evident that there is some change in the elasticities as well – both the elasticities have declined, such that the elasticity for CDMA for post 2008 turns out to be less than unity. In other words, an increase in the tax in this period would reduce demand by only about 0.67 percentage points in response to one per cent increase in price. The revenue from this service would not decline with an increase in the price. In the case of GSM services, the elasticity is about 1.42, indicating that the revenue from these services does remain sensitive to changes in prices.

In order to understand whether the observed results are led by the trends in number of subscribers or by the average demand per subscriber, the same equation was repeated for MOU as well as number of subscribers. These results are reported in columns three and four of the Table 9. These results indicate that while the overall results remain the same, there are a few differences. If one considers MOU as the variable being explained, changes in prices do lead to a reduction in the demand for GSM, and even more so for CDMA. In this case, CDMA subscribers emerge as being more sensitive to changes in prices. On the other hand, if one considers the number of subscribers, GSM numbers do respond negatively to change in prices – a decline in prices would encourage an expansion in the number of subscribers. This response is significantly muted in the case of CDMA. For a one percentage point decline in prices, the response from CDMA subscribers is only about 0.64 per cent, as against 1.59 per cent in the case of GSM. Further, unlike in the case of MOU, the number of subscribers is more sensitive to changes in prices to the post-2008 period as compared to the pre-2008 period. A reduction in price brings in more customers post-2008, while the MOU per customer is less sensitive to changes in prices during this period.

In terms of its relevance to the discussion on taxes, it would appear now, that a reduction in taxes, if passed forward as lower prices by the companies, would not result in major expansions in MOU, but could bring in more than proportionate number of subscribers. It

should however be mentioned that the data utilized for this analysis refers to only five years. For a more robust analysis, a long time series should be utilized.

6. Assessment of significant issues and options

1. Should the sector be treated as providing goods or services?

Within the present assignment of tax powers, the right to tax manufacturing and services is assigned to the Union government and the right to tax sale of goods is assigned to the state governments. In the context of telecom services, there is a degree of confusion in classification of these services. While the Union government taxes them under service tax, the state governments have been attempting to identify parts/services/transactions that can be termed as sale of goods, so that they can tax as well. Some of the important attempts by state governments to expand the scope of activities taxable under state taxes and the resulting disputes are summarized below.

- a. The first case in the realm of disputed tax base relates to whether the rentals that are collected by the Department of Telecom should be taxable under the state sales tax act (in this case UP Sales Tax Act). The Supreme Court of India upheld the right of the states to levy sales tax on fixed line telephony.¹²
- b. The next case relates to the mobile phone sector, where states contended that the "goods" element in telecommunication was the electromagnetic waves by which data generated by the subscriber was transmitted to the desired destination, and hence taxable by the states.
 - i. In the case of SIM cards and sometimes in the case of recharge coupons however the states have been able to levy a sales tax. The recent verdict of the Supreme Court (*Commissioner of Central Excise, Cochin vs. IDEA Mobile Communication Limited*) does not preclude the state governments to levy taxes on the value of SIM cards as sale of

¹² For details of the related cases see Appendix 1

goods but allows the Central government to put service tax on the value of the SIM cards.¹³

- c. The third major attempt to expand the base by the states has come through the efforts of the Commercial Taxes Department of Karnataka, on broadband services. The High Court of Karnataka has ruled in favour of the Commercial Taxes Department, and has made the entire revenue from broadband assessable under Karnataka VAT Act. While this case is still being contested in higher courts of law, any such levy can substantially impact the service providers in the sector, more so if the levy is sought to be introduced with retrospective effect.

The above discussion illustrates the need for some clarity in the coverage of taxes, the demarcation between the coverage of sales tax on goods versus service tax. While this could also be considered an ideal example of the need to move from the present assignment of tax powers to a more generalized Goods and Services Tax, until such time the transition to the proposed regime is implemented, there is need for some other mechanism to achieve some clarity on this front. The present approach of expanding the tax base creates two difficulties for the sector –

- The service providers are expected to pay taxes on transactions where the taxes have not been recovered from the subscribers. The consequences for the companies can be substantial if the governments seek to assess these transactions to tax on a retrospective basis.
 - The above would also apply to the levy of General Sales Tax by the Government of Jammu and Kashmir on telecom revenues.
- There would be persistent uncertainty on what additional liabilities could be brought under the tax net – this contributes to an unstable tax environment. While it is difficult to infer whether these measures would affect the investment or growth of this sector, it is not conducive to the overall business environment.

¹³ 2011-TIOL-71SC-ST (Dated 4 August 2011)

Two measures that can be explored for easing the concerns on these fronts are

1. Where effectively new levies are being proposed or hitherto unrecognized taxable activities are being recognized, the sector should ask for a mandate that the tax would be payable only prospectively.
 - a. The tax departments should be asked to issue guidelines for sectors where they perceive a taxable activity or transaction. This would reduce litigation and provide more predictable environment both for the tax payers and the administrators. This is beyond the normal purview of provisions like advance ruling.
2. An alternative mechanism for obtaining a sectoral advance ruling can be for the sector to ask for a joint review of the sector by both levels of government and clear definition of the taxes leviable on this sector. There could be a periodic review since the activities in this sector are expected to expand quite rapidly. In principle, this can be expanded to other sectors as well, where there are any contentious issues or perceived expansion in coverage.

2. A Tax credit for state taxes:

Apart from issues concerning uncertainties on the tax base within state taxes, representatives of the telecom sector discussed at length, the numerous levies and the resultant sunk cost for the companies concerned. The state taxes paid by the telecom companies can be divided into the following categories:

- VAT and entry tax paid on inputs purchased by the sector
- VAT and entry tax paid on SIM cards and recharge vouchers
- Central sales tax paid on goods procured from other states.

The first set of levies applies to purchases by the companies for the provision of services. In the present scenario, these taxes are considered sunk costs since there is no mechanism available to recover these costs. To the extent these costs get capitalized and realized through depreciation allowances in income tax, the extent of sunk costs is the interest cost of financing these purchases, until such time these costs are recovered through the route of

depreciation. The second category relates to levies that are potentially billed to the customer and hence realized. These could not legitimately be considered sunk costs. The third category, i.e., central sales tax paid on procurement from outside the state, is a tax that accrues to the exporting state. This would be a sunk cost. Most states attempt to levy entry tax to disincentivize such procurement or centralized procurement, since this reduces the tax base of the state into which the goods are imported.

Although this is a tax regime that all sectors face, the difference between other goods sectors and the telecom sector is that the dealers of goods have the option of claiming input tax which the telecom sector does not seem to be invoking. Since the inputs bought by the companies are utilized in order to provide the service that is utilized through the purchase of SIM cards and recharge vouchers, it is very important to ask the question - why no tax credit is availed for the taxes on inputs against the taxes collected on SIM cards and recharge vouchers. The principle of value added tax suggests that taxes paid on any inputs that are used by the dealer in the taxable activity can be setoff against taxes collected on the taxable transactions. It is important to establish that the inputs purchased are used for the supply of the service underlying the SIM cards and the recharge vouchers.

The entry tax charged in states, includes two types of levies. One set of levies is introduced in order to protect the tax base in the state – often firms or individuals choose to procure goods from outside the state, by paying only Central Sales Tax and avoiding state VAT. Usually, under the state VAT laws, a taxable dealer can claim input tax credit for such entry taxes, if there is a subsequent taxable transactions. The second kind of entry taxes was introduced to find revenues to replace octroi. The state VAT laws do not allow input tax credit for this levy. If a case can be established for allowing input tax credit for inputs against taxes collected on SIM cards and recharge vouchers, the first kind of entry tax too can be covered.

3. Central tax credit on towers

One of the critical and contentious issues with respect to central indirect taxation of this sector is the refusal of input tax credit in respect of CENVAT paid for procuring the materials required to set up towers for providing services.¹⁴ The issue has a checkered history.

The issue began with the contention by the Central Excise Department that towers are distinct from the material from which they are assembled and hence the process of setting up a tower should be called manufacture and since the towers can be dismantled and/or moved, they can be classified as goods and hence should be subject to Central Excise. The CESTAT as well as the High Court of Bombay struck down this interpretation, the former on the ground that the towers by themselves were not marketable and the latter on the ground that they were not movable.¹⁵

In the second round, the dispute related to Cenvat credit. Some of the service tax assesses had availed Cenvat credit on towers and parts of towers, as capital goods for the purpose of the output service. Taking a cue from the High Court's order in the earlier case, the CBEC took the view that these items are used for erecting towers and making housing/ storage units and cannot be called excisable goods being attached to earth and not used for providing taxable service. Therefore the Board took the view that credits of duty paid on these items are not available to the telecom service providers.

Recently, on appeal from the Bharti Televenture case, the Mumbai High Court has held that whether construction of a tower on which antenna is mounted constitutes capital goods or

¹⁴ This is an issue which applies to structure in general. After the change in definition of inputs (Notification No. 3/2011-CE(NT) dated 1 March 2011), it is clear that no credit is admissible of the excise duty paid on any goods used for – a) construction of a building or a civil structure or a part thereof; or b) laying foundation or making structures for support of capital goods, except for the provision of any taxable service specified in sub-clauses (zn), (zsl), (zsm), (zzq), (zzzh) and (zzzza) of clause (105) of section 65 of the Finance Act. So far as renting of towers is concerned, the service tax paid on such renting is admissible for credit.

¹⁵ See Appendix 1 for details

not was not the question considered earlier.¹⁶ Accordingly, the High Court in its order [dated November 18, 2010] directed the CESTAT to dispose off the appeal along with other pending appeals without any pre-deposit within a period of six months. So, by May 2011 there should be a definitive pronouncement on the issue at least from the CESTAT.

The scenario, in the meantime, evolves further, where the tower part of the activities of the telecom companies are being hived off into separate businesses. These “passive infrastructure” providers provide the bare tower, i.e., the passive infrastructure to the telecom service providers for a fee. This rental is subject to service tax. In the case of the passive infrastructure providers, their core activity is to provide these towers for hire. Clearly, they cannot provide these for lease, if they are not setup and maintained. For the business of these companies therefore, these would constitute the inputs.

While the debate on moveable and immovable, and on cenvatable or otherwise is playing itself out, the core essence of the principle of value added tax is lost sight off. In cases where real estate transactions are not a part of the tax base, the leasing of property too cannot be a taxable transaction. If on the other hand, real estate transactions like the rental of a property are sought to be brought within the tax net, it is important to provide input tax credit for inputs that are used to provide those services.

In this light it would appear now, that with cross-credit flows between cenvat and service tax, it would be in the interest of the companies if the towers can be called excisable goods and further as excisable capital goods. A review of the sector by the Central Excise Department should therefore be requested. A clear policy decision in this regard would not be conferring undue benefits on the sector – it would in fact clear the field of a tenuous argument. This review can be part of an overall review of taxation for this sector as well, as proposed in the last sub-section.

¹⁶ 20011-TIOL-35-HC- Mum –ST

4. Limitations on service tax credit

The bulk of telecom services are subject to service tax. There are however some exemptions. These exemptions can be classified into two categories:

- Exemptions provided to service providers – small service providers with taxable turnover less than Rs 10 lakh can avail of exemption from tax
- Exemptions to supplies to specified users: these include export of supplies, as well as supplies to SEZ units and developers, and Technology Business Incubator (TBI) and Science and Technology Entrepreneurship Park (STEP) and units therein, as well as to foreign diplomatic missions.

In the first category, the service provider would not be entitled to claim any input tax credit. In the second case as well, an exemption would mean that the suppliers would not be allowed to claim input tax credit for taxes paid on the inputs or input services. In the case of exports to SEZs and general exports, the export of services rules provides for input tax credit subject to some conditions. The notification in the case of supplies to SEZ based users prescribes that in such cases, the service tax paid would be refunded.

In case a supplier has both exempt and taxable supplies, the CENVAT Credit (Amendment) Rules, 2011 (Notification No. 3/2011-CE(NT) dated 1 March 2011) prescribe that in order to claim input tax credit for taxes paid on inputs and input services, the supplier is expected to maintain separate records of inputs and inputs services used for these two supplies.

Rule (6), Sub-rule (2) reads that - with effective from 1 April 2011

(2) Where a manufacturer or provider of output service avails of CENVAT credit in respect of any inputs or input services and manufactures such final products or provides such output service which are chargeable to duty or tax as well as exempted goods or services, then, the manufacturer or provider of output service shall maintain separate accounts for-

(a) the receipt, consumption and inventory of inputs used-

- (i) in or in relation to the manufacture of exempted goods;
- (ii) in or in relation to the manufacture of dutiable final products excluding exempted goods;
- (iii) for the provision of exempted services;
- (iv) for the provision of output services excluding exempted services; and

(b) the receipt and use of input services-

- (i) in or in relation to the manufacture of exempted goods and their clearance upto the place of removal;
- (ii) in or in relation to the manufacture of dutiable final products, excluding exempted goods, and their clearance upto the place of removal;
- (iii) for the provision of exempted services; and
- (iv) for the provision of output services excluding exempted services,

and shall take CENVAT credit only on inputs under sub-clauses (ii) and (iv) of clause (a) and input services under sub-clauses (ii) and (iv) of clause (b).

Alternatively, if separate accounts cannot be maintained, then the amount of tax credit that can be claimed is guided by the following:

Rule (6), Sub-rule (3) reads that -- with effective from 1 April 2011

(3) Notwithstanding anything contained in sub-rules (1) and (2), the manufacturer of goods or the provider of output service, opting not to maintain separate accounts, shall follow any one the following options, as applicable to him, namely:-

- (i) pay an amount equal to five per cent of value of the exempted goods and exempted services; or
- (ii) pay an amount as determined under sub-rule (3A); or

(iii) maintain separate accounts for the receipt, consumption and inventory of inputs as provided for in clause (a) of sub-rule (2), take CENVAT credit only on inputs under sub-clauses (ii) and (iv) of said clause (a) and pay an amount as determined under sub-rule (3A) in respect of input services. The provisions of sub-clauses (i) and (ii) of clause (b) and sub-clauses (i) and (ii) of clause (c) of sub-rule (3A) shall not apply for such payment:

Provided that if any duty of excise is paid on the exempted goods, the same shall be reduced from the amount payable under clause (i):

Provided further that if any part of the value of a taxable service has been exempted on the condition that no CENVAT credit of inputs and input services, used for providing such taxable service, shall be taken then the amount specified in clause (i) shall be five per cent of the value so exempted.

With reference to credit against capital goods, the sub-rule (4) of rule (6) clearly mentions that capital goods are partly used for taxable services, Cenvat credit will be available.

(4) No CENVAT credit shall be allowed on capital goods which are used exclusively in the manufacture of exempted goods or in providing exempted services, other than the final products which are exempt from the whole of the duty of excise leviable thereon under any notification where exemption is granted based upon the value or quantity of clearances made in a financial year

From discussions with the service providers, and the limited data made available to the study team, it appears that the extent of service tax paid through utilization of credit is in the range of 45 to 75 per cent of total service tax payable. If there are exempt supplies, clearly there would be a significant blocking of credit. This could result in a disincentive to the company to provide exempt services. If the above is not the desired outcome of the

provisions in the rules, two alternative routes can be explored, without undermining the commitments made in terms of exempt services:

1. all the transactions can be taxed, and the receiver of the services can claim refund of input taxes from the government
 - a. this would increase the benefits provided to the users, since the refund would be of all input taxes – this would be akin to zero-rating
2. the extent of tax credit available for setoff can be in proportion to the share of taxable transactions in total supplies by the supplier. If the exempt transactions account for 10 per cent of the total supplies, the input tax credit to the extent of 10 per cent of total taxes on inputs and input services can be denied.

Either of these options would reduce the resulting distortions. It should however be mentioned that in the case of export of services, zero-rating is expected to be the preferred route since the user of the service cannot claim a refund from the government. If a supplier is supplying only zero-rated services, taxable services and no exempt services, since full input tax credit would be available, insistence on maintenance of separate accounts for purchases could be dispensed with. Cross utilization of credit would also ease administration as well as compliance.

5. Some rationalization of local body charges for towers

One of the other charges which are receiving a lot of press in recent times is the charges/ fees being levied by local bodies for the installation of the transmission towers. The rates vary and have been hiked quite substantially by some local bodies in an attempt to find a lucrative source of money for financing their activities. Apart from being a fee that gets embedded/ sunk into the costs of service provision, the tower charges by local bodies too are an evolving set of fees. Not only are there increasing number of local bodies entering the arena to collect such fees, sometimes the extent of fees collected by the local bodies can increase quite substantially. Delhi for instance, sought to increase the fees from ` 1 lakh per tower for a period of 20 years to ` 5 lakh per tower for a period of five years.

As can be seen from Table 7, the amounts paid towards these charges do not appear large. However, with claims of significant number of illegal towers by the local bodies and complaints of “very heavy fees”, by the companies, it would appear that the revenue considerations of the local bodies can be balanced with concerns of appropriate reporting by the companies themselves.

For every tower to be setup, the company concerned is expected to intimate the Department of Telecommunications and pay the Standing Advisory Committee on Radio Frequency Allocation (SACFA) a fee of ` 1000, for getting a clearance. Since the location map of the proposed tower is intimated to the committee, in order to avoid issues of supposed non-compliance with respect to local levies– illegal towers – such documentation of sanctioned towers can be made available on demand and/or easily accessible to states and local bodies. Alternatively, it can be dispatched electronically by the SACFA secretariat to the respective states, so that the local bodies concerned too can take action on the matter.

On the other hand, keeping the interests of the telecom companies in perspective, streamlining the procedures to reduce cost of compliance as well as rationalizing the levies are important. One mechanism for reducing the cost of compliance can be to centralize, at least for a circle, the payment of levies. Since the information on towers is centrally generated through the approval process of SACFA, the list can be passed on to a relevant

authority at the circle, who can be assigned the task of collecting and remitting the charges for all the local bodies. In cases where the circle overlaps with a city or with a state, the issue is relatively easy to visualize. It could be somewhat more complex if there are multiple states within the jurisdiction of a single circle. On the rationalization front, it is tempting to think along the lines of a standardized rate for all local bodies in a state for instance, but since this is a charge or fee raised by the local bodies, this would be unacceptable and an unviable alternative to pursue. The alternative route is to explore the possibility of a lower levy on an annualized basis. This would provide an annualized and consistent source of revenue to the local bodies and reduce the extent of liability for the companies concerned in any given year.

6. Issues of concern within Income Tax

While the study team does not find major areas of concern within the ambit of income tax, there are a number of issues often flagged by companies or associations related with the sector. In this sub-section, an attempt is made to highlight the reasons why the desired treatment might not be forthcoming. There is a consistent change in Income Tax Policy, where the government is opting for investment based incentives rather than profit based incentives. Further, unless there is an eventuality of crisis in any given sector, there is an attempt to refrain from introducing special treatment for any of the sectors concerned. In this light, many of the elements of what may be called the “wish-list” of the sector, do not meet with the present Tax Policy approach. Given the overall need for a stable and consistent tax environment, there is very little merit in asking for a sector specific policy. It is therefore, the view of this study team that the desired treatment by the sector, does not conform to any norms of direct tax policy nor is it in line with the adopted stance of the government. This study therefore does not attempt to identify ways of addressing these “demands”. The following table summarizes some of the reasons why.

Table 10: Income Tax Wish-list: An Assessment of Possibilities

Desired Treatment	Present Treatment	Case for Why Not?
80IA should provide benefit to telecom sector at par with other infrastructure facilities	80IA(2A)- 5years 100%, next 5 years 30%	Telecom has been enjoying the benefit of deduction for over two decades now. It is a developed sector. These benefits are given for nascent industries, those involving long gestation period and heavy capital investment. The Government seems to be of the view that the sector having come of age does not require any more fiscal prop. The reduction was done for a phased withdrawal of the benefits
	Extend from 5 years to 10years	The stated policy of the government is to move from profit based to investment based incentives, in the sectors where incentives remain. Therefore, the variable of importance here is not number of years any more.
Identification of undertaking	Each road is an undertaking. In case of	-----Do-----

Desired Treatment	Present Treatment	Case for Why Not?
	<p>telecom, it is difficult to identify undertaking. Increase in level of penetration in an area already serviced is not recognized as undertaking.</p> <p>Expansion of undertaking by fresh investment of greater than a threshold (10%of capital employed) should qualify.</p>	
Extension of the date of setting up	From 31.3.2005 to 31.3.2011	The telecom sector in India is considered an aggressive and mature sector, which was willing to pay significant amounts when bidding for spectrum. Where the sector is extending its services into “uneconomical” areas, the USO provision provides for support. It is therefore, no further rationale for providing tax incentives to this sector.
Extension of 80IA to companies undergoing amalgamation or demerger after 31.3.2007		The measure was introduced as an anti-abuse measure although no specific reason is given.
Continuance of benefits in case of slump sale	Continuance of benefits in case of slump sale has not been provided	These are matters of interpretation- not specific to a sector.
Clarification on TDS w.r.t interconnect user charges	Interconnect user charges are not technical services but payments for allowing call from one service provider to another. Should not be subject to 194J	Supreme Court has already directed the Government to clarify the position.
TDS on reimbursements	Reimbursement is not	These are anti- abuse measures. Moreover in case of genuine reimbursement, there should not be a

Desired Treatment	Present Treatment	Case for Why Not?
should be discontinued.	income	problem.
MAT should not be charged on Infra companies	Alternatively MAT may be charged if return on capital employed is greater than 16%(say)	The special position of infrastructure sectors relates to the issue of long gestation lags and the possibility of not realizing the returns on capital invested. Since MAT would apply only on book profits, the company would need to have crossed the above stages before it becomes liable for MAT. To the extent the rate of return on other sectors are not assured in the treatment for purposes of MAT, there is no ground to make a special claim for infrastructure sectors. Any such considerations however, can be taken into account by the government in determining its expenditure policies.
No tax on distributed profits on domestic companies availing 80IA		No exception has been made for any other sector.
Restoration of benefits u/s 80HHE	80HHE was also available to Call centers, Back office operations, data processing	All export incentives have progressively been removed. There is no possibility of bringing back these deductions.
Deduction of upfront charges paid for 3G/BWA spectrum	Due to varied interpretation at the field level, deduction u/s 35ABB is denied in certain cases. Add: Clause (iv)- Licence means to include upfront fee paid for acquiring licence and/or upfront fee for acquiring spectrum.	These are individual cases. However, there may be question regarding deductibility under the DTC
Requirement of PAN/ Form 60/61	Low tariffs, handsets have helped spreading mobile services. Many of the low end subscribers in rural areas do not have any	Those that do not have PAN can submit the form. There does not seem any justification for this demand.

Desired Treatment	Present Treatment	Case for Why Not?
	PAN and are not income tax assesses. Requirement of Rule 114B may be dropped.	

It may be mentioned here that while MAT is conceptually a distorting levy, for all the sectors concerned, since the law seeks to provide incentives on one hand and reduce the benefit from the incentives through the provisions of MAT, this is not an issue specific to this sector.

7. GST and emerging issues for the sector

A number of above issues relating to indirect taxes critically affecting the sector are expected to undergo substantial changes with the introduction of the Goods and Services Tax in India. The new regime however would pose some additional challenges which need to be addressed. Before identifying the challenges, it would be useful to know the salient features of the proposed structure of GST in India. These are first discussed below.

Salient features

- The tax (the proposed GST) would replace CENVAT, Service tax, CVD and SAD, and some surcharges and cesses at the central level and state VAT, Central Sales Tax, entry not in lieu of octroi, entertainment tax, and potentially levies such as purchase tax and surcharges on the same of goods.
- The tax would be in the form of a dual VAT comprising a central GST (CGST) and a state GST (SGST). Every transaction of sale of goods or supply of services would be subject to both these levies, with the provision for input tax credit. No cross utilization of credit would be feasible. However, the present practice of levying sales tax on a base inclusive of central excise would be done away with.
- The tax would work on the same principles as the present CENVAT and state VAT, i.e., agents are allowed to claim setoff of inputs taxes paid against output taxes collected and remit only the balance to the government. The effectiveness of this regime would however depend on the rules formulated for input tax credit in the new regime. It would, for instance, be desirable to avoid formulating a separate rule for capital goods as against inputs.
- It is proposed that the natural gas, petrol, diesel, crude oil, ATF, tobacco and tobacco products, and alcoholic products would remain outside the ambit of GST. In other words, there will be no option of tax credit for the taxes paid on any of these goods that are used as inputs by other sectors. Further, either the central government or the state governments would have the authority to levy higher than normal rates of tax on these commodities. Within services, the coverage of the regime is still somewhat uncertain. While the Thirteenth Finance Commission suggested the incorporation of real estate transactions within the base, the state governments are not keen on this step, at least in the initial phase of introduction of the tax. Similarly,

the states seek to retain electricity duty outside the GST regime. This in effect suggests that the taxes paid on most fuels would not be available for setoff against taxes collected on supplies. The other sector, where there is lack of clarity is financial services – the services to be covered, the process of valuation of the tax liability and the form in which services are to be covered, are not yet defined.

- Central sales tax would be eliminated and on all inter-state transactions, the levy would be called IGST. In discussions so far, the IGST would be a combination of CGST and SGST. Against this tax collected, the supplier can claim credit of both CGST as well as SGST on inputs used. This levy will be introduced in order to establish neutrality in the tax treatment of local supplies and inter-state supplies, and is expected to work as a mechanism of transferring the taxes collected from the exporting state to the importing or consuming state. This levy would be administered by the central government and would include the taxes payable to the centre and those payable to the states. In order to reduce the extent of revenue flows between departments and dealers as well as between central and state departments, it is proposed that the tax credit for IGST, CGST and SGST can be taken in the following sequence – in case the dealer has any IGST purchases, (s)he would be required to set off these taxes against any IGST collected on supplies. This would be followed by credit of CGST paid on purchases and finally of SGST paid on purchases. It was proposed in the First Discussion Paper issued by the Empowered Committee of State Finance Ministers, that the IGST would be applicable in the case of B-to-B as well as B-to-C transactions. In the case of the latter, clearly, the revenue collected in the exporting state by the Union administration would be transferred to the importing state. While the discussion paper does mention that services too would be covered by the IGST designed, in the public discourse so far, there is yet no formal discussion of the form in which it would be implemented.
- As for the rates of tax, the First Discussion Paper has proposed that apart from special rates for a few commodities, there would be three rates of tax: a lower rate and standard rate for goods and a separate rate for services. While initially the Union government was keen on a uniform rate of tax, in subsequent pronouncements, the Union Finance Minister has accepted the classification proposed by the states. It is still to be decided what goods are to be classified in which category. A related concern is regarding the choice of the rate of tax, and more importantly whether the rates of tax would remain the same across all states. The First Discussion Paper has suggested uniform rates of tax across all states in the country and the Union government too prefers this model. However, some states are raising concerns about the chosen rate and questioning as to whether the same would be adequate to

meet their revenue needs. One proposal now doing the rounds therefore is the prescription of a floor rate of tax for all three categories mentioned above. No decisions on this front have yet been announced.

- It is proposed for purposes of coordination in setting up a common market for the country that the GST regime would be guided by a GST Council, and a Dispute Settlement Authority. Given that any agreement for coordination among multiple governments needs to be managed to ensure that the agreement is sustained and adhered to, such institutions would be required. However the roles assigned to these institutions are still being discussed.
- There is not much discussion on how GST would be administered in the country. The Discussion Paper proposes that while it is desirable to have coordination in some functions, for the most part, the two levels of government would independently administer the tax. Apart from imposing substantial compliance costs on the tax payers, this approach would also contribute to a substantial retraining cost for the tax administrators. One major step in coordination has been initiated in the form of a common GST portal for filing returns and making payments. For all effective purposes, the system should be working with a single return, which would capture information on all the three levies proposed. Coordination among some of the other functions too would be desirable.

Given the available details on the proposed GST regime, within the public domain, there are some concerns specific to the telecom sector and some issues on which greater elaboration should be requested.

1. Since one of the major concerns with the existing regime is the embedded taxes which result in higher costs for the companies, it would be useful to know if this problem would be corrected or at least reduced in the proposed regime. From the discussion above, it appears that the extent of embedded taxes to be reduced would depend on some critical features of the design.
 - a. Since state taxes would become comprehensive, it would be possible to get tax credit for state taxes paid on inputs. So this component of embedded taxes (sunk costs) would get reduced. However, with some caveats.
 - b. The present discussion on GST does not provide a clear view on the inclusion or otherwise of real estate – i.e., immovable property, within the base for GST. In the event that this sector is left out of the base, the problem of tax credit

for input taxes on towers for instance would remain. The sector should therefore ask for either inclusion of this sector within the base or for an explicit discussion of the tax credit rules for this sector especially for towers. This would be a very critical issue particularly for companies which are specializing in the provision of these units of “passive infrastructure”. More so since, the tax liabilities in the GST regime would be higher - the option of procurement of inputs at lower rates of tax through the Central Sales Tax route will no longer be available. This might induce perverse incentives to the suppliers of passive infrastructure, whereby there are tax benefits to be derived by merging with a unit manufacturing the angles and nuts and bolts required for the setting up a tower unit. Unlike in the CENVAT case, since the GST would not be based on manufacture but on supplies for a consideration, there would be no tax liability if these two units are merged. Since the purpose of introducing a comprehensive value added tax is to reduce the need and opportunity for such tax induced decisions, a suitable design of GST for this sector should be requested.

It should be mentioned here that taxes on leases of “immovable property” cannot or should not be introduced without a tax on the purchase and sale of such property. This would constitute a poor and distorted design.

- c. The present design of GST proposes that natural gas, petrol, diesel, ATF and crude oil, as well as electricity duty would remain outside the purview of the tax. This would imply that for all diesel/fuel purchased by the sector, there would be no tax credit available. It would be desirable for the sector if at least partial credit is available, even if full credit is not available. This can be achieved by retaining these commodities in GST, with a separate excise duty being levied over and above GST for maintaining the revenue or for meeting other objectives like energy efficiency. Similarly, not only for this sector, but for all sectors in the country, it would be very useful to have electricity duty incorporated into the GST regime. This would reduce the extent of cascading in the system by reducing the number and extent of embedded taxes or blocked tax credits.

Table 11: Share of Power and fuel expenditure in Adjusted Expenditure (in %)

Name of the Company	2008-2009	2009-10
Aircel Ltd.	6.842	9.054
Bharti Airtel Ltd.	9.995	11.674
G T L Infrastructure Ltd.	25.468	N.A.
G T L Ltd.	0.243	0.202
Idea Cellular Ltd.	6.240	9.298
Mahanagar Telephone Nigam Ltd.	N.A.	11.290
Net 4 India Ltd.	1.606	N.A.
Quadrant Televentures Ltd.	N.A.	N.A.
Reliance Communications Ltd.	2.795	5.458
S Kumars Online Ltd.	5.015	7.884
Tata Communications Ltd.	1.961	N.A.
Tata Teleservices (Maharashtra) Ltd.	1.993	1.991
Tulip Telecom Ltd.	2.874	4.402

Source: Computed from PROWESS Database.

The Table 11 shows that for the older and relatively more established companies, the cost of power and fuel expenditure is between seven to eleven per cent of their adjusted expenditure in 2009-10 (other than Tata Group Companies).¹⁷ If taxes on these expenses are assumed to be in the range of 10 per cent (while the electricity duty rates are lower, the taxes on diesel tend to be higher), the blocked taxes would amount to 1 per cent of adjusted expenditures or approximately ` 7,000 crore for these companies, during 2009-10.¹⁸

A study conducted by Mukherjee and Rao (2009), suggests that keeping electricity and petroleum products out of GST could result in cascading across the sectors. The cascading effects will vary across the sectors - depending on their direct and indirect energy (power and fuel) intensity. A comparison of three sectors from the study is presented in Table 12. The table shows that

¹⁷ Adjusted expenditure is the total expenditure less compensation to employees less indirect taxes less amortization less write-offs less expenses capitalized less expenses transferred to DRE less prior period and extraordinary expenses. This is an appropriate point of comparison since this would be a reasonable approximation of the material cost of providing the service.

¹⁸ For the companies in the Table 11 total expenditure on power and fuel is ` 73,102 crore, and at 10% tax, the blocked taxes could be ` 7,310.2 crore, which is 0.88 per cent of adjusted expenditures of the companies - ` 827,157 crore.

direct impact is highest in air transport, whereas the cascading impact is the highest in financial services and post and telecommunication. What is, however, more important is that the total impact of cascading on telecom sector is significantly higher than the perceived direct impact. A more streamlined strategy for taxation of fuel and power would therefore be beneficial to the telecom sector as well. The study suggested that both electricity and petroleum should be brought under GST and additional excise duty (cascading type) could be levied on petroleum products to keep revenue from the sector intact.

Table 12: Direct and Total Impacts of Power and Fuel Expenses across Sectors

Description of the Sectors	Direct Impact (DI): Average Expenses on Power and Fuel as Percentage of Total Expenses (adjusted) (%)		Total Impact (TI)(Cascading Impact): Power and Fuel		Difference (Total - Direct Impact)		Difference as Percentage of Direct Impact (%)	
	2007	2008	2007	2008	2007	2008	2007	2008
Air transport	22.32	29.72	27.09	33.98	4.77	4.26	21.37	14.32
Post and telecommunications	2.74	3.60	4.81	5.56	2.07	1.95	75.47	54.17
Financial intermediaries, Banking and financial services	1.18	1.13	2.43	2.27	1.25	1.14	106.10	100.89

Source: Mukherjee and Rao (2009)¹⁹

- d. In its report, the Taskforce on GST for the Thirteenth Finance Commission had suggested that for an ideal GST, an extra percentage point of tax could be levied and collected solely for the urban local bodies. In a number of other fora as well, when options for alternative sources of revenue for urban local bodies are being explored, it has been suggested that urban local bodies too should get a share of the GST revenues. This however is not formally proposed as yet by the Empowered Committee. This could be one mechanism through which the levies introduced by the urban local bodies can be streamlined. In the absence of such initiatives, however, the urban component of the levies would remain unaffected by the switchover to GST. To this extent, there would continue to be embedded taxes/ levies.

¹⁹ Mukherjee, S. and R. K. Rao (2009), "Understanding the Impact of Taxation of Petroleum Products in India", in the proceedings of the Papers in Indian Public Economics, NIPFP, New Delhi, December 15, 2009.

2. What happens to inter-state purchases of inputs? In the present regime, these purchases are subject to entry tax in some of the states. Further, there would be some embedded taxes in these purchases in the form of CST or VAT paid in the state where the purchases are made. While the IGST regime would correct these anomalies – since the companies would be registered in both the exporting and the importing states, and the taxes paid in one state would be available for credit in the other state through the IGST mechanism – there would still remain some uncertainties regarding the exact form of this levy.
 - a. The first issue that is not yet clear is whether the rate of tax under GST would be same across all the states in the country. In the event that the GST rates are not the same across the country, it is useful for this sector as well as for other sectors, if the IGST mechanism provide for a uniform rate of tax for all inter-state transactions. This rate could be equal to the floor rate proposed in the GST regime, if such a floor is proposed.
 - b. The second issue which could potentially create difficulties is how central procurement for an organization with multiple business locations will be treated. If for instance, companies seek to procure their goods centrally, in the present regime, they can seek separate billing by region/ state with corresponding paper work. In some of these cases, the state into which the goods are being brought in, levy an entry tax. In the new regime, since such entry taxes would be subsumed, and input tax credit would be available for purchases from outside the state, against local supplies, even if goods are centrally procured, it would be better to segregate billing/ invoicing by state, within the IGST regime. Even if this is not mandated by law, it might be a preferable mode of operation, at least for tax purposes. The role of an ‘input service distributor’ becomes important which receives tax paid invoices/ bills of input services procured (on which CENVAT credit could be claimed) and distributes such credits across to its units providing taxable services.²⁰
3. There is an overall issue of determining the basis for taxation – in the present regime, For the purpose of registration, service tax works through the existing circles of taxation. Some of the companies have taken central registration while others have

²⁰ Source: http://www.servicetax.gov.in/circular/st-circular07/st_circ_97-2k7.htm (accessed on 10 December 2011)

taken registration locally/regionally. The taxes are all remitted to the Union government and there is no issue of allocation of revenue to the various states/circles. However, in the new regime, there is need for clarity on how the reporting of revenue and the tax computations need to be done. In other words, there is need for a clear definition of **place of supply** as well as of the taxable event.

- a. The **place of supply** of telecom services has undergone some significant changes in the major multi-jurisdiction VAT regimes of the world – EU and Canada. In EU, the general place of supply rules mandate that for B-to-B transactions, the place of supply is the place where the customer belongs and for others, it is the place where the supplier is located. For telecommunications, however, there is a specific provision that even for supplies to final consumers, the place of supply is the location of the customer and the vendor is expected to account for local VAT. This can however be done through a single tax authority. The Canadian counterpart to these rules is somewhat more extended. The general rule states that the place of supply is the place of residence or business of the recipient, and where this rule does not apply the place of supply is the place where the service is performed. In addition, the Canadian rules provide for a separate treatment of “personal services”. In the case of telecom services, these would imply that for B-to-B supplies, there is a clearly specified address and this would be the place of supply. In the case of B-to-C supplies of telecom services, the rules provide for a special provision – the place of supply is the address to which the billing is done. What these two alternative systems of place of supply rules ensure is that there is no tax advantage for getting supplies from a non-local vendor.

Drawing lessons for the telecom sector, the place of supply should be the registered place of business or residence of the customer. If the rules of registration require the suppliers to be registered in all the jurisdictions where they supply services, then this would mean levy of CGST and SGST on these transactions. On the other hand, if the supplies can be provided without requiring mandatory registration, then the transactions can be taxed under the IGST mechanism and the revenue in the case of final consumers can be remitted to the state of residence. In case of B-to-B transactions, the usual credit rules would apply.

In the case of inter-connect charges as well, or any other inter-company transactions, it is expected, depending on the location of the two companies

concerned, that the transactions would be subject to IGST or SGST+CGST, with credit being made available against subsequent transactions. A comprehensive coverage would ensure that there is no incentive to articulate a case for exemptions for specific supplies, especially if they are in the nature of B-to-B supplies.

In so far as the taxation of prepaid vouchers is concerned, specific rules will be required to determine the jurisdiction in which these should be taxed-either in the State of purchase or in the State of the registered address of the user. While compliance or administration wise the former seems easy, the latter would be closer to the destination principle.

- b. The second critical issue is the definition of **time of supply**. In the case of post paid telecom services, it is clear that the payment being made is for specific services rendered. However, there are number of alternative forms of services associated with and related to the telecom sector. In these cases, it would be useful to explore what the appropriate time of supply would be. In the case of a pre-paid recharge voucher – should it be the time of purchase of the voucher, the time when the voucher is redeemed, i.e., when the balance contained in the voucher is loaded on a connection, or when the balance is utilized? If these were the only forms of vouchers, in the interest of ease of administration, it might be worthwhile to propose taxation at the time of purchase of the voucher. However, if the balance provided by the voucher can be utilized for multiple purposes, the picture becomes more complicated– the M-wallet introduced by Bharti is an example. Since the money charged to the mobile can be used for buying goods as well as services, the voucher used to load the money on the mobile is in effect like a debit card. If the tax treatment of debit cards and other similar forms of payment is that it is treated as a medium, not taxable in itself, then the same treatment should be accorded to multi-use vouchers. Any fees deducted by the service provider can only be the basis for taxation. Here, it is interesting to note that the Reserve Bank of India has issued guidelines indicating that such vouchers would be treated as modes of payment and would be regulated as such.²¹

²¹ The Point of Taxation Rules, 2011 which is notified on 1 March 2011 and it is effective since 1 April 2011 is a step forward towards adoption comprehensive GST in India.

Another reason why this issue needs further analysis and some clear solutions, is evident if one examines the tax treatment of goods and/or service procured through the use of such modes of payment. If the entire value of the voucher is taxed as supply of services, payment for any goods or services purchased using the voucher should be made tax free, in order to avoid double taxation. This could be a serious consideration in the case of a multi-rate tax regime. Opportunities for arbitrage would emerge. It is important to point out that this is not an issue specific to the telecom sector. It would be equally applicable for instance, on any gift voucher of a multi-product establishment, like Shopper's Stop for instance. Specific treatment of all vouchers would therefore be called for. One option would be to tax the goods or services when they are procured. In the context of single use vouchers, like recharge vouchers, this would be at the time the balance is utilized. If such a rule is considered, it would be necessary to clarify what the tax treatment of any balance remaining on the voucher at the end of the validity period would be.

8. Comparison of tax liabilities: Inter-sectoral and cross country

In assessing the tax liability of a sector, it is often useful to seek a comparison of the sector with other sectors in the country as well as with the treatment of the same sector in other countries. Table 13 shows the statutory rates of tax for Income tax and VAT for some select countries. The table shows that India is neither very high nor is it very low when compared to the tax treatment in other countries, as reflected in these statutory rates. Table 14 presents a comparison of the effective rates of tax within corporate tax for some countries.

Table 13: Cross Country Comparison of Regulatory Charges, VAT/GST Rates and Corporate Tax Rates

Country	Price per MHz of spectrum per head of population (\$/MHz/pop)	Regulatory Charges per Subscriber (\$/sub).	Vat (Statutory Rates)	Corporate Tax Rates (Statutory Rates)
Belgium	0.0315	0.027	21	33.99
Bangladesh		0.814 (1 USD = BDT 71)	15	35**
France 900MHz 1800 MHz	0.0132 0.0070	4.3513 2.3264	19.6	33.33
Germany	0.0002	0.0288	19	33.3
India		0.941 (1 USD= Rs. 45)	10.3***	33.99
Indonesia		5.278042 (1 USD = 9400 IDR)	10% (VAT/GST)	25*
Japan	0.0163	3.0541	5	40.87
New Zealand	0.0158	0.7595	15	30
Pakistan		1.55 (1USD = PKR 85)	16	35
Spain	0.0245	0.0206	18	30
Sweden	0.0017	0.2828	25	26.3
UK 900 MHz 1800 MHz	0.0089 0.0069	0.4869 0.7682	17.5	28
USA - CMRS	0.0006	0.1943	--	35

Note: *- implies for resident companies; **-45% for not publicly traded mobile company; ***-service tax applicable for telecom companies

Source: IBFD Tax Research Platform- EU VAT Rates Tables and Country Key Features (www.ibfd.org)

Ovum Consulting (2010), "Comparative analysis of spectrum fees", June 2010. London: UK.

Bangladesh: Grameenphone, Annual Report 2009. Indonesia: PT Indosat Tbk, Consolidated Financial Statement 2009. Pakistan:

http://www.pta.gov.pk/index.php?option=com_content&view=article&id=269:telecom-indicators&catid=124:industry-report&Itemid=599 (accessed on February 12, 2011).

Table 14: Comparison of effective tax rates: Corporate tax (2009-10)

Companies	Country	Currency	Turnover	Profit (Loss) Before Taxation	Provision for Taxation	Profit/(Loss) after Taxation	Provision for Taxation as % of Turnover	Provision for Taxation as % of Profit Before Taxation
FLAG Telecom Development Services Company LLC	Egypt	(USD)	417,142	36,895	11,346	25,549	2.72	30.8
FLAG Telecom Deutschland GmbH	Germany	(USD)	65,791	29,574	1,188	28,386	1.81	4.0
Vanco EpE	Greece	(GBP)	51,895	18,504	4,531	13,972	8.73	24.5
Tata Communications (Hongkong) Limited	Hong Kong	(USD)	103.06	0.15	0.08	0.07	0.08	53.3
Bharati Hexacom Ltd.	India	(` Crore)	2641	736	112	624	4.23	15.2
Bharti Airtel Services Ltd.	India	(` Crore)	422	25	10	15	2.35	39.5
Bharti Infratel Ltd.	India	(` Crore)	2453	321	115	205	4.70	35.9
	India	(` Crore)	122.53	24.34	1.85	22.49	1.51	7.6
Reliance Infratel Ltd.	India	(` Lakh)	627,654	97,877	7,319	90,558	1.17	7.5
Global Innovative Solutions Pvt. Ltd.	India	(` Lakh)	0.50	0.04	0.01	0.03	2.00	25.0
Bharti Airtel (Singapore) Pvt. Ltd.	Singapore	(` Crore)	9.8	1.2	0.3	1.0	2.87	22.6
VSNL SNOSPV Pte Ltd	Singapore	(GBP)	-	30.94	4.42	26.52		14.3
Tata Communications Lanka Limited	Sri Lanka	(LKR)	96.3	13.23	1.32	11.91	1.37	10.0
Vanco B.V.	The Netherlands	(USD)	14,613,168	751,702	11,838	739,864	0.08	1.6
Bharti Airtel (UK) Ltd.	UK	(` Crore)	15	6	1	6	3.92	8.9
Reliance WiMAX World UK Ltd.	United Kingdom	(USD)	1,790,031	11,602	3,186	8,415	0.18	27.5
Reliance Communications Inc.	USA	(USD)	208,635,375	2,796,737	209,736	2,587,001	0.10	7.5
Reliance Communications International	USA	(USD)	55,905,432	1,759,151	125,226	1,633,925	0.22	7.1
Reliance Communications Canada Inc.	USA	(USD)	2,266,551	50,464	3,255	47,209	0.14	6.5

Source: Compiled from the following:

Reliance Communications Annual Report 2009-10, pp. 84-87; TATA Communications 24th Annual Report, 2009-10, pp. 94-95; IDEA Cellular Ltd., Annual Report 2009-10, pp. 88; and Bharti Airtel, Annual Report 2009-10, pp. 158.

Usually, it is possible to get figures for statutory rates of tax across countries. However, the actual liability of a company differs depending on the specific provisions in the tax laws and the actual liability of tax can often be considerably different from the statutory rates. In order to get a sense of the effective rates, information on subsidiary operations of Indian companies located in other countries was culled out from the Annual Reports of three companies – Reliance Communications, Tata Communications and Idea Cellular, for the financial year 2009-10. The figures reveal that the rates for some of the Indian companies are quite low while those of some of the others are among the highest in the Table 14.

Like in the case of India, it is very difficult to get a listing of the different levies imposed on the sector in other countries. Evidence for some countries however, does suggest that there are number of levies in other countries as well. The US experience for instance indicates that there are more than six types of levies on this sector, as listed below. Some estimations in the cases of the states of US indicate that there are substantial variations in the rates across states, with rates ranging from over 21 per cent in the case of New York to about 6 per cent in the case of Nevada.

Federal Excise Tax - The infamous federal excise tax was signed into law in 1898 to help fund the Spanish American war. Since virtually no one had phones in 1898 (except the wealthy) the tax was originally designed as a luxury tax. 111 years later, wireless customers still pay a 3% federal excise tax on monthly bills.

Federal Regulatory Fee - The introduction of local number portability created this federal tax. It is intended to cover local number portability costs and other regulatory license fees and charges that are incurred by the carriers. This fee can vary significantly from carrier to carrier. It is often found in the surcharges section of the wireless bill and not the taxes and fees section.

Federal Universal Service Fee - The federal government imposes this tax to promote affordable telecommunications to all Americans — including low income consumers, schools, libraries, etc. The fee is actually imposed upon the carriers who then have the

option to pass the costs along to the consumer. Nearly all carriers typically recover this tax on monthly wireless bills either as a fixed charge or as a percentage of revenue based on what they have estimated the total cost will be to meet this requirement.

State Universal Service Fee - Some states impose a State Universal tax along with the Federal Universal tax. As with the federal tax of the same name, this fee can either be levied on to the carrier or directly onto the wireless bill of the customer.

State 911 fees - All but five states impose a 911 fee to help fund state and local emergency communications systems. The amount of this tax can vary greatly from state to state.

State and Local Excise Taxes - For states that do not have a sales tax such as Montana, New Hampshire or Delaware, an excise tax on wireless service is imposed. This category of taxes is placed directly on the wireless customer bill and can be found in the taxes and fees section of the bill.

Wireless Taxes with Percentages by State, USA

New York - 21.71%	Arkansas - 15.69%	Iowa - 12.01%
Florida - 21.60%	Kentucky- 15.46%	Maine- 12.01%
Washington - 21.52%	Indiana - 15.10%	South Carolina - 11.98%
Illinois - 21.05%	Oklahoma- 15.06%	Connecticut- 11.89%
Nebraska - 20.61%	Colorado - 14.85%	Hawaii - 11.62%
Texas - 19.67%	Mississippi - 14.55%	New Jersey - 11.48%
Rhode Island - 19.55%	Minnesota - 13.58%	Massachusetts- 11.11%
Pennsylvania - 19.05%	New Hampshire - 13.35%	Wisconsin - 11.03%
California - 18.66%	Virginia - 13.23%	Delaware- 10.97%
District of Columbia - 18.05%	North Carolina - 13.13%	Montana- 10.47%
South Dakota - 17.49%	Georgia- 13.12%	Louisiana - 9.87%
Tennessee - 17.05%	New Mexico - 13.11%	Alaska - 9.53%
Missouri - 16.60%	Ohio - 13.11%	Oregon - 7.75%
Arizona - 16.54%	Alabama - 12.93%	Idaho- 7.71%
North Dakota - 16.42%	Vermont - 12.75%	West Virginia- 7.42%
Wyoming - 16.15%	Maryland - 12.55%	Nevada - 6.62
Kansas - 15.80%	Michigan - 12.55%	
Utah - 15.73%		

Source: <http://www.telecomauditguide.com/taxes/are-wireless-phone-taxes-out-of-control/>

On the other hand, if one compares the performance of Indian Telecom with other Sectors in the country, depending on the sector one considers, most of the levies would be similar to that levied on the telecom sector. As illustrations, we consider three sectors – Automobiles, Air travel and financial services. The corporate tax faced by all these sectors statutorily would be the same. The Telecom Sector had some exemptions available to it, the period for which is drawing to a close. To that extent, this sector has a preferred deal. If one looks at indirect taxes, apart from service tax levied by the Union government, there is also VAT on a part of the transactions. When compared to Automobiles, the taxes on telecom would be lower, where as when compared to financial services or air travel, the taxes would appear to be higher. While only a part of financial services is subject to tax under service tax, there are no state taxes on supplies. In the case of air travel too, there is only service tax liability of this sector. In terms of blocked taxes, the figures indicated by the telecom industry, to the limited extent some data was made available, do not suggest a higher liability. The liability in terms of blocked credits can be substantially higher for air travel, since there is no credit available for the VAT paid on Aviation Turbine Fuel. In the case of manufacture of automobiles, any taxes paid on fuels cannot be set off. In the case of financial services, since only a part of the services are taxed, even if the credit mechanism works, they would be able to avail of only part of the credit. The extent of blocked credit cannot be determined, but that it remains an irksome issue is true for all the sectors considered. So far as local levies are concerned, all of the economic activities in the country need to maintain establishment in some local bodies, and taxes or levies if any need to be paid correspondingly. However, since the telecom sector, by the nature of its business, needs to maintain multiple places of business in any local body, the cost of the levies and the compliance cost of being in the system can be higher. However, it has not been possible to document, even anecdotally, the dimensions of such levies. In order to get a sense of whether the environment is relatively more distorted for this sector when compared to the other sectors, an attempt is made to compare the returns to net fixed assets for firms in these sectors. Table 15 below shows

that in terms of this indicator, telecom's performance is neither very poor nor the best when compared with the other sectors considered here.

Table 15: Tax Liabilities and the Bottomlines - A Comparison

Sector Name	Year	Air transport	Automobiles	Financial services	Telecom
Provision for Direct Taxes as % of PBT	2008-2009	6.39	26.84	21.61	25.38
	2009-2010		29.27	23.57	13.05
VAT rate (statutory)		0.04	0.13	EXEMPT	0.04
Service tax rate (statutory)		0.10		0.10	0.10
Excise Duty			0.10		
Average of Power and fuel exp as % of adjusted exp	2008-2009	41.98	1.49	0.47	5.01
	2009-2010	33.05	1.13	0.42	5.56
PBDITA*/Net Fixed Assets	2008-2009	4.12	33.95	29.03	26.80
	2009-2010	9.78	62.72	22.14	19.68

Note: * - PBDITA implies Profit Before Depreciation, Interest, Tax and Amortization

Source: Computed from PROWESS database

9. Role of Regulators

As a part of the terms of reference, the study is also expected to provide inputs on the role of regulators in the context of taxation of the telecom sector. Appendix 2 provides a comparative table of the functions assigned to the regulators in different countries. These functions have been divided into 5 categories – general regulation, economic regulation, technical regulation, social regulation, consumer protection and others. While there is some overlap in the specification of these categories, categories make a distinction on the basis of the emphasis in the defined role. Technical regulation referring to the efficient utilization of spectrum, followed by consumer protection and supervising the service providers constitute the most common functions of the regulator in addition to implementing and enforcing the national telecom policy of the government. What is important for the purposes of this study is that none of the functions relate directly or even implicitly to a role in determining tax policy for this sector.

The functions assigned to the Indian Telecom Regulator, in terms of sheer listing of the functions is larger than those for a number of the other regulators discussed in the appendix table. Australia and Thailand are a close second.

10. Conclusions and some Policy options

In terms of levels of taxation, the Indian telecom sector is not an outlier when compared with other sectors in India or with telecom sectors in the rest of the world. However, there are a few specific issues that this sector faces – issues that can significantly disturb the working environment for the sector. These can be summarized as follows:

1. **The evolving nature of levies on this sector:** All levels of government are exploring ways of bringing this sector within the ambit of taxation.
2. Since the form of service delivery in the sector requires the establishment of a wide network of service points (transmission towers, fibre optic network, etc.), this sector, unlike a number of other sectors, cannot undertake a strategic location of its business. As a result, the sector has to face and comply with wide variations in the levies imposed at the sub-national level. Whether or not these add substantially to the cost, it is clear that **these levies can impose significant compliance costs**, more so if the levies change very frequently.

This study attempts to identify some measures that can address these issues, so as to improve the work environment for this sector. In principle, these are measures that can be useful for other sectors as well.

SUMMARY OF POLICY SUGGESTIONS

1. **Where effectively new levies are being proposed or hitherto unrecognized taxable activities are being recognized, the sector should ask for a mandate that the tax would be payable prospectively.** Departments should be asked to issue guidelines for sectors where they perceive changes in taxable activities. This would reduce litigation and provide more predictable environment both for the tax payers and the tax administrators. This is beyond the normal purview of provisions like advance ruling.

An alternative mechanism can be for the sector to ask for a joint review of taxation by both levels of government and a clear definition of the taxes leviable on this sector. This could be a periodic review since the activities in this sector are expected to expand quite rapidly.

2. In so far as the VAT treatment of telecom sector is concerned, since this sector is paying VAT on SIM cards and recharge vouchers, input tax credit should be available against these taxes. **Input tax credit should be available for taxes paid on goods used for provision of the services concerned. In case, entry taxes not in lieu of octroi are operational in a state, tax credit of these taxes too should be available.** Since some of the services could be taxable while others might be exempt, a suitable rule for apportioning the credit needs to be evolved. For other sectors, most of the state VAT laws provide for apportioning in proportion to shares of taxable and exempt transactions. The same principle can be applied here.
3. For CENVAT credit for inputs used to setup towers, the discussion on towers being exciseable should be reopened. **The sector could opt to pay CENVAT on the value of towers and thereby get credit for inputs used.** On the other hand, **for the infrastructure companies as well as the service providers, the CENVAT credit on towers would flow through.** In the absence of such provisions, the basic principle of value added tax is defeated.
4. For limitations on **service tax credit in the case of exempt supplies**, since the objective is not to induce distortions in decisions by the service providers, **two alternative solutions are possible**, which should be discussed with the Revenue Department:
 - a. all the transactions can be taxed, and the receiver of the services can claim refund of input taxes from the government. This would increase the benefits provided to the users, since the refund would be of all input taxes – this would be akin to zero-rating

- b. the extent of tax credit available for setoff can be in proportion to the share of taxable transactions in total supplies by the supplier. If the exempt transactions account for 10 per cent of the total supplies, the input tax credit to the extent of 10 per cent of total taxes on inputs and input services may be denied.
5. The revised rules for CenVAT credit actually allow for the above, thus addressing the concerns of this sector at least on this front. **To reduce high compliance costs associated with local body charges on towers, the sector should ask for centralized payment of levies, at least at the level of circle.** Since the information on towers is centrally generated through the approval process of SACFA, the list can be passed on to a relevant authority at the circle, which can collect and remit the charges for all the local bodies. In cases where the circle overlaps with a city or with a state, the issue is relatively easy to visualize. It could be somewhat more complex if there are multiple states within the jurisdiction of a single circle.
6. **While the rate of levy will vary across local bodies, some rationalization of rates would be possible through transforming the present one time levy into an annualized levy at a lower rate.** This would provide a stable source of revenue for the local bodies and reduce the fluctuations in liabilities for the companies in any given year.

Within the ambit of Income Tax, there are no major areas of concern. While some issues were discussed with the representatives of the telecom companies, it is the opinion of the study team that **the present regime of sector specific policies tends to distort the investment environment and induce greater instability into the tax regime. Sector specific incentives have therefore not been considered desirable not feasible within the current policy regime.**

Apart from the specific issues within the present regime, a major concern for the sector, relates to the provisions within the proposed **Goods and Services Tax** Regime. There are two separate concerns for the sector:

1. What happens to the taxes that remain embedded in the cost of services within the present regime? Will the extent of embedded taxes reduce? From the discussion in section 5, it is clear that while the extent of embedded taxes would reduce, there would still be some concerns left.
 - a. Since electricity and diesel/petrol are to be left out of the base, the taxes on these items would remain embedded.
 - b. Since real estate is not proposed to be included in the base, at least, initially, the issues relating tax credit for towers would persist.

These two policy decisions considerably reduce the benefits of GST to the telecom sector. The sectors views on GST policy should include the following:

- i. **Electricity and petroleum products should be included in the ambit of GST.** For electricity duty, the revenue implications would not be large, since the rate of tax is usually lower than the standard VAT rate. For petroleum products, the revenue considerations might require the introduction of additional state specific non-rebatable excise (regulatory levy). Even this would improve the bottom line of the sector, since the total cascading impact – direct and indirect put together - of such taxes on the sector is considerably higher than the direct impact of such levies, as shown in Table 12.
 - ii. **For real estate related issues,** it would be imperative, to request for sector specific guidelines that can address the issue of blocked credit in the case of towers. For instance, **bringing commercial property under GST would provide a solution.**
2. How would the GST regime affect the organization of business of the sector?
 - a. It is not clear what features of the GST regime would remain harmonized across the country. **The telecom sector should ask for uniform compliance**

procedures across all the jurisdictions. Further, if the State GST rates are varying across jurisdictions, the sector should ask for uniform rates of IGST.

- b. What happens in case the company seeks to procure centrally for all its operations? Given the proposed format of IGST- the tax on inter-state transactions, it would be necessary and desirable to generate invoices specific to states (distribution of credit across states), even if the goods are centrally procured.
- c. The place of supply of telecom services needs to be defined. **The rules should align the place of supply with the registered place of business or residence of the customer.** Depending on whether centralized registration is allowed or not, the mechanism of billing and reporting too would undergo changes.
 - i. Presently, the consensus is state specific registration. In this case, the customers in a given state would be subject to SGST and the relevant revenue remitted to the state.
 - ii. **Here, one important clarification is required from the policy makers— what is the place of supply of recharge vouchers – the place of purchase of the voucher, the place of activation of the voucher or the place of residence of the user? If taxation of pre-paid connections is to be on par with post- paid connections, the last option, i.e., place of residence, should be chosen.**
- d. The rules have to provide a clear definition of “time of supply”. In the case of post paid transactions, the tax is due when the bill is raised. However, in the context of pre-paid transactions, the notion is not as clear, and becomes even more complex with multi-purpose vouchers being introduced in the system. If all supplies of goods and services are taxable and the rate of tax is the same, then the transaction can be taxed at the time of purchase of the recharge

voucher. However, if there are variations in the above, then there is need for a different rule.

- i. The time of supply can be the time of purchase of voucher, the activation of the voucher or the time of utilization of the balance. Of these three options, **taxation at the time of utilization of the balance would ensure a level playing field.** Corresponding to this option, the place of supply would be the place of residence of the user.
- ii. Some clarification of the tax treatment of the balance at the end of the validity period is required, if taxation is to be at the time of utilization of the balance.

While the structure of taxes is important from the perspective of attracting investment into the sector, it is equally important to assess whether the demand for the services being provided are sensitive to changes in prices. If the demand is not very sensitive, higher taxes can be passed on as higher prices, thereby reducing the impact on the investor. On the other hand, if the demand is sensitive to prices, higher taxes would squeeze the margins of the operators. From an analysis of quarterly data for GSM and CDMA demand, section 5 establishes that while Minutes of Usage (MOU) is not very sensitive to price, the number of subscribers is sensitive. Lowering of taxes can therefore induce more customers or alternatively, higher taxes and costs can result in smaller number of subscribers. While the robustness of these results needs to be checked with the use of longer time series of data, the results do indicate the possibility of some more expansion in the demand for this sector, with a reduction in indirect taxes through the rationalization options discussed above.

Appendix 1

Discussion of disputes with respect to liability of sales tax/VAT for companies

A. The first time a case came to the Supreme Court over the right of taxation over telecom services was in the case of *State of UP vs. Union of India*. This was a case relating to fixed line telephony. In this case, the question for consideration of the Supreme Court was whether rentals collected by the Department of Telecom from the subscribers of telephone in the State, could be assessed to tax under the U.P. Sales Tax Act. On behalf of the Union of India, it was argued that the Department of Telecommunication (DOT) would not fall within the definition of the term 'dealer' as defined in the Sales Tax Act. This contention was negated by the Court by holding that had the intention of the legislature been to exclude 'a government' from the definition of 'dealer' in regard to a transfer of the right to use the goods, it would have said so specifically.

The other point raised by the DOT was that even though telephone instruments and other movables, including wiring, cable etc., are undoubtedly goods, what was being supplied as service is a telephone connection with an instrument which is connected with permanent telephone lines laid up to the subscriber's place where the telephone system is installed and the same is connected with the exchanges which were housed in immovable properties. The Court overruled this objection on the ground that intangible object, like electricity which is generated in projects and transmitted through sub-stations, housed in buildings, has been held to be goods.

The other question considered by the Court was whether the supply of telephone connection involves a transfer of the right to use any goods or amounts to providing a service. In this connection, the Supreme Court held that the question whether a given activity is one of sale or service is a vexed question. However, the terminology employed to describe an activity as sale or service is not conclusive in itself.

The Court held that providing telephone service by the DOT which comprises of allotment of number, installation of an instrument/ apparatus and other appliances at the premises of a subscriber, which are connected with a telephone line to the area exchange to enable the subscriber to have access to the whole system, to dial and to receive calls, in effect, falls within the meaning of the extended definition of 'sale', viz., within the meaning of 'the transfer of the right to use any goods' and the fact that it is described as service under the Indian Telegraph Act, 1885 and the Rules made there under or under the Finance Act, 1994 would not militate against the same being a 'sale' within the meaning of the U.P. Act. As regards the contention that in a contract providing telephone by the DOT, the service and sale - transfer of the right to use the goods - are so inter-twined that the rentals cannot be

attributed to one or the other part and, therefore, such a composite contract cannot be dissected so as to attribute one part of the rentals to service and the other part to the transfer of the right to use the goods and accordingly assess that part of rentals to tax, the Supreme Court held that here the service of telephone connection cannot be artificially split into various categories - supply of instruments and accompaniment on the one hand and supply of telegraphic line/connection on the other, to name the former as 'sale' and the latter as 'service'. It was held that the analogy of composite contract will apply where 'sale' and 'service' are two different independent objects.

It was finally held that since the DOT is a 'dealer' as defined in Section 2(c) of the U.P. Act and it collects rentals for the supply of transfer of use of telephone connection, which is compendiously called 'service' and that the supply of telephone satisfies the requirements of a transfer of the right to use the goods within the meaning of 'sale' in Section 2(h) it also receives consideration, therefore, the requirements of charging Section 3 read with Section 3(f) are satisfied. Thus the Supreme Court in this case upheld the authority of the States to levy sales tax on fixed line telephony.

B. The next case relating to telecommunication services to be brought before the Supreme Court was the case of Bharat Sanchar Nigam Ltd & Anr Vs Union of India. In this case, the Supreme Court of India considered the nature of the transaction by which mobile phones are enjoyed, whether the same represented a sale or service or both. In this case, the service providers and the Union Government argued that there was no sale involved while the State governments argued that the transaction was a deemed sale under Article 366(29A)(d) of the Constitution and accordingly, the States were competent to levy sales tax on the same. The service providers argued that they were licensees under section 4 of the Telegraph Act, 1885 and provide 'telecommunication services' as provided under section 2(k) of the Telecom Regulatory Authority of India Act, 1997. Service tax is imposed on them under the Finance Act, 1994 on the basis of tariff realized from the subscribers and hence the question of levying sales tax did not arise.

The nature of the service provided has been explained in the concurring judgment. The contract between the telecom service provider and the subscriber is to receive, transmit and deliver messages of the subscriber through a complex system of fibre optics, satellite and cables. Briefly, the subscriber originates/ generates his voice message through the handset. The transmitter in the handset converts the voice into radio waves within the frequency band allotted to the service providers. The radio waves are transmitted to the switching apparatus in the local exchange and thereafter after verifying the authenticity of the subscriber, the message is transmitted to the telephone exchange of the called party and

then to the nearest Base Transceiver Station (BTS). The BTS transmits the signal to the receiver apparatus of the called subscriber, which converts the signals into voice, which the subscriber can hear.

On these facts, the Supreme Court, *inter alia*, held as follows:

“Of all the different kinds of composite transactions the drafters of the 46th Amendment chose three specific situations, a works contract, a hire purchase contract and a catering contract to bring within the fiction of a deemed sale. Of these three, the first and third involve a kind of service and sale at the same time. Apart from these two cases, where splitting of the service and supply has been constitutionally permitted in Clauses (b) and (g) of Clause 29A of Art. 366, there is no other service which has been permitted to be so split. For example, the clauses of Art 366(29A) do not cover hospital services. Therefore, if during the treatment of a patient in a hospital, he or she is given a pill, can the sales tax authorities tax the transaction as a sale? Doctors, lawyers and other professionals render service in the course of which can it be said that there is a sale of goods when a doctor writes out and hands over a prescription or a lawyer drafts a document and delivers it to his/her client? Strictly speaking with the payment of fees, consideration does pass from the patient or client to the doctor or lawyer for the documents in both cases.

The test therefore for composite contracts other than those mentioned in Article 366 (29A) is – did the parties have in mind or intend separate rights arising out of the sale of goods. If there was no such intention there is no sale even if the contract could be disintegrated. The test for deciding whether a contract falls into one category or the other is to decide what is the substance of the contract – the dominant nature test.

What are the "goods" in a sales transaction, therefore, remains primarily a matter of contract and intention. The seller and such purchaser would have to be *ad idem* as to the subject matter of sale or purchase. The Court would have to arrive at the conclusion as to what the parties had intended when they entered into a particular transaction of sale, as being the subject matter of sale or purchase. In arriving at a conclusion the Court would have to approach the matter from the point of view of a reasonable person of average intelligence.

The States had initially differed as to what constituted 'goods' in telecommunication. Ultimately, the consensus was that the "goods" element in telecommunication was the electromagnetic waves by which data generated by the subscriber was transmitted to the desired destination.

In this connection, the Supreme Court held that electromagnetic waves are neither abstracted nor are they consumed in the sense that their user does not extinguish them.

They are not delivered, stored or possessed. Nor are they marketable. They are merely the medium of communication. What is transmitted is not an electromagnetic wave but the signal through such means. The signals are generated by the subscribers themselves. In telecommunication what is transmitted is the message by means of the telegraph. No part of the telegraph is transferable or deliverable to the subscribers.

A subscriber to a telephone service could not reasonably be taken to have intended to purchase or obtain any right to use electromagnetic waves or radio frequencies when a telephone connection is given. Nor does the subscriber intend to use any portion of the wiring, the cable, the satellite, the telephone exchange etc. At the most the concept of the sale in a subscriber's mind would be limited to the handset that may have been purchased for the purposes of getting a telephone connection. As far as the subscriber is concerned, no right to the use of any other goods, incorporeal or corporeal, is given to him or her with the telephone connection.

It was held that the essence of the right under Article 366(29A)(d) is that it relates to user of goods. It may be that the actual delivery of the goods is not necessary for effecting the transfer of the right to use the goods but the goods must be available at the time of transfer, must be deliverable and delivered at some stage.

But if there are no deliverable goods in existence as in this case, there is no transfer of use at all. Providing access or telephone connection does not put the subscriber in possession of the electromagnetic waves any more than a toll collector puts a road or bridge into the possession of the toll payer by lifting a toll gate.

In the concurring Judgement, it was explained that traditionally, a contract for carriage of goods or passengers is by roadways, railways, airways and waterways. This is associated with carriage of tangible goods. Such a carrier has no right over the goods of the customer and does not effect transfer of right to use any goods used by the carrier for goods. On this analogy, the telecom companies carry messages. They are only carriers and have neither property in the message nor effects any transfer to the subscriber. The advancement of technology should be so absorbed in the interpretation that this method of carriage of message should also be understood as carriage of goods and not a transfer of a right to use goods, if any.

It was further held that the license clearly manifests that it is one for providing telecommunication service and not for supply of any goods or transfer of right to use any goods. It expressly prohibits transfer or assignment. The integrity of license cannot be broken into pieces nor can the telecommunication service rendered by them be so mutilated. Not only this position flows from the terms of contract, this also flows from

Section 4 of the Indian Telegraph Act which provides for grant of license on such conditions and in consideration of such payments as it thinks fit, to any person "to establish, maintain or work at telegraph". The integrity of establishing, maintaining and working is not to be mutilated.

C. Notwithstanding the finding of the Supreme Court that there was no goods involved in telecom services, a fresh attempt has been made to tax by the state of Karnataka, this time of the broadband services provided by the Telecom operators. In this case, the facts were as follows:

Bharti Airtel (BT) provided broadband connectivity service by laying down about 35,000 kms of optic fiber cables across the country five feet deep in the ground. These cables have enormous data carrying capacity at a very high speed at which light travels without any interference. BT provides leased lines to its customers which are used by them to transmit data throughout the period of subscription. It was the case of BT that there is no sale of goods by it and accordingly, there was no liability for charge of VAT.

Karnataka State VAT authorities, however, issued notices to BT for the purpose of reassessment by adding to the turnover, the amounts received by BT towards leasing of broadband by treating the same as transfer of right to use goods. The Assessing authority passed orders of reassessment and also imposed penalties and interest.

BT challenged the order through a writ instead of pursuing the normal appellate channel. In the first round, its writ was dismissed by a single judge on the ground that alternate remedy was available to BT. BT, thereafter appealed to the Division Bench of the High Court which held that the writ was maintainable in as much as one of the questions to be determined was whether the Government of Karnataka was competent to levy taxes under the KVAT Act once service tax was already levied on it in terms of the Finance Act, 1994 and also paid by the taxpayer. While holding that the writ remedy was indeed available to the assessee, the High Court also considered the question as to whether the light energy required for transmitting data from one point to another through optic fiber cable was artificially created by BT and if so whether such artificially created light energy was capable of being held as goods. The Court also had to determine whether Karnataka Government would have authority to levy tax on the said sale despite its being assessed to service tax by the Central Government by the Finance Act, 1994.

The process of transmission of data through broadband service was described by the Court as follows:

a. When a leased line subscriber transmits data from (his) computer, the data will be in the form of electrical signals. The electrical signal is terminated in a Multiplexer Device in an

Electrical interface with the ITU-T (International Telecommunications Union). The multiplexer will have an Electrical / optical input and an optical output. The optical output is a fibre cable which passes through many places in a given geography.

b. The electrical signals are multiplexed through the optical network using the Time Division Multiplexing technology. The data sent from the source is mapped to the destination in a logical way in the network and the data is effectively delivered from source to destination. At the destination end the multiplexer does the de-multiplexing function and delivers the actual data from the optical source into an Electrical signal and the computer will be able to process the data.

c. The Multiplexer has the light source which would be a Light Emitting Device (LED) / Laser Device (LD). The data which is in electrical signals modulates the light. The multiplexer converts these signals into a corresponding optical signal (a form of an electromagnetic wave). This stage onwards the data travels in the form of light through the optic fibre cable (OFC).

d. When the data reaches the other end, it falls on a “photodetector”, which senses the modulations in the light and reproduces the original data and sends the electrical signals to the computer. The photodetector surface absorbs the light and hence the light does not travel any further.

e. In the entire activity of transmission of data from place to place, what is delivered by the broadband users is data in electrical wave form and what is given back to the said users is data in electrical wave form only. The light that is emitted by the LD in the transmitter is only for the purpose of transmission of either data or voice information.

From the said process, the High Court deduced that OFC broadband Lines necessarily and invariably work on 'light- energy' and it is only this 'light energy', which carries data / information belonging to the subscribers of the service providers through the OFCs from one place to another desired place; this 'light energy' is not created from any natural source of light, but it is 'artificially created' by the Company itself within its network. The court held that it is also not in dispute that this 'light energy' is 'irretrievable' in the sense that once it is used for transmission of a particular data, it cannot be re-used for transmission of another data; this light energy is intangible one and highly movable; it travels through the OFCs laid by the Company at the same speed at which the light travels in the free open space.

Distinguishing the case from the BSNL case, it was held: “From the above observations of Supreme Court in the case of BSNL Vs Union of India it is clear that the term 'goods' does not include 'electro magnetic waves' or 'radio frequencies' for the reasons that they are neither abstracted nor are they consumed, in the sense that they are not extinguished by

their user, and that they are not delivered, stored or possessed nor are they marketable. Therefore, the converse of it would be, if the electro magnetic waves of any kind can be 'abstracted' consumed and used, and they are capable of being delivered, possessed and stored, they can be termed as “goods”.

The Court held that from the opinion of experts in the field obtained by the assessing authority as also the assessee, it is clear that electro magnetic waves used in the operation of mobile phones and artificially created light energy, though it is electro magnetic waves of high frequency, are distinct from each other having different characteristics and being used for different purposes. It was held that the artificially created light energy was capable of being possessed, transmitted, delivered, used and, to some extent, stored which are the essential characteristics of goods. Therefore, the Court held that despite the observation of the Supreme Court in the BSNL case, it was goods which could be sold and hence liable to VAT.

In the BSNL case, it was held by the SC that the operators were mere carrier of goods and hence not subject to sales tax. Distinguishing the present case, the High Court held that in the case of 'transportation of goods', what is consumed is petrol / diesel which used as source of energy (fuel) for making the lorry (carrier) to run for the purpose of carrying the goods, but not the carrier (lorry) itself. But, in the case of transmission of data, the carrier viz; ACLE itself is fully consumed. This being so, carrying of data by ACLE(Artificially created light energy) through OFC Network cannot be equated with the carrying of goods by transporter by using a vehicle like lorry and the appellant-company cannot be taken as the 'carrier' of data of its subscribers.

The High Court further held that even if the activities of the company are comprehensively termed as services under the service level agreement entered into by the company with its subscribers, they answer the description of sale within the meaning of the term in section 2(29)(d) of KVAT Act. The Court held that in the present case, the transaction was a composite one and the elements of service and sale cannot be split.

Applying the dominant object theory in the case of composite contract, the HC held: “we are of the considered opinion that having regard to the nature of the transaction between the appellant Company and its subscribers and all other circumstances of the case with respect thereto, the dominant object of the transaction/contract has been the ‘sale of artificially created light energy’ by the appellant Company to its subscribers and the providing of infrastructure of OFC network by the appellant Company to its subscribers to facilitate the carrying of the data/information is only incidental to the said dominant object though the transaction of the appellant Company is described in the Service Line Agreement as ‘service”.

Finally, and what is most troubling for the telecom operators, the Court held: “we are of the considered view that since elements of service and sale in the instant transaction cannot be separated from each other, as rightly held by the Assessing Authority in the impugned order of reassessment, the entire proceeds received by the appellant Company from its subscribers as ‘Service rentals’ shall have to be brought under tax under the provisions of KVAT Act treating the entire transaction of the appellant Company in providing the broad band connectivity to its subscribers as sale of artificially created light energy.”

The net result of the analysis by the High Court is that the broad band service providers are held liable to pay VAT in respect of the same transaction on which service tax has already been paid. Moreover, this interpretation has been applied in reassessment proceedings. The amounts involved in these transactions are significant. If retrospective effect is given to such interpretation, there is no way the service providers will be able to recover the same from their clients. The logic given by the Karnataka High Court has since been adopted by other States. The State of Delhi has already issued a notification to this effect. It is likely that others will follow suit.

Appendix 2

International Comparison of Functions of Regulators

Country	Afghanistan	Australia	Austria	Bahamas	Bahrain	Barbados	Botswana
Name of the Telecom Regulatory Authority	Afghanistan Telecom Regulatory Authority (ATRA)	Australian Communications & Media Authority (ACMA)	Austrian Regulatory Authority for Broadcasting and Telecommunications (RTR-GmbH)	Utilities Regulation & Competition Authority	Telecommunications Regulatory Authority of Bahrain (TRA)	Telecommunications Unit	Botswana Telecommunications Authority
General functions							
(a) Regulate and supervise operators and service providers, in accordance with the provisions of the law(s)	√	√	√	√			
(b) Supervise compliance by operators and service providers with international obligations prescribed for telecommunications sector; represent the country in international regulation of communications; help for global harmonisation & coordination in telecommunication	√	√				√	√
(c) to implement and promote the Government's national policy objectives for the telecommunications and related sector, to promote growth, investment and innovations in telecom sector	√		√			√	√
(d) to oversee the new regulatory framework for the converging industries of telecommunications, broadcasting and on-line activities							
(e) to ensure availability of quality communication services, network efficiency and effectiveness; universal service obligations		√					√
Economic regulation							
(a) promotion of competition and prohibition of anti-competitive conduct, as well as the development and enforcement of access codes and standards		√	√	√	√	√	

Country	Afghanistan	Australia	Austria	Bahamas	Bahrain	Barbados	Botswana
Name of the Telecom Regulatory Authority	Afghanistan Telecom Regulatory Authority (ATRA)	Australian Communications & Media Authority (ACMA)	Austrian Regulatory Authority for Broadcasting and Telecommunications (RTR-GmbH)	Utilities Regulation & Competition Authority	Telecommunications Regulatory Authority of Bahrain (TRA)	Telecommunications Unit	Botswana Telecommunications Authority
(b) licensing, enforcement of license conditions for network and application providers and ensuring compliance to rules and performance/service quality.	√	√	√				√
(c) making decision on mergers, acquisitions and changes of ownership in ICT services							
(d) Affordable ICT services, approving/ setting tariff, tariff regulation							√
Technical regulation							
(a) efficient frequency spectrum assignment, the development and enforcement of technical codes and standards, and the administration of numbering and electronic addressing	√	√	√	√		√	√
Consumer protection							
(a) the empowerment of consumers while at the same time ensures adequate protection measures in areas such as dispute resolution, affordability of services and service availability, restriction of third party interference to protect personal privacy, ensuring security and efficiency in telecom network, ensuring security	√	√	√		√	√	√
(b) Dissemination of information/ regulations and industry performance on telecommunication		√					
Social regulation							
(a) twin areas of content development as well as content regulation; the latter includes the prohibition of offensive content as well as public education on content-related issues,				√			

Country	Afghanistan	Australia	Austria	Bahamas	Bahrain	Barbados	Botswana
Name of the Telecom Regulatory Authority	Afghanistan Telecom Regulatory Authority (ATRA)	Australian Communications & Media Authority (ACMA)	Austrian Regulatory Authority for Broadcasting and Telecommunications (RTR-GmbH)	Utilities Regulation & Competition Authority	Telecommunications Regulatory Authority of Bahrain (TRA)	Telecommunications Unit	Botswana Telecommunications Authority
Other functions							
Establishment, supervision and regulation of Universal Service Obligation Fund/ Telecom Development Fund and other similar fund(s)	√	√	√				√

Country	Brunei Darussalam	Bulgaria	Canada	Croatia	India	Ireland	Israel	Lesotho
Name of the Telecom Regulatory Authority	Authority for Info-Communications Technology Industry	Communications Regulation Commission	Canadian Radio-Television & Telecommunications Commission (CRTC)	Croatian Post and Electronic Communications Agency	Telecom Regulatory Authority of India (TRAI)	Commission for Communications Regulation (ComReg)	Ministry of Communications (MOC)	Lesotho Communications Authority (LCA)
General functions								
(a) Regulate and supervise operators and service providers, in accordance with the provisions of the law(s)	√	√	√	√	√	√	√	√
(b) Supervise compliance by operators and service providers with international obligations prescribed for telecommunications sector; represent the country in international regulation of communications; help for global harmonisation & coordination in telecommunication								
(c) to implement and promote the Government's national policy objectives for the telecommunications and related sector, to promote growth, investment and innovations in telecom sector				√	√			√
(d) to oversee the new regulatory framework for the converging industries of telecommunications, broadcasting and on-line activities					√			
(e) to ensure availability of quality communication services, network efficiency and effectiveness; universal service obligations					√			√
Economic regulation								
(a) promotion of competition and prohibition of anti-competitive conduct, as well as the development and enforcement of access codes and standards			√		√	√		√
(b) licensing, enforcement of license conditions for network and application providers and ensuring compliance to rules and performance/service quality.			√		√	√		

Country	Brunei Darussalam	Bulgaria	Canada	Croatia	India	Ireland	Israel	Lesotho
Name of the Telecom Regulatory Authority	Authority for Info-Communications Technology Industry	Communications Regulation Commission	Canadian Radio-Television & Telecommunications Commission (CRTC)	Croatian Post and Electronic Communications Agency	Telecom Regulatory Authority of India (TRAI)	Commission for Communications Regulation (ComReg)	Ministry of Communications (MOC)	Lesotho Communications Authority (LCA)
(c) making decision on mergers, acquisitions and changes of ownership in ICT services			√					
(d) Affordable ICT services, approving/ setting tariff, tariff regulation			√	√			√	
Technical regulation								
(a) efficient frequency spectrum assignment, the development and enforcement of technical codes and standards, and the administration of numbering and electronic addressing	√				√	√	√	√
Consumer protection								
(a) the empowerment of consumers and ensures adequate protection measures in areas such as dispute resolution, affordability of services and service availability, restriction of third party interference to protect personal privacy, ensuring security and efficiency in telecom network, ensuring security				√	√	√		√
(b) Dissemination of information/ regulations and industry performance on telecommunication			√		√	√		
Social regulation								
(a) twin areas of content development as well as content regulation; the latter includes the prohibition of offensive content as well as public education on content-related issues,								
Other functions								
Establishment, supervision and regulation of Universal Service Obligation Fund/ Telecom Development Fund and other similar					√			

Country	Brunei Darussalam	Bulgaria	Canada	Croatia	India	Ireland	Israel	Lesotho
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fund(s)								

Country	Malaysia	Malawi	Nepal	Pakistan	South Africa	Sri Lanka	Thailand	United Kingdom
Name of the Telecom Regulatory Authority	Malaysian Communications and Multimedia Commission	Communications Regulatory Authority (MACRA)	Nepal Telecommunications Authority	Pakistan Telecommunications Authority (PTA)	Independent Communications Authority of South Africa (ICASA)	Telecommunications Regulatory Commission of Sri Lanka (TRC)	National Telecommunications Commission (NTC)	Ofcom
General functions								
(a) Regulate and supervise operators and service providers, in accordance with the provisions of the law(s)		√		√	√		√	
(b) Supervise compliance by operators and service providers with international obligations prescribed for telecommunications sector; represent the country in international regulation of communications; help for global harmonisation & coordination in telecommunication					√			

Country	Malaysia	Malawi	Nepal	Pakistan	South Africa	Sri Lanka	Thailand	United Kingdom
Name of the Telecom Regulatory Authority	Malaysian Communications and Multimedia Commission	Communications Regulatory Authority (MACRA)	Nepal Telecommunications Authority	Pakistan Telecommunications Authority (PTA)	Independent Communications Authority of South Africa (ICASA)	Telecommunications Regulatory Commission of Sri Lanka (TRC)	National Telecommunications Commission (NTC)	Ofcom
(c) to implement and promote the Government's national policy objectives for the telecommunications and related sector, to promote growth, investment and innovations in telecom sector	√		√	√	√		√	
(d) to oversee the new regulatory framework for the converging industries of telecommunications, broadcasting and on-line activities	√						√	
(e) to ensure availability of quality communication services, network efficiency and effectiveness; universal service obligations			√	√			√	√
Economic regulation								
(a) promotion of competition and prohibition of anti-competitive conduct, as well as the development and enforcement of access codes and standards	√		√				√	√
(b) licensing, enforcement of license conditions for network and application providers and ensuring compliance to rules and performance/service quality.	√	√	√		√	√	√	
(c) making decision on mergers, acquisitions and changes of ownership in ICT services								
(d) Affordable ICT services, approving/ setting tariff, tariff regulation						√	√	
Technical regulation								
(a) efficient frequency spectrum assignment, the development and enforcement of technical codes and standards, and the administration of numbering and electronic addressing	√	√	√	√	√	√	√	√
Consumer protection								

Country	Malaysia	Malawi	Nepal	Pakistan	South Africa	Sri Lanka	Thailand	United Kingdom
Name of the Telecom Regulatory Authority	Malaysian Communications and Multimedia Commission	Communications Regulatory Authority (MACRA)	Nepal Telecommunications Authority	Pakistan Telecommunications Authority (PTA)	Independent Communications Authority of South Africa (ICASA)	Telecommunications Regulatory Commission of Sri Lanka (TRC)	National Telecommunications Commission (NTC)	Ofcom
(a) the empowerment of consumers while at the same time ensures adequate protection measures in areas such as dispute resolution, affordability of services and service availability, restriction of third party interference to protect personal privacy, ensuring security and efficiency in telecom network, ensuring security	√	√	√	√	√		√	√
(b) Dissemination of information/ regulations and industry performance on telecommunication						√		
Social regulation								
(a) twin areas of content development as well as content regulation; the latter includes the prohibition of offensive content as well as public education on content-related issues,	√							
Other functions								
Establishment, supervision and regulation of Universal Service Obligation Fund/ Telecom Development Fund and other similar fund(s)								

Source: Compiled from websites of the respective Telecom Regulator

Annexure 1: Details of Meetings and Outcomes

Date	NIPFP Members	TRAI Members	Discussion (main points)	Follow-up Action
November 10, 2010 (TRAI Office)	Dr. S. Mukherjee & Mr. D. P. Sengupta	Ms. Anuradha Mitra, Mr. S. Chawla, and Mr. Dhingra	<p>Broad scope & coverage of the study</p> <ul style="list-style-type: none"> ▪ Three sets of taxes are levied on telecom companies – regulatory charges (spectrum charges & licence fees), local government levies & charges (Tower Charges, Right of Way charges etc.) and Direct and Indirect Taxes ▪ Three level of government collects taxes/ charges from the telecom companies (Central Government (Service Tax & Corporate Income Tax); State Government (VAT on RCVs, Entry Tax, Entertainment Tax etc.) and Local Government or Urban Local Bodies (Tower Charges, Right of Way Charges etc.) 	Requested to share the information on payment made by the telecom companies to local governments (either Urban Local Bodies or Rural Local Bodies) in terms of Tower Charges (or related charges for setting and operating towers, e.g., property tax etc) and Right-of-Way charges for laying cable etc. at the disaggregated level / State Level.
November 22, 2010 (TRAI Office)	Dr. R. Kavita Rao, Mr. D. P. Sengupta & Dr. S. Mukherjee	TRAI Officials and Representative from 5 Telecom Companies (Bharti Airtel, Idea Cellular, Vodafone, BSNL, Tata	Telecom service providers/ companies interacted with us and shared their concerns for taxes/ levies / charges that they pay to different level of governments (Centre/ State/ Local Governments) and other issues/ concerns related to the study	It was decided that a proforma will be sent to telecom companies to send the information required to carry out the study. A draft proforma was sent to TRAI on November 16, 2010.

Date	NIPFP Members	TRAI Members	Discussion (main points)	Follow-up Action
		Teleservices Ltd.)		
December 22, 2011 (NIPFP)	Dr. R. Kavita Rao, Mr. D. P. Sengupta & Dr. S. Mukherjee	Ms. Anuradha Mitra and Mr. S. Chawla	To discuss about the quality of the response received from telecom companies and whether to continue with the study with the limited information.	TRAI sent us a list of contacts (mobile number) of officials of telecom companies involved in indirect taxation issues. Follow up call were made and meetings fixed to get clarifications.
December 29, 2010 (Bharti Airtel Gurgaon and BSNL, Cannught Place)	Dr. R. Kavita Rao, Mr. D. P. Sengupta & Dr. S. Mukherjee	Meeting with Bharti Airtel and BSNL	To reconcile the information received through the proforma and that with the details available in the Annual Reports, specific queries were sent to the major telecom companies (Bharti Airtel, BSNL, Tata Teleservices, Reliance Communication and Vodafone). After several attempts to get clarifications on the information that the companies sent through the proforma, meetings were arranged with Bharti Airtel and BSNL.	Certain clarifications received from Bharti Airtel. Except for few items, no clarification could be obtained from BSNL
January 10, 2011 (NIPFP)	Dr. R. Kavita Rao, Mr. D. P. Sengupta & Dr. S. Mukherjee	Mr. Sunil Kr. Gupta and Mr. Sameer Seth (Reliance Communication)	In response to queries, a meeting was arranged with the representatives of Reliance Communication. However, they didn't offer any clarifications on our queries and promised to send the details.	With reference to our meeting, we asked for following information: a) Case studies in relation to licence fee and specturm charges applicable to telecom companies in other countries (international experiences - probably ITU

Date	NIPFP Members	TRAI Members	Discussion (main points)	Follow-up Action
				<p>case studies)</p> <p>b) Letters to the Local Governments that were sent from AUSPI on Towers and Right of Way charges (letters sent to Rajasthan, Madhya Pradesh, Kerala, Karnataka, Maharashtra, Bihar and Delhi)</p> <p>c) Chart prepared by RCOM on Right of Way charges that was sent to TRAI</p> <p>d) Meeting Service tax liability through CENVAT credit and decomposition and year-wise projection thereof.</p> <p>e) Year-wise figure on Disputed Liabilities in Appeal (e.g., Sales tax and VAT, Excise and service tax, Entry tax and octroi, other litigations)</p> <p>Instead of several reminders and follow up, we didn't receive any clarification or information from them</p>
February 01, 2011 (NIPFP)	Dr. R. Kavita Rao, Mr. D. P. Sengupta & Dr. S. Mukherjee	Mr. Amitabh Kehma (Vodafone Essar Ltd.)	To get clarifications on the queries that we sent to VEL and to get more information a meeting was organised with Mr. Khemka.	Information on Service Tax Payment through cash and CENVAT credit was sought. No information is furnished till date.

Date	NIPFP Members	TRAI Members	Discussion (main points)	Follow-up Action
March 22, 20011 (TRAI)	Dr. R. Kavita Rao, Mr. D. P. Sengupta & Dr. S. Mukherjee	Ms. Anuradha Mitra, Mr. S. Chawla, and Mr. Dhingra	To discuss the comments raised on Draft Report	<p>It was decided as follows:</p> <ul style="list-style-type: none"> a) on the basis of available information a section on impacts of taxes, levies and charges on telecom service sector to be added in the final report b) a section on role of telecom regulatory authorities across some selected countries will be added in the final report c) the draft report will be edited and recommendations will be highlighted clearly in the final report

Apart from the above meetings, Ms. Sanjukta Sarkar from NIPFP made several visits to TRAI office to collect various information (Annual Reports of the Telecom Companies, TRAI's Quarterly Reports and Filled-up Proforma).