Telecom Regulatory Authority of India

Recommendations on components of Adjusted Gross Revenue (AGR)

(Pursuant to the directions of Hon'ble TDSAT in their Order dated 7th July 2006 in petition No. 7/2003 & other connected petitions)

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Chapter 1: Background

1.1 The Association of Unified Telecom Service Providers of India, Cellular Operators Association of India and some Individual Telecom service providers challenged before the Hon'ble TDSAT the definition of "Gross Revenue" and "Adjusted Gross Revenue" (AGR) as applied and implemented by the Department of Telecom (DoT) for the purpose of levying licence fee under the 1st and 2nd cellular/4th cellular/Unified Licence Agreement issued by the DoT and as amended from time to time as being unfair, unjust, violative of the terms of the migration package and beyond the scope and powers vested with DoT under Section 4 of the Indian Telegraph Act 1885. It was submitted that the present definition of Adjusted Gross Revenue results in the following anomalies:

- It includes several revenues unrelated to licensed activities under the licence.
- It includes service items that strictly do not fall under the definition of revenue.
- It results in dual charge of the same revenues twice in the hand of different operators.
- It includes notional income that is unrealized/remains uncollected by the Licencee.
- It includes item on accrual/billed basis but allows deduction on collected/paid basis.
- It includes several items of pass through revenues resulting in differential treatment of similar revenue.

1.2 The petitioners therefore sought relief by way of quashing demand notices issued by the Government and also prayed for refund of excess amount as licence fee based on the definition of AGR adopted by

Government. The Hon'ble TDSAT in its order dated 7.7.2006 remitted the matter to the Authority and asked the Authority to make comprehensive recommendations on individual components of revenue which can be considered as part of AGR. The relevant portion of the Order is given below:

> *"In view of the fact we have come to the conclusion that there has not been an effective consultation with the TRAI which is mandatory under the TRAI Act, we think we should not further delve into the exercise of finding out which component of the AGR, as defined by the Government in the conditions of licence, deserves to be retained and which component which the petitioners contend is not derived from the licensed revenue of the Licencee should be excluded at this stage. We think it more appropriate that the matter should be remanded to the TRAI which is the 3rd Respondent herein, before whom the Government should produce the material relied by it while rejecting TRAI's recommendation so that TRAI can consider the same and send its conclusions to this Tribunal and thereafter, this Tribunal will have the benefit of a comprehensive recommendation of the TRAI after considering the materials relied upon by the Government."*

NTP'99 and Migration to Revenue Share Licence fee Regime

1.3 The National Telecom Policy' 99 (NTP 99) envisaged the introduction of a new regime, whereby multiple operators would be permitted to operate and licence fee would be based on revenue sharing basis for telecom service providers, as against a fixed amount of licence fee being charged prior to NTP'99. It was also envisaged in the NTP'99, that the appropriate level of entry fee, percentage of revenue share and basis for selection of new operators for different service areas of operation

would be recommended by Telecom Regulatory Authority of India (hereinafter mentioned as the Authority) in a time bound manner, keeping in view the objectives of NTP'99.

1.4 To enable the transition from a fixed licence fee to a revenue share licence fee a migration package was worked out by DoT and issued on of 22.07.1999. This provided for integration of existing licences- Basic and Cellular, with the requirement of payment of a licence fee based on the percentage of revenue earned under the Licence. The relevant portion of the migration package is reproduced below:

> *"(i) The Licencee will be required to pay one time entry fee and licence fee as a percentage share of* ***gross revenue under the Licence*** *. The entry fee chargeable will be the licence fee dues payable by existing Licencees upto 31.7.1999, calculated upto this date duly adjusted consequent upon notional extension of effective date as in para (ix) below, as per the condition of the existing Licence.*
>
> *(ii) The Licence fee as a percentage of* ***gross revenue under the licence*** *shall be payable w.e.f.1.8.99. "*

1.5 Similarly in September 2000, Government prepared a new draft Licence Agreement for International Long Distance Services(ILD). The draft Licence Agreement contained a provision that licence fee was payable as percentage of revenue. For the Public Mobile Radio Trunk Service (PMRTS), the revenue share regime was made applicable from 1.11.2001.

1.6 The migration package was accepted by all existing basic service providers and cellular mobile telephone service providers. The Authority

in its recommendations proposed revenue share licence fee for services like Global Mobile Personal Communications by Satellite (GMPCS), Cellular Mobile Telephone Service (CMTS), Basic Telephone Service, PMRTS, Very Small Aperture Terminal (VSAT), National long Distance Service (NLD) and ILD. The definition and scope of revenue recommended by the Authority for all telecom services was broadly the same, based on the principle that gross revenue accruing to the Licencee for the purpose of levying licence fee shall be generated by way of operation of the service mandated under the Licence but as reduced by charges like Interconnection Usage Charge (IUC)/Access Charges and roaming revenue payable to other service providers, service tax and proceeds from sale of handsets or terminal equipment. The service wise definition of AGR recommended by the Authority and that adopted by the DoT is given in *Annexure I.*

Definition of AGR

1.7 The source of power for granting Licence to provide telecom services and collecting licence fee is derived under the proviso to section 4 of the Indian Telegraph Act. Under section 4 of the Indian Telegraph Act 1885, the Central Government has exclusive privilege of 'establishing, maintaining and working of telecommunication' and under the proviso of said section the Government has the right to transfer its privilege by way of Licence to any person on such conditions and for consideration of such payments, as it thinks fit. Licences to service providers have been issued under the above provision and the Government is charging licence fee on the basis of revenue share. A fixed percentage of revenue share is charged on the AGR based on the service for which DoT has issued the Licence. At present revenue share percentage varies from 0 per cent to 10 per cent, depending upon the

nature of the licence. Details of prevailing level of revenue share licence fee is at *Annexure II.*

1.8 The definition of revenue adopted in the Licences by the DoT is broadly the same across all services. The AGR is defined as the gross revenue derived from providing licensed service/ accruing to the licencees , revenue on account of interest, dividend, value added services, supplementary services etc. and adjusted for certain pass through items like (i) Public Switched Telecom Network (PSTN) related call charges actually paid to other service providers within India, (ii) roaming revenue on account of revenue charges actually passed to other service providers and service tax actually paid to Government.

Hon'ble TDSAT Order

1.9 The Hon'ble Tribunal examined the contention of the petitioners that the Government had rejected the recommendations of the Authority on the computation of AGR without proper consultation. The Hon'ble Tribunal was informed by the Government that recommendations of the Authority were considered in two stages and the same were examined in the background of an opinion received from an Accounting expert. In this regard the Hon'ble Tribunal held that there has not been an effective consultation with the Authority before rejecting their recommendations which is mandatory under the Act. The relevant portion of the judgement is as under:

> *"Coming to the recommendations of renowned expert in Accounting, it was noticed that the same was not communicated to the TRAI which has deprived the TRAI the benefit of considering that opinion. Under Section 11 (1) (a) proviso 3 requires that Central Government to furnish such information or document as may be necessary for the*

purpose of making recommendations by the TRAI. The said proviso directs that the Government shall supply such information within a period of 7 days from the receipt of such request. Even though the proviso only mandates the Central Government to furnish the information on demand by TRAI, on a holistic reading of the object of the TRAI Act and its provisions, in our opinion it makes it obligatory for the Central Government to place before the TRAI such information which the Government is likely to rely upon while rejecting the recommendations of the TRAI. Possibly for this purpose the Section has provided the second consultation with the Authority under fifth proviso of the above section. In the instant case, we do not find from the material on record that the opinion or recommendation of the renowned expert in accountancy having been placed before the TRAI. This lacunae in our opinion has vitiated the proceeding contemplated under Section 11 (1) (a) of the TRAI Act which mandates the Central Government to seek the recommendation of TRAI. If we notice the importance of TRAI's recommendations as seen in the National Telecom policy and also the representation made in the Migration Package, we think there has not been a proper effective consultation as required under the Act and the statement of the Ist respondent that it has given due weightage while considering the recommendation of TRAI cannot be accepted."

