



# **POST BUDGET MEMORANDUM**

**Cellular Operators Association of India**

**March 2007**



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## **INDIRECT TAXES**

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## **1. Levy of Service Tax on Renting of Immovable Property for use in Commerce and Business**

- **Present Scenario:**

The ***Union Budget of 2007 -2008*** has extended the levy of Service tax to Renting of immovable property for use in commerce and business.

It may be pertinent to note that Stamp Duty is already payable at the time of entering the agreement. Levy of Service Tax on Renting of Immovable Property for use in Commerce and Business was not called for and this levy will act as an additional burden on the telecom service providers.

- **Adverse Impact**

- This levy will lead to administrative problems, as the service provider will first pay the service tax and then claim the credit.
- This levy will act as a burden and have a cascading effect on the costs and will thus result in inflationary pressures in the economy. This will thus increase the cost of service for the end user.
- There will be an adverse impact on roll out of affordable services to all areas and especially to the semi-urban and rural areas.
- Thus it will act against the Government objective of rapid spread of affordable telecom service – achieving 500 million telecom subscribers by 2010.

- **COAI Recommendations**

***Service tax on renting of immovable property for use in commerce and business should not be levied.***



## 2. Excise Duty CENVAT rule in respect of Cable / Shelter and Towers

- **Present Scenario:**

Telecom service providers lay cables across the country and the same is covered under chapter 85 of the Excise Tariff rules hence it is treated as capital goods under the CENVAT credit rules.

To avail the credit, capital goods should be installed with in the premises of the company, however in case of cable laid across the country the same is not possible.

If capital goods are taken out of the premises of the output service provider and not returned within a period of 180 days then the CENVAT credit claimed on the same has to be reversed.

- **COAI Recommendations:**

The telecom service providers have to install assets such as BTS, cables, RSUs, boosters across their respective service area.

Suppose the operators were to consider BTS sites as business premises then there will be a need to inform the department about the same. This will entail informing for huge number of sites on account of additions and changes in addresses.

Magnitude of administration, record keeping, both from the operator's point of view as well as department's perspective, would be very high.

***The business premises for telecom operators should be clearly defined so as to include the licensed service area in terms of the allotted telecom licenses. OR CENVAT credit rules be modified suitably to take care of needs of Telecom industry.***

- **Benefits:**

- This step will **result** CENVAT rules have been picked up from the manufacturing sector.
- After the marriage of service tax with excise, **there is a urgent need to re-look at the rules from the service industries point of view also.**
- A clarification on this would **remove administrative problems.**
- **This will also enable smoother and faster roll-out of service.**
- **In the present scenario when TRAI on one side trying to motivate the industry to go in for expansion in rural areas and has also recommended subsidies to private operators setting up network in rural areas,** such restrictions on CENVAT credits is uncalled for particularly when this industry is booming and is generating huge revenues for the Central Govt.



### 3. 8% CVD on Packaged or Canned Software

- **Present Scenario:**

The Union Budget 2006-07 has imposed a 8% CVD on Packaged or Canned Software while exempting Customized Software from this levy.

Some Custom Houses who are processing the software shipments conceive the software imported for the telecom equipment as the Canned Software and are not accepting the aforesaid classification and directing the levy of 8% with 2% surcharge applicable on it on all software imported for installation on telecom equipment.

- **COAI Recommendations:**

Telecom Companies are purchasing telecom software, which is specific user program prepared only for a particular service provider and is thus different from the normal computer software. ***The telecom software is equipment specific and has to be configured in the equipment.***

***Therefore the software used for telecom equipment fulfills all the criteria of customized software*** and thus cannot be classified as canned or off the shelf software.

In view of the above 8% CVD should not be levied on the telecom software.

***A notification should be issued to exempt Telecom software being imported by Telecom Service providers. OR An unambiguous circular be issued clarifying that Telecom software satisfying any of the conditions mentioned below is Customized Software, if***

- ***Software comes on CD-R and not on pre-printed standard CD's Or***
- ***Manual for software clearly mentions the modifications/ changes done for buyer, Or***
- ***Software is not being sold off the shelf. (On the basis of declaration of importer).***

- **Benefits:**

- On this account it is pertinent to mention that, this levy leads to a huge delay in clearing the equipment, as a result of which there is a delay in network roll-out.
- Further, this is an incorrect additional financial levy that is not envisaged in the Union Budget.
- This levy imposes an additional financial burden on the operators and increases the cost of service.



## **DIRECT TAXES**

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## **1. Tax benefit under section 80-IA not available to companies undergoing amalgamation or demerger after 31.3.2007**

### **• Present Scenario:**

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

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

Union Budget of 2007 -2008, proposes to insert a new sub-section (12A) in section 80-IA so as to provide that the **provisions of sub-section (12) shall NOT apply to any undertaking or enterprise which is transferred in a scheme of amalgamation or demerger after 31.3.2007.**

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

### **• Adverse Impact**

- **Denial of tax holiday benefit on mergers / amalgamations of telecom companies is a retrograde step.**
- This step will go against the expansion of affordable telecom service in India.
- This step could **result in confusion and disputes** on reorganization of telecom companies in the future.
- Because of the above step, the expansion by the telecom operators by way of acquisitions is likely to become tax inefficient.

### **• COAI Recommendations**

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

***The position, as was, prior to the announcement of Union Budget 2007 – 08 should be maintained.***

***Section 80 – IA benefits should be available to companies undergoing amalgamation or demerger after 31.3.2007***



## 2. Deduction in respect of Section 80-IA

- **Present Scenario:**

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

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

- **COAI Recommendations:**

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

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

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

➤ Telecom operators have incurred heavy business losses and significant tax depreciation on account of capitalization in its initial years due to which 80IA benefits have not been triggered by many operators till now which is almost 10 years since the licenses were granted.

***100% exemption for successive 10 years out of the 20 years.***

➤ As significant capital investment and proliferation in rural area is envisaged, tax depreciation is anticipated to be high in the coming years as well.

- **Benefits:**

➤ This step will **result in a higher disposable funds for reinvestment in the business.**

➤ This will thus enable faster expansion of service thereby resulting in higher revenues for the service providers.

➤ **These higher revenues will result in higher License Fee revenue and higher Service Tax revenue for the government.**

➤ **Therefore any measure that leads to expansion of service will also result in much higher tax revenues for the government.**



### 3. Tax Holiday under Section 80-IA

- **Present Scenario:**

Under existing provision, to avail this exemption services should commence before 1.4.2005.

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

- **COAI Recommendations:**

*For the new licences issued in 2001, this period should be extended by 3 years i.e. upto 1.4.2008.*

*Proposed clause (ii) of sub-section 4 of section 80IA should therefore states that any undertaking which has started or starts providing telecommunication services... on or before the 31<sup>st</sup> day of March, 2008.*

- **Benefits:**

- This would greatly enhance viability of cellular projects. This would also go a long way in enabling companies to achieve financial closure.
- As the projects become viable and the cellular industry grows, the **government would not only derive benefits from higher tax revenues but also from the resultant economic growth.**



## 4. Fringe Benefit Tax on ESOPs

- **Present Scenario:**

The Union Budget of 2007 -2008 has brought ESOPs given by companies to their employees under the purview of Fringe Benefit Tax (FBT).

It is important to note that capital gains tax is already applicable when the ESOPs are exercised. Since the Capital gains tax was already applicable, another tax was not called for.

ESOPs was an attractive tool for companies to hire and retain talent. More importantly ESOPs is also a way by which companies share wealth/ benefits of growth with their employees.

- **Adverse Impact**

- If the companies were to bear the burden of FBT on ESOPs, then the impact on cost/ margins could be significant. This step will thus increase the cost for companies for retaining talent.
- On the other hand, FBT on ESOPs can become a major problem in case the companies decide to pass on the tax liability to the employees.
- This step will reduce the attractiveness of ESOPs as a tool to hire and retain talent.
- This levy will increase Operating Costs (Salaries) for Service Providers in the medium to long run.

- **COAI Recommendations**

***Fringe Benefit Tax should NOT be applicable on ESOPs.***



## 5. Accelerated Depreciation for Telecom Industry

- **Present Scenario:**

Sec 32 (1) (ii) (a) provides additional depreciation to the extent of 15% of actual cost of New Plant & Machinery to assessees manufacturing any article or thing.

The additional depreciation is allowed to:

(A) A new industrial undertaking during any previous year in which such undertaking begins to manufacture or produce any article or thing on or after the 1st day of April, 2002; or

(B) Any industrial undertaking existing before the 1st day of April, 2002, during any previous year in which it achieves the substantial expansion by way of increase in installed capacity by not less than twenty-five per cent.

- **COAI Recommendations:**

***The provisions should be further extended to New Plant & Machinery Capitalized by assessees engaged in providing Telecom Services and either setting up a new undertaking on or after 1 April 2002 or undertaking existing prior to 1 April 2002 and achieving substantial expansion during any year.***

- **Benefits:**

- Since Telecom Industry is highly Capital Intensive and requires huge amount of Capitalization, providing **additional depreciation** would provide a boost to the Telecom sector.
- **Reduction in capital costs ultimately would benefit the consumer through availability of affordable telecom service.**
- Moreover, this **would accelerate network rollouts to semi-urban and rural areas.**



## 6. Utilization of MAT Credit

- **Present Scenario:**

Presently the MAT credit, which can be carried forward, is restricted to the extent of the difference between MAT and normal tax for the year.

- **COAI Recommendations:**

When MAT is applicable, the assessee is entitled for a corresponding MAT credit to be utilized over the following seven years.

However, though telecom companies are entitled to tax holiday u/s 80IA , the MAT is an outflow , which the companies have to incur , due to the limitation put in the section ( section 115JAA(2)) .

***The MAT credit should NOT be restricted to the extent of the difference between the MAT and the normal tax for the year and credit should be available of the full amount paid as MAT.***

- **Benefits:**

- Telecom companies are expanding network at a fast pace and are making losses.
- This will enable service providers to utilize MAT credit and will thus result in higher funds available for reinvestment in the business.
- This step will act as an enabler for faster expansion of affordable service.