1.10 Therefore, Hon'ble TDSAT in its order dated 7.7.2006 remitted the matter to the Authority and asked the Authority to prepare a comprehensive recommendation on individual components of revenue which can be considered as part of AGR. While forming its conclusions the Authority shall have to hear the Government as well as the Licencees and consider the materials that may be placed before it by either side. Hon'ble TDSAT order in this regard is reproduced below:

"During this proceeding before the TRAI the petitioners shall place before it their contentions in regard to the various components of AGR which they have challenged before this Tribunal and the TRAI after hearing the Government on this issue also, send its recommendations to this Tribunal preferably within three months of the receipt of this order."

1.11 Hon'ble TDSAT also examined the contention of the petitioners that the Government could not levy any licence fee beyond the provisions of Section 4 of the Indian Telegraph Act. Hon'ble TDSAT in its Order held that on the construction of Section 4 of the Indian Telegraph Act 1885 it is only the revenue from the licensed activity which has to be included in the computation of AGR. The relevant extracts of the said Order (obtained at pages 23 and 24) read as follows:

"A plain reading of this Section and its proviso shows the Government has the exclusive privilege of establishing maintaining and working of a Telegraph (in this case, Telecommunication). Therefore, this right conferred under Section 4 of the Telegraph Act is confined to "establishing", "maintaining" and "working of a telecommunication". The scope of the Licence does not go beyond the three activities mentioned therein. Proviso to that Section empowers the Central Government to transfer that privilege of establishing, maintaining or working of a telecommunication to any person by way of Licence for consideration by such payments as the Government thinks fit. A careful reading of the Section indicates that the consideration contemplated, therein is only for the privilege the Government has i.e. to establishing, maintaining or working of a telegraph and not beyond that. Therefore, if the Central Government thinks it fit to transfer this privilege for a fixed sum of money and the Licencee accepts that demand, there can be no further dispute but if

the Government chooses to take a percentage share of the gross revenue of the Licencee as its consideration then it is logical to conclude that such sharing can be only of gross revenue derived from the transferred privilege of establishing, maintaining and working of telecommunication. In our opinion, it would be doing violence to the Section if we are to accept the argument of the learned counsel for the 1st Respondent that words "as it thinks fit" found in the proviso would allow the Government to demand and collect a share of revenue from all the activities of the Licencee irrespective of the fact whether such revenue is traceable to the revenue realized from the activities under the Licence or not."

1.12 Hon'ble TDSAT also stated that any observation made by them in regard to any particular head of revenue will not be taken by the Authority as a conclusive opinion. The Authority is free to make its recommendations after independent appraisal of material that is obtained by it or placed before it during various hearings. The relevant extracts from the Order is reproduced below:

"Further, while considering the issue now remitted to the TRAI, the TRAI will bear in mind our findings in regard to the inclusion in gross revenue of the licence revenue derived from non-licensed activities. Apart from that finding, any observations made by us in regard to any particular head of revenue will not be taken by the TRAI as a conclusive opinion .The Authority is free to make its recommendations after independent appraisal of the material that is placed before or obtained by it."

Chapter 2: Presentations and Issues Raised.

2.1 As per the Order of the Hon'ble TDSAT, the Authority had called all material used by the Government while taking a view regarding definition of AGR. The material that was provided by the Government vide letter dated 19 July 2006 include following documents: (i) opinion received from the DoT's consultant; (ii) observations made by the Auditor and Comptroller General of India and (iii) copies of correspondence of the licensor with the Authority. Further the Authority gave an opportunity to all petitioners to make presentations before them.

2.2 Hon'ble TDSAT in its Order on the matter had given discretion to the Authority to decide that during the process of making recommendations it is not necessary for the Authority to hold fresh consultative proceedings unless it thinks necessary. However, during this proceeding before the Authority the petitioners shall place before it their contentions in regard to the various components of AGR which they have challenged before the Hon'ble TDSAT. The Authority considered the necessity of holding fresh consultations. The Authority noted that in the present matter the only stakeholders who were concerned were the service providers and majority of them had already petitioned the Hon'ble TDSAT. The Authority therefore considered it not necessary to go through a fresh consultative procedure, but decided to hear the service providers including those who had not petitioned the Hon'ble TDSAT so that the Authority had the benefit of the view of all concerned stakeholders. The schedule of presentation is at *Annexure III*. The Authority also received written submissions from few petitioners which are in a *separate folder* and are being forwarded along with this recommendation to Hon'ble TDSAT.

2.3 The service providers during presentations raised issues relating to items of revenues which, according to them should not be part of the AGR, and items of cost for which adjustments need to be carried out for arriving at a final figure of AGR. As far as items relating to revenues are concerned, their main contention was that the AGR should include only revenue derived from the licensed telecom activities. The revenue should only be that which is derived from users of telecom services/ sale or lease of bandwidth or receipt from sale of value added services permitted under the Licence. It should not include items like, interest, dividend etc as these activities are not covered by Section 4 of the Indian Telegraph Act, 1885. As regards items relating to deduction of expenditure from the revenue, it was contended that unless payments made to other telecom operators on account of lease circuits, port charges etc is excluded it would amount to double payment of licence fee on the same revenue. In addition certain issues arising out of inclusion of service tax in the statements for computation of AGR were also raised by the service provider. There were also diverse views on few issues amongst service providers especially relating to bundling of telecom services with sales of goods and other services. The main items raised by service providers are summarized below:

(i) Exclusion of items of revenue

a) Income from Dividend;

b) Income from Interest;

c) Capital gains on account of profit on sale of assets and securities;

d) Gains from foreign exchange fluctuations;

e) Income from property rent;

f) Income from rent/lease of passive infrastructure like towers, dark fibre;

g)Other income on account of insurance claim, sale of scraps, management consultancy fee, forfeiture earnest money etc;

h) Revenue collected on behalf the third party;

i) Income from sale of equipment including handsets;

j) Income from reversal of provisions and vendor's credit;

k) Receipt from Universal Service Obligation (USO) Fund and Access Deficit Charge (ADC); and

l) Inclusion of revenue from one Licensed activity in the revenue of another licensed activity.

(ii) Exclusion of specific items from Gross Revenue for AGR

a) Payment for port charges, leased line charges, bandwidth charges, rent for sharing of space, power and any other payments to any other Licencee; and

b) Write off of Bad debts or waiver/adjustments/discounts

(iii) Service tax should not be added in AGR statement- neither on revenue side nor on expenditure side

(iv) Pass-through IUC&ADC on accrual basis instead of payment basis.

2.4 All these items have been individually examined and analysed in Chapter 3 of this Recommendation**.**

2.5 The DoT through its Representative also put forth its line of reasoning while deciding both the definition and components of AGR. The Representative informed the Authority that the basic rationale

adopted by the Government while formulating the definition of AGR was that (i) it should be easy to interpret- so as to pose fewer problems in application and less disputes and litigations, and less prone to reduction in licence fee liability by way of accounting jugglery, (ii) It should be easy to verify- desirability to keep definition of revenue uniform to enable a uniform, transparent and simple procedure for verification of revenue, (iii) It should be comprehensive enough- to discourage designing of tariff packages and schemes for the prime purpose of reducing licence fee liability to minimum, (iv) The scope for exercise of discretion is minimized at the level of assessing authority. Therefore the DoT had tried to evolve a system of revenue share which was comprehensive and less complicated. It was also emphasized that the DoT had gone largely by the report of the Accounting expert and by the Accounting Standards of the Institute of Chartered Accountants of India (ICAI). The Authority was also informed that the DoT had kept in mind the observations made by the Comptroller and Auditor General (C&AG) of India in regard to the revenue sharing scheme (D.O. No. RRC /I(d)/VAS/Revenue Sharing/1609 dated 14-12-99). The C&AG had stated that the system should be so designed so as to enable proper verification of operator's gross revenue and secure an effective check on the assessment, collection and proper allocation of revenue.

2.6 The Authority also took note of the recent Government order on gross revenue on which licence fee is payable for DTH service. The gross revenue for purpose of levying licence fee for DTH service would be the gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of the Direct to Home enterprise from rendering of services and from the use by others of the enterprise resources yielding rent, interest, dividend, royalties, commissions etc.

Chapter 3: Analysis and Recommendations

3.1 The previous Chapter dealt with the various issues raised by the Service Providers, the consideration of the Govt. while finalizing the definition of AGR and the views of the C&AG. This chapter deals with the analysis of the various components of AGR and the current definition of AGR on which licence fee is being paid.

3.2 While examining the existing AGR definitions, the Authority noted that the definition varies from service to service, for example, in the definition of AGR given in the National Long Distance Licence, revenue for the purpose of levying licence fee means the gross revenue accruing by way of providing NLD service under the licence including the revenue on account of supplementary/value added services and leasing of infrastructure, interest, dividend etc. The revenue referred to in the Unified Access Licence for the purpose of levying licence fee is inclusive of installation charges, late fees, sale proceeds of handsets (or any other terminal equipment etc.), revenue on account of interest, dividend, value added services, supplementary services, access or interconnection charges, roaming charges, revenue from permissible sharing of infrastructure and any other miscellaneous revenue, without any set-off for related item of expense, etc. On comparison it can be seen that in the NLD Licence, the revenue accruing by way of providing NLD service is taken for levying licence fee but in the Unified Access Licence, the AGR definition is much broader and includes other miscellaneous revenue. In addition the scope of the revenue which can be included in the AGR definition of Unified Access Licence has been kept open-ended through the word “etc.” It is therefore necessary to remove ambiguities between definitions of AGR given in different service licences and to bring it in line with observation of Hon’ble TDSAT as quoted in para 1.11 of chapter 1

that “sharing can be only of gross revenue derived from the transferred privilege of establishing, maintaining and working of telecommunication”.

3.3 The Authority also noted that computation of AGR is done on the basis of formats of “Statement of Revenue and Licence fee” given in the Licence Agreement. Not only the ambiguities in the AGR definitions need to be removed but consequently the formats would also require redevising to comprehensively reflect the inclusions and deductions as it is not possible to include all the details in the definition of AGR itself. The detailed formats would help to precisely define the items which can be included/ excluded from the revenue for the purpose of levying licence fee.

3.4 The Authority also examined the need for amending the definition of AGR in the various licences. The Authority noted that it may become necessary to amend the definitions as they exist presently in view of the changes that may be required based on the final Order of the TDSAT. The Authority, therefore, observed that the definition of AGR along with the “Statement of Revenue and Licence Fee” appended to the respective Licence Agreements would need to be brought in line by DoT with the final Order of TDSAT.

3.5 The Authority, therefore, carried out its analysis in the light of above position. While analyzing the various issues raised by the service providers, the Authority formulated certain broad principles/criteria for deciding on inclusion or otherwise of any item of revenue or cost in the computation of AGR for purposes of payment of licence fee. While evolving these broad principles the Authority not merely examined the views of the service providers and the views expressed by the Consultant of DoT but also gave due weightage to the views of the CAG, accounting principles, and the concerns of the DOT on the necessity of a system of

assessment which was easily verifiable and transparent and did not lend itself to reducing the AGR by means of accounting jugglery. The broad principles/criteria decided by the Authority are the following:

- Revenue accruing both direct and indirect from activities under the Licence should form part of the AGR.
- Exclusion of revenues from verifiable non-licensed activity.
- Proper audit trails should be available for items which are to be excluded from AGR.
- Revenue from bundled sale of goods and services to be considered as part of AGR unless sale of goods is clearly discernible and services offered remain unaltered even on a stand alone basis.

The above criteria have served as the guiding principles for the recommendations of the Authority on items of cost and revenue raised by the petitioners and other service providers who filed oral and written submissions before the Authority during the course of hearings on this subject.

3.6 While making its recommendations, the Authority was fully conscious of the fact that the assessment of AGR would require deft handling and accounting skills to ensure that precious revenue on account of licence fee due to the Government is correctly calculated and therefore, may require reassessment of the human resources available by the DoT.

3.7 The Authority noted that while formulating the definition of AGR the DOT had taken the advice of an independent consultant, who had

relied on Accounting Standard 9 (AS-9) for revenue recognition. A copy of AS-9 is at *Annexure IV*. The Authority therefore examined various provisions of AS-9 and noted that this standard explains when the revenue should be recognized in the profit and loss account and also states the circumstances in which revenue recognition can be postponed. The activities which generate revenue have been enumerated in AS-9 as under:

- Sales of goods;
- Rendering of Services; and
- Use by others of enterprise resources yielding interests, royalties and dividends.

The Authority noted that AS-9 is a broad statement explaining how the revenue from each activity be recognised and dealt with in the profit and loss account. The term 'revenue' used in AS-9 is a wide term. Within the meaning of AS 9, the term 'revenue' includes revenue from sales transactions, rendering of services and from the use by others of enterprise resources yielding interest, royalty and dividend. Therefore the term 'revenue' as used in the AS-9 does not exclusively cover the revenue generated from telecom services but also revenue from non-telecom service activities that should be recognized in the profit and loss account. The AS-9, therefore, can be used to recognize all possible revenue streams in the profit and loss account but it cannot be solely used to formulate components of revenue for computation of AGR. Therefore detailed examination of individual components of AGR is needed to ascertain whether a particular revenue can be part of AGR for the purpose of levying licence fee or not.

3.8 The Authority also noted that besides challenging the components of revenue, the petitioners had also challenged inclusion of certain

components of costs in the AGR. Hon'ble TDSAT has made no specific findings or observations on any component of cost, but has however directed that the petitioners shall place before TRAI their contentions in regard to various components of AGR which they have challenged before the Hon'ble Tribunal. Therefore the Authority has also carried out detailed analysis of those components of costs which have been challenged before the Hon'ble Tribunal.

Items of Revenue

3.9 Income from Dividend

3.9.1 Petitioners' Contention: Investment of idle cash to earn dividend does not require a telecom licence and dividend is earned on account of non telecom activity viz. investment of idle cash in securities. The petitioners also contended that dividend is an income from investments of surplus funds in equity share, preference share, mutual funds etc. The petitioners contended that income from dividend can be generated by Licencee Company even in the absence of a telecom licence.

3.9.2 DoT's View: Income from dividend should be included in the revenue. As per opinion of DoT's consultant there could be a contrary view that income in the nature of interest/dividend from investment has no nexus with the rendering of telecom services and it is in the nature of income from financing activities and therefore should be excluded from revenue. Exclusion of interest/dividend from revenue may encourage telecom companies to introduce schemes where-by the customers are allowed monthly tariff/airtime at very low (or even nil) charges in return for making substantial deposits that may then be invested to earn interest/dividend income. The DoT also concurs with these views

3.9.3.1 Analysis and Recommendation of the Authority: The Authority analysed the various views expressed by petitioners. It noted that when cash flow generated by a company is greater than what is required for reinvestment in the business, then companies either pay out dividends or invest in other businesses subsidiaries, joint ventures, associates, mutual funds etc. Such investments fetch dividend from those investments. Such revenue is generally recognised as revenue under the head "Other Income". The Authority noted that as per para 13 of the Accounting Standard 9 (AS-9), revenue from dividend relates to a separate activity and cannot be equated with the revenue from rendering of services (*Copy of AS-9 is at Annexure IV*). In this regard para 13 of AS-9 is reproduced below:

> *"Revenue arising from the use by others of enterprise resources yielding interest, royalties and dividends should only be recognised when no significant uncertainty as to measurability or collectability exists. These revenues are recognised on the following basis:*
>
> *i. Interest: on a time proportion basis taking into account the amount outstanding and the rate applicable.*
>
> *ii. Royalties: on an accrual basis in accordance with the terms of the relevant agreement.*
>
> *iii. Dividends from investment in shares: when the owner's right to receive payment is established. "*

3.9.3.2 The Authority also noted that the methodology for recognition of revenues from rendering of services is not laid down in para 9 but separately discussed in para 7 and 12 of AS-9. Hence, revenue recognition from rendering of services and from dividend are treated separately in the accounting terms.

3.9.3.3 The Authority also recalled that while costing of IPLC it did not include investments in the costs as these were not found to be relevant for providing telecom service. In this regard relevant portions of the Telecom Tariff Order (Thirty Fourth Amendment) dated 11.3.2005 is reproduced below:

> *"**Funds not related to IPLC business**: The amount of capital employed for IPLC in VSNL's separated account includes portion of its investment in the Tata Teleservices Ltd and money raised from its GDR issue which is presently lying in the bank. These items have been excluded as they are not relevant for IPLC service for which costing is done. VSNL had submitted to the Authority that this amount should not be reduced because investment in TTSL is made to foster growth of VSNL's business and hence be treated as part of operating capital .Further, VSNL claimed that deposits representing monies raised during GDR issue are financial resources for use and has a cost attached to it and consider as part of capital employed. The Authority does not agree with this view. These funds are not linked to the operation of IPLC per se, and the cost related to them should not be imposed on the customer of IPLC and this has been excluded."*

3.9.3.4 The Authority also recalled that capital employed for telecom services is defined in the DOT's order number 7-4/2001-Tariff notified in gazette dated 8.1.2003 as the sum of net fixed assets, working capital and capital work in progress. Even in this definition, funds deployed for investment is not considered to be part of the funds deployed for providing telecom services. A copy of this Order is placed at *Annexure V.*

3.9.3.5 The Authority is also aware that companies like Videsh Sanchar Nigam Ltd., Mahanagar Telephone Nigam Ltd. and Bharti Airtel

Ltd. have invested in other telecom companies and many of them are their overseas subsidiaries. Oversees subsidiaries are not governed by the Indian Telegraph Act, 1885. Similarly there are companies like Arvind Mills having core business of textiles and subsequently diversified into other business areas like telecom. The revenue from telecom activity for this company is miniscule when compared to the revenues from core business activity. In these cases the dividend income cannot be considered to be generated on the strength of the Licences issued under the Indian Telegraph Act, 1885.

3.9.3.6 The Authority has also examined the views of DoT's consultant regarding inclusion of dividend income in revenue for purpose of levying licence fee. The Authority noted that customer's deposits are generally security deposits and such deposits are liabilities of the company and not part of the revenue. No licence fee is payable on such refundable security deposits. Funds which are in the nature of short term liabilities are normally not invested for a long term to earn income from interest or dividend. The Authority also observed that under Section 227 of the Companies Act, 1956, Auditors are required give their opinion whether funds raised on short term basis have been used for long term investment. Additionally the Authority noted that security deposits are used mainly to adjust the unpaid bills or amounts recoverable from the customer and, therefore, is a backup available with the service provider to minimize bad debts.

3.9.3.7 The Authority, in view of the above, recommends that income from dividend even though part of the revenue, cannot be said to represent revenue from the licensed activity and therefore should not be included in the AGR. As dividend income is separately stated in the annual accounts of service providers, there would be no difficulty in verifying its correctness.

3.10 Interest Income

3.10.1.1 Petitioners' Contention: Service providers earn interest income by investing funds in banks or through lending moneys and therefore income earned from the interest cannot be considered as licensed activity and therefore should not be part of AGR.

3.10.1.2 The petitioners argued before the Authority that service providers raise funds through public issues/private placement of equity and other securities, which are parked in various investment avenues till actual deployment of such fund. Similarly proceeds of loans provided by the lending banks/institutions are parked with various banks and in other investment avenues. Amounts of loans from banks remain idle for some time and earn low interest, however, the company pays much higher interest, as typically lending rates are higher than borrowing rates. When such funds are not deployed immediately to provide telecom services and are invested temporarily, any income generated from those funds cannot be considered as part of Telecom revenues.

3.10.2 DoT's View: DoT is of the view that inclusion of income from interest in the AGR is in line with the AS-9. It is also evident from the affidavit filed by the DoT in petition no 7 of 2003 that exclusion of interest/dividend income from revenue is not allowed as it may encourage telecom companies to introduce schemes whereby the customers are allowed monthly tariff in return for making substantial security deposits that may be invested to earn interest/dividend income.

3.10.3.1 Analysis and Recommendation of the Authority: The Authority noted that as per Accounting Standard 3 (AS-3), cash flows from the investing activities are treated separately from the cash flows from the operating activities. A copy of AS-3 is attached as *Annexure VI*. The

income from interest and dividend is considered as income from investing activities and therefore clearly shown under a separate head in the cash flow statement of a company. Therefore in terms of accountancy, the income generated from interest is treated differently from the income generated from the operating activities. The relevant portion of the AS-3 is reproduced below:

> *"In the case of other enterprises, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities."*

3.10.3.2 The Authority's observation for exclusion of idle funds while costing IPLC is already stated in para 3.9.3.3. Inclusion of revenues on idle funds for a particular service for levying licence fee when corresponding costs are excluded for pricing is against the fundamental 'matching concept' of accountancy. The matching concept states that expenses incurred in earning revenues should be matched against the revenues.

3.10.3.3 The Authority noted that various sources of funds available with the service provider for investment in the business are equity, debt, reserves and surpluses. In addition, telecom service providers take security deposits from customers which are shown under current liabilities head of the balance sheet. The refundable deposits can also be raised by service providers from telecom vendors or other operators/companies as earnest money deposits. Such deposits are from telecom business and therefore any interest earned on this need to be included in the AGR. The Authority however noted that it is not always possible to easily segregate the amount of interest earned from security deposits from the total interest earned by a company on its total

deposits. The Authority therefore examined various options to segregate the interest earned from security deposits and other refundable deposits for the purpose of including it in the AGR. The Authority noted that refundable deposits cannot be long term investments being a current liability, therefore the interest earned on such deposits will normally be at lower rate than for long term investments. Therefore for purpose of transparency and ease of verification there was a need to specify a rate of interest for such deposits.

3.10.3.4 The Authority, therefore, recommends that interest on refundable deposits be calculated at a rate of SBI's term deposit rate for six months' deposits. For licence fee payable in first half of the financial year, the prevalent interest rate on 1st April and for payments in second half of the financial year the prevalent interest rate on 1st of October can be made applicable. Any fund raised and income earned on the strength of telecom service viz. linkage with tariff will also have similar treatment for inclusion in AGR. The Authority also recommends that only interest so calculated on the refundable deposits should be added to the AGR instead of entire amount of interest earned.

3.11 Capital Gains

3.11.1 Petitioners' Contention: Capital gains arise on account of sale of immovable property or security. The capital gains are in the nature of capital receipt and are not normal revenue accrued from operating activities.

3.11.2 DoT's View- DoT in the case of COAI Vs UOI, petition no 82 of 2005 filed before Hon'ble TDSAT filed an affidavit wherein it has been

indicated that profit on sales of assets clearly falls under the definition of AGR as agreed between the parties.

3.11.3.1 Analysis and Recommendation of the Authority: The Authority noted that in the Accounting Standard 3 the cash flows received through sale of fixed assets and securities are considered as cash generated from the investing activities and not as part of the cash flows from the operating activities. Therefore in accounting terms income earned from sale of immovable property or securities is treated differently from the income generated from operating activities.

3.11.3.2 The Authority also noted that the receipts on account of sale of immovable property or on sale of securities are in the nature of capital receipts and not the revenue receipts generated from the operating activities of a service provider.

3.11.3.3 The Authority, keeping in view the above, recommends that revenue on account of sale of immovable property, securities, warrants or debt instruments, other items of fixed assets should not be part of AGR unless there is verifiable data that the receipts have come from 'establishing, maintaining and working of telecommunication'.

3.12 Gains from Foreign Exchange Fluctuations (FOREX Gain)

3.12.1 Petitioners' Contention: Forex gains result when liabilities for payment in foreign exchange decrease on account of appreciation of domestic currency vis-à-vis foreign currency. The Forex gains generally result on account of revaluation of foreign exchange reserves lying in bank accounts, revaluation of provisions made for overseas vendors etc. and their gains or losses are notional and remain unrealized and

therefore should not be included in the AGR. It was also brought out that no set off is given in the eventuality of loss on account of foreign exchange fluctuation.

3.12.2 DoT's View: DoT in its affidavit filed in the case of COAI Vs UOI, Petition No 82 of 2005 filed before TDSAT submitted the effect of foreign exchange fluctuations are credited to profit and loss account except for the case when the changes impact the carrying value of assets and liabilities. The accounting policy of crediting foreign exchange impact is in accordance with accounting standards. Therefore, such incomes/revenues accruing on account of foreign exchange fluctuations will necessarily form part of revenues and shall necessarily be subject to levy of licence fee.

3.12.3.1 Analysis and Recommendation of the Authority: The Authority noted that foreign exchange differences arise when rates differ from those at which they were initially recorded in the books. In case payments are to be made to the foreign vendor and rupee depreciates against the foreign currency then it is recognized as expense in the annual financial statement and if it appreciates, it is recognized as gain. The forex gains reflected in the profit and loss statement could arise from reduction of payment liability of a company or increase in the value of foreign exchange accounts receivable.

3.12.3.2 The Authority also noted that the forex gain can arise from provisioning of telecom service or from non-telecom activities. In case forex gain is on account of revaluation of foreign exchange reserves lying in bank accounts, foreign securities or revaluation of provisions made for overseas telecom equipment vendors then such gain cannot be called arising from the telecom services. The Authority further noted that the forex gain arising out of reduction in liability is only notional revenue.

3.12.3.3 The Authority noted that foreign exchange is also receivable for providing telecom services and when forex gain arise on account of telecom services has to be considered as part of the telecom revenues. However, at any point of time, while the value of Rupee may appreciate against one set of currencies, it may also depreciate in value vis-à-vis another set of currencies. Over a period of time, say in a quarter, this would change in a dynamic way such that gains may offset losses. Thus revenue if any on this account could at the best be nil or marginal. In the view of the Authority, the cost of scrutiny and collection does not justify inclusion of this item in the AGR.

3.12.3.4 The Authority, therefore, recommends that any revenue arising out of upward valuation or devaluation on account of fluctuation of foreign exchange should not be part of AGR.

3.13 Reversal of provisions and Vendor Credits

3.13.1 Petitioners' Contention: The AGR definition includes reversal of provisions of previous years and discounts offered on credit given by vendors. Such a transaction is a mere adjustment in the accounting heads. The revenue given in the profit and loss account for such transactions is only notional revenue and there is no actual inflow of cash. Therefore, these revenues should not be included in the AGR. Regarding vendor's credit, the petitioner submitted that expenses incurred by companies in one year are provided and debited to profit and loss account. Subsequently, while making payments such companies may get rebate or concessions from the creditors/ vendors. This amount is credited to the profit and loss account. In other words it is reversal of debit of past years.

3.13.2 DoT's View: DoT in its affidavit filed in the case of ABTO Vs UOI, Petition No 7 of 2003 filed before TDSAT submitted that the gross revenue shall include reversal of previous debits (e.g. bad debt recovered, write back of excess provision in earlier years) and of sales returns, which have been actually paid/adjusted in accounts. In addition the DoT's consultant had also given an opinion on exclusion of revenues on account of reversal of previous debits in the AGR. The relevant portion of consultant's opinion is given below:

> *"Some items on the credit side of the profit and loss account represent reversal of debits appearing in the profit and loss account of one or more earlier years, e.g., write-back of excess provisions made in earlier years, bad debts recovered etc. These items merely represent an adjustment to the amount of an expense as estimated in a earlier year and should not therefore be included in revenue."*

3.13.3.1 Analysis and Recommendation of Authority: The Authority noted that companies set aside certain amounts called provisions for known liabilities, even if specific amount may not be known, or for the diminution in value of an asset. Commonly such provisions are made for bad debts and taxes. Service providers keep provisions for various expenses to ensure that they have sufficient funds in hand when they are required to make payment for such expenses. In case a company's liability ceases to exist or crystallizes upon occurrence of any specific event like receipt of payment which had been declared as bad debt in the previous years, the company writes back such provisions to the extent that they are no longer required. Therefore, reversal of provisions is not actual inflow of cash from business activities but only an adjustment in the accounting heads.

3.13.3.2 The Authority also noted that provisions are created out of revenue earned by the company which has already been subject to levy of the licence fee. Inclusion of revenues on account of reversal of provisions would result in levying licence fee again on the same revenue.

3.13.3.3 With regard to reversal of vendor's credit, the Authority noted that the revenue does not arise from reversal of items of profit and loss account but occurs because of reversal of capital expenditure. The Authority is of the view that when there is reversal of vendor's credit then corresponding accounting adjustment should be made in the value of capital assets and not in the revenue side of the profit and loss account. This accounting adjustment would not only reflect the true value of the fixed assets but also the correct picture of the profit and loss account. If this accounting practice is not followed, the capital assets would reflect higher value and correspondingly the company would also claim higher depreciation which is otherwise not due.

3.13.3.4 The Authority, on the basis of the above, recommends that:

- **Revenue arising out of reversal of provisions like bad debts and taxes should not form part of AGR.**
- **Revenue arising from reversal of vendors' credit should form part of AGR.**

3.14 Income from property rent

3.14.1 Petitioner's Contention: The Petitioners submitted before the Authority that licencee companies permit third parties (who may or may not be telecom licencee companies) to use immoveable properties (Land / Buildings) own or leased by the licencee companies when they do not require such properties for their own operations. Such use by third

parties does not require any authorization under a telecom licence and can be done by the licencee companies even in the absence of telecom licence. These properties have been developed in previous years out of surplus fund generated on which licence fee has already been paid. Therefore, income from property rent should not be part of AGR as it is not a licensed activity.

3.14.2 DoT's View- The definition of AGR is prescribed in the Licence Agreement and the amended terms thereto. Income arising out of miscellaneous items of revenue is to be added for the purposes of arriving at the AGR.

3.14.3.1 Analysis and Recommendation of the Authority: The Authority noted that telecom companies have number of revenue streams which may not necessarily be from *"establishing", "maintaining" and "working of a telecommunication"*. Service providers may rent or lease part of their properties and to carry out such activities no licence is required. Service providers are also providing staff quarters to their employees and receive rent for staff quarters.

3.14.3.2. The Authority also noted that there was no specific reference to property rent in the definition of AGR or in the formats enclosed with the licence agreement. The property rent is perhaps being included in the AGR as "Miscellaneous Revenue" as part of "etc.".

3.14.3.3 The Authority, therefore, recommends that revenue from property rent should be excluded from AGR provided it is clearly established that the property is no where connected to 'establishing, maintaining and working of telecommunication'.

3.15 Income from sale/lease of Passive Infrastructure like Towers, dark Fibre etc.

3.15.1.1 Petitioners' Contention: The petitioners submitted before the Authority that setting up of passive infrastructure like towers is not an activity which requires Licence. Even under the present scheme, the tower structure is being erected by the independent parties and is being offered to service providers. Since passive infrastructure is being set up by independent companies and offered to service providers on rent, similar activity when carried out by service providers should not be treated as part of the licensed activity. Therefore revenue earned from rent/leasing of passive infrastructure should not form part of AGR.

3.15.2 DoT's View: DoT includes income from renting/leasing of passive infrastructure in the AGR.

3.15.1.2 Petitioners also argued that renting/leasing of dark fibre, towers etc. is carried out by IP-1 operators. These operators do not require Licence under section 4 of the Indian Telegraph Act, 1885 and therefore this is a non-licensed activity.

3.15.3.1 Analysis and Recommendation of the Authority: It has already been stated in para 3.14.3.1 that the Authority's view is that service providers create assets for establishing, maintaining and carrying out the telecom activities and capabilities to provide towers and dark fibre on rent emanate from the Licence. The licencees have special privileges, like right of way which facilitates laying down of ducts and fibre, which are not available to independent companies. Therefore, renting/leasing of passive infrastructure by a service provider has to be considered as part of normal telecom activity.

3.15.3.2 The Authority, therefore, recommends that revenue from rent of towers, dark fibre, should be part of the AGR.

3.16 Other Income including miscellaneous income

3.16.1.1 Petitioner's Contention: The Petitioners submitted that miscellaneous income from liquidated damages, sale of scraps, insurance claim, revenue collected on behalf of non-licence company, reimbursement of costs/ expenses received from other companies, management consultancy fees, training charges, notice pay received from employees do not accrue either from subscribers or from other telecom service providers for provisioning of telecom service and therefore should not be part of the AGR.

3.16.1.2 The petitioners also submitted before the Authority that the telecom companies have elaborate billing systems with huge transaction processing capabilities. Hence companies engaged in other businesses like ISPs, handset vendors, insurance companies like to leverage these sources for their benefit by providing goods/services to the subscribers of telecom companies. Hence such amounts collected by telecom companies on behalf of third party as well as commission earned by telecom companies for providing billing, collection and other services to third parties should not be included in AGR.

3.16.2.1 DoT's View: DoT in its affidavit filed in the case of COAI Vs UOI, Petition No 82 of 2005 filed before Hon'ble TDSAT submitted that incomes from insurance proceeds, sale of assets are revenue as they are accounted for in the profit and loss account. Therefore it should be part of AGR.

3.16.3.1 Analysis and Recommendation of the Authority: The Authority is of the view that other income is a very broad term and includes revenue streams of a number of activities which are closely related to telecom. Some of these incomes are in the nature of capital receipts and others

are revenue receipts. The Authority clearly recognizes that capital receipts cannot be part of the AGR as such revenues do not generally arise from provisioning of telecom services. Such items include profit on sale of fixed assets and insurance claims.

3.16.3.2 The Authority also examined financial statements of few service providers to check various revenue streams classified under the miscellaneous and other income heads. Some revenue streams classified as other/miscellaneous income were pertaining to the sale of directories and forms. The revenue from the sale of forms is revenue generated from the licensed activity as such forms can only be issued by the licensed service provider. Similarly income from sale of tender to select a service provider to carry long distance calls or a tender to select an infrastructure provider for lease lines cannot be considered as something totally independent of the licensed activity. Service providers also gain special expertise on telecom infrastructure roll out during course of establishment of telecom networks and offer consultancies and trainings on acquired knowledge and expertise. This revenue stream is again not independent of telecom activity. The Authority also noted that expenditure incurred by telecom service providers on their training institutions is considered as part of the telecom costs and are included while pricing of telecom services. Since costs relating to telecom training institutions are considered as part of telecom service, the revenue generated from such activities has also to be considered as part of telecom revenues.

3.16.3.3 Therefore, the Authority is of the view that other/miscellaneous income accounting head covers number of revenue streams which could be from the licensed activity or non-Licensed activity. The Authority also noted that as per the affidavit of DOT in the case of VSNL Vs UOI the

miscellaneous income is proportionately added to AGR on the basis of revenues from different streams.

3.16.3.4 With regard to amounts collected by telecom companies on behalf of third parties, the Authority noted that in such cases service providers merely act as a collection agent of such third parties. The Authority noted that as per the provisions of AS-9, the complete payment received from the third parties cannot be considered as revenue. In such cases the revenue is amount of commission and not the gross inflow of cash receivable. In this regard, the definition of revenue given in AS-9 (Copy attached at *Annexure IV*) is reproduced below:

> "4.1 *Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. <u>In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration</u>"*

3.16.3.5 The Authority is of the view that commission received for providing services to other ISPs, handset vendors, credit card agencies and insurance companies emanate from the Licence and therefore cannot be considered as non-telecom revenue and should therefore be part of AGR.

3.16.3.6 The Authority also holds the view that it is not possible to include an exhaustive list of all items falling under the category of

miscellaneous items. Besides the views given on specific items other items have to be examined on the basis of whether they fall under the category of licence activity or not and accordingly decided.

3.16.3.7 The Authority, in view of the above, recommends that:

- **Revenue streams like sale of tenders, directories, forms, forfeiture of deposits/earnest money, management fees, consultancy fees, and training charges from the telecom service should form part of the AGR.**
- **Revenue from sale of fixed assets which is in the nature of capital receipts and insurance claims should not be part of AGR.**
- **Payments received on behalf of third party should form part of AGR.**
- **Other items falling under categories of miscellaneous/other income will have to be decided for taking a view regarding its inclusion or exclusion on a case to case basis.**

3.17 Inclusion of revenue from one licensed activity in the revenue of another licensed activity.

3.17.1.1 Petitioners views: The petitioners brought out the following as instances of inclusion of revenue of one licensed activity in the other licensed activity:

- In case of VSNL, income from TV uplinking by leasing transponder is included in the AGR for ILD Licence. The TV uplinking service can be provided under a Licence issued by Ministry of I&B. The

company is paying licence fee for two Licences, one issued by I&B and an other by DoT.

- HFCL is providing internet and Unified Access Services. The revenue from internet service is included in AGR for Unified Access Licence.

3.17.1.2 VSNL contended that TV uplinking service can be offered only under the Licence granted by the I&B Ministry and all the other broadcasters who offer such services have a similar Licence from the I&B Ministry. Under the present regime such service cannot be offered under the ILD Licence due to definition of service given in the Licence. The "service" is defined as follows:

> *"SERVICE" covers collection, carriage, transmission and delivery of voice or non-voice message over LICENCEE's network and includes provision of all types of services except for those requiring a separate Licence."*

TV uplinking requires a separate licence and therefore it no longer can be considered as part of the ILD Licence. Moreover, other service providers of TV uplinking service do not have to pay any licence fee to DoT and VSNL is being charged licence fee twice over under the different licences.

3.17.1.3 The petitioners' also contended that the AGR should include only the revenue accrued out of Licence of telecom service and should not include income from other telecom Licence like ISP.

3.17.2.1 DoT's View: DoT is of the view, with regard to TV uplinking service, that TV transmission is a telecommunication activity and essentially involves carriage of voice, images and data. Further ILD Licence issued to VSNL also covers the service explicitly and therefore all revenue generated there-from necessarily attracts prescribed levies under the ILD Licence. With regard to payment of licence fee under two licences for the same service, DoT in its affidavit before Hon'ble Tribunal had submitted that "it is akin to a situation where an operator would need to obtain a telecom service licence to offer cellular services and at the same time would need to be governed by the relevant Shop and Establishment Act if it intends to put up a shop for selling SIM cards etc. The levies would get attracted under each of the relevant Acts in a different manner and shelter cannot be taken that no charges are payable under one set of Act as charges are paid or levied (or not levied but governed) under another set".

3.17.2.2 With regard to inclusion of ISP revenue in the Unified Access Service Licence, the DoT had submitted in its affidavit that this income could be considered as miscellaneous item of revenue for arriving at the AGR. Further more, it is possible to design tariff plans which may result in a decrease in revenues for the basic service and increase in the revenue of internet service with the prime purpose of reducing the liability of licence fee to a minimum by means of accounting jugglery.

3.17.3.1 Analysis and Recommendation of the Authority: The Authority noted that the VSNL has legal authorization from DoT to provide TV uplinking service under the ILD Licence as also a separate licence issued by Ministry of I&B to establish, maintain and operate uplinking hubs (Teleports). Both of these Licences have been issued under Section 4 of the Indian Telegraph Act, 1885. As provision of TV uplinking service is covered by two separate licences, VSNL is paying licence fee under two

licences. The Authority further noted that the scope of the ILD Licence issued to VSNL explicitly covers TV uplinking service.

3.17.3.2 As far as inclusion of internet income in the AGR under Unified Access Licence the Authority noted that the scope of the Licence has been expanded and now unified access providers can provide internet service under that Licence. The Authority further noted that licence fee is payable on revenues from internet telephony.

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

3.17.3.4 The Authority in light of the existing provisions of the Licence recommends that revenue from TV uplinking service and internet service should be part of the AGR.

3.18 Revenue from sale of Equipment including handsets

3.18.1 Petitioners' Contention: Petitioners submitted before the Authority that sale of telecom equipment like VSAT terminal, PMRTS handsets, CMTS handsets is not a licensed activity and therefore should not be part of the AGR.

3.18.2 DoT's View: DoT in its affidavit filed before Hon'ble TDSAT in petition No. 81 of 2005 in the matter of Arvind Mills Ltd. Vs. DoT stated that inclusion of revenues accruing from sale of handsets in the computation of AGR is in the line with AS-9 of ICAI which is mandatory standard for preparation of accounting statements. The opinion of DoT's consultant on the inclusion of revenue from the sales of handsets in the AGR is that amounts billed to customers in respect of handsets as accessories sold is covered by the definition of the term 'revenue'. "Sale of handsets and accessories is an integral part of telecom business and has been always so recognized. Sale of handsets and accessories and rendering of service is not an independent activity. Exclusion of sale proceed of handsets from revenue may also trigger schemes whereby airtime is charged at a low price or even provided free of charge".

3.18.3.1 Analysis and Recommendation of Authority: The Authority noted that as per AS-9, para 6.1, a key criterion for determining when to recognize a revenue from a transaction involving the sale of goods is that the seller has transferred the property in the goods to the buyer for a consideration. In the sale of handsets or other telecom equipment service provider transfers the property in equipment as goods to the buyer.

3.18.3.2 The Authority also noted that the sale of equipment and accessories is a trading activity, therefore, revenue generated from such sales should not be part of AGR. However, handsets are also frequently bundled with telecom service charges and sold as one composite package. When handsets and telecom service charges are bundled then it is not a sale of goods on a standalone basis. Therefore the question before the Authority was to evolve a discernible criterion for sale of handsets which did not alter the structure of tariff even if the subscriber was to obtain the handset from other sources.

3.18.3.3 The Authority also noted that service providers frequently subsidise handsets and also offer discounts on telecom service. In return of subsidization of handsets and discounting in telecom service, the service providers lock in customers for certain period of time. Service providers treat cost incurred on account of subsidization as customer acquisition costs.

3.18.3.4 The Authority in its earlier recommendations had suggested that revenue accrued from the sales of terminal equipment at customer premises should not be part of AGR. The Authority in addition had recommended that in case a service provider subsidises the sale of handsets through rebates or discounts in service then the revenue foregone on account of such discount/rebates be added in the AGR. Therefore Authority had taken a stand that in case handsets are bundled with the telecom service than value of service, if included in the sale of handsets be added to the AGR. DoT was of the view that segregation of revenue between service and equipment is difficult in a bundled scenario. DoT also was of the view that the TRAI's recommendation was difficult to implement as there was no scientific way to assess the value of services if offered on discount/rebates against sale of handsets and, therefore, did not accept the recommendations of the Authority. The Authority therefore decided to re-examine the issue in the light of the foregoing views.

3.18.3.5 In this context The Authority studied Hon'ble Supreme Court's judgment given in the case of BSNL Vs UOI & Other on the issue that mobile phone connection is a sale or is a service or both. The Hon'ble Supreme Court has held goods in telecommunications are limited to handset supplied by the service providers. Hon'ble Court for composite sale of SIM cards and activation of telecom service has further held that

"i*f the SIM card is not sold by the assessee to the subscribers but is merely part of the services rendered by the service providers, then a SIM card cannot be charged separately to sales tax. It would depend ultimately upon the intention of the parties. If the parties intended that the SIM Card would be separate objective of sale, it would be open to sales tax Authorities to levy sales tax thereon."* Hon'ble Court therefore held that "*the nature of the transaction involved in providing the telephone connection may be a composite contract of service and sale. It is possible for the State to tax the sale element provided there is a discernible sale and only to the extent relatable to such sale.*

3.18.3.6 The Authority then considered the option of regulating the bundle packages to limit the nature and extent of bundling to few manageable tariff plans so that the administrative complexity is minimized and scope for avoidance of contribution is eliminated. Intense competition in the mobile services market may produce any number of bundled packages and options to the consumer and these are difficult to predict let alone prescribing any methodology of isolating revenue from one particular stream from the gross revenue. Prescription of verifiable safeguards with the view to prevent attempts to avoid contribution would not only result in artificial restriction of competitive play of market forces but would also lead to micro-management of the market particularly after the Authority has moved away from tariff regulation regime of telecom services.

3.18.3.7 In fact this issue was posed to all the service providers and their representatives during their meetings with the Authority during the last few weeks. The concerns of the Government about the possibility of running the risk of opening the system to abuse, resulting in contribution avoidance remains valid.

3.18.3.8 In an over all sense, it emerges that the incremental relief that may arise out of providing such a dispensation of separating revenue on account of handset sale will not be commensurate with the cost associated with the administrative complexity, onerous auditing requirements, the opportunity for contribution avoidance and the attendant disputes.

3.18.3.9 The Authority is therefore of the view that separation of sale of goods is possible only when there is a discernible standalone sale. In the bundled scenario described above it is not possible to identify sale value of the handset. Moreover when a sale gets integrated with service then it may be considered as a composite contract and any attempt to separate the two could lead to evasions.

3.18.3.10 The Authority, therefore, recommends that:

- **Revenue from discernible and stand alone sale of handset or telecom equipment which is not bundled with telecom service should be excluded from the AGR.**
- **Sale of handsets or telecom equipment bundled with telecom service should be part of AGR.**

3.19 Receipts from USO Funds

3.19.1 Petitioners' Contention: The petitioners submitted before the Authority that USO subsidy is granted by the DoT to cover the operating losses of the telecom licencees from telecom connections provided in rural areas. The subsidy does not generate any profit for telecom licencees but only helps them to reduce their losses from rural

connections to a certain extent. Therefore such revenues should not be included in the AGR.

3.19.2 DoT's View: The DoT in its affidavit in the case of ABTO Vs UOI has stated that the reimbursement of expenses in term of USO guidelines is not treated as revenue. In letter No 17-20/2203-LF dated 4.1.2005 addressed to BSNL, the DoT has permitted exclusion of USO subsidy receipts from AGR.

3.19.3Analysis and Recommendation of the Authority: Since DoT has already taken a view that receipts from USO fund will not be part of AGR, the Authority recommends that necessary amendments should also be carried out in the Licence to make it clear that revenues received from USO fund do not form part of AGR. This fund is mainly utilized for the implementation of Government's recognised projects and policy inducement.

3.20 Receipts from ADC

3.20.1 Petitioners' Contention: This issue was mainly raised by BSNL which is not a petitioner before the Hon'ble TDSAT. BSNL submitted that it is receiving ADC from other operators for providing telephone service to meet operating losses from telecom connections provided in rural areas and other unviable areas. It further submitted that ADC is similar to the subsidies received from USO and like USO such receipts on account of ADC should not be included in the AGR.

3.20.2 DoT's View: The issue of excluding ADC receipts from AGR for the purpose of levying licence fee was discussed with the DoT. The Authority was informed that presently it is being considered as part of AGR.

3.20.3.1 Analysis and Recommendation of the Authority: The Authority recall that it had assessed access deficit charge by taking into account affordable level for rental/call charges, special concessionary local call charges in the rural areas, provision of free calls, and in other below cost tariffs, that the Regulator may need to specify to make the basic telecom services affordable to the common man to promote both universal service and universal access as per NTP 1999. The Authority further recalls that ADC is a scheme which has a limited period and has a specified sunset clause.

3.20.3.2 The Authority also noted that though the purpose of ADC and USO appear to be similar but there is major qualitative difference in the purpose, sourcing/generation of fund and the end result. In the case of USO there are clear directions from the Universal Service Fund administrator for making investments in particular area and the eligibility is determined on the basis of tender for specific work performance and therefore these are mostly in the nature of capital receipts. As far as ADC is concerned there are no directions from the Authority for making investments in the specified areas and are mainly to compensate the provisioning of services at below cost. Therefore the purpose and nature of receipts from USO and ADC are different to that extent. Moreover, revenues from ADC are telecom revenues because the ADC amount paid by other operators compensates for what BSNL would have generated had no restrictions in terms of regulated tariffs been placed on it.

3.20.3.1 The Authority, therefore, recommends that revenue receipts on account of ADC should be part of AGR.

Items of Costs

3.21 Deduction of Leased line charges, Port charges, Interconnection set up cost, signaling charges

3.21.1 Petitioners' Contention: Petitioners submitted before the Authority that many charges which are paid by one operator to another operator are treated as revenues at the hands of both the operators resulting in dual charge on the same revenue. For example charges under leased circuits, port charges, co-location and set up facilities are paid by one telecom operator to the other. These charges are not allowed as deduction even though these are interconnection or access charges which are essentially incurred for carriage and termination of calls. The petitioners have submitted that as deduction of these charges is not permitted, it is resulting into dual levy of licence fee on the same revenue. Petitioners also submitted that these charges are in the nature of interconnection charges and should be allowed exclusion from AGR on the same premise that interconnection usage charges are allowed for deduction from AGR.

3.21.2 DoT's View: The DoT levies licence fee on AGR which is arrived at after accounting for certain allowable deductions from the gross revenue. These deductions are (i) call charges (access charges) actually paid to other telecom service providers for carriage of call, (ii) roaming revenue actually passed on to other telecom operators, and (iii) service tax on provision of service and sales tax actually paid to Government. The DoT is of the view that the deductible costs are those which are charged on call by call basis, the amount passed on to other service providers for acquiring leased circuits, ports, bandwidth from others for provisioning of network capable of offering telecom service and

which are not for physical carriage of calls is not deductible as these are not items of costs.

3.22.3.1 Analysis and Recommendation of the Authority: The Authority noted that telecom is a networked industry and setting up interconnection with other operators is as much part of an operators' cost as any other element of its own network. Payments made to other service providers on account of port charges, leased line are costs for the service providers for giving effective telecom services, expansion of their own network and interconnecting with other operators which is also mandatory under the Licence. Further, there is no double counting of revenues for the purpose of levying licence fee as revenue for providing ports, leased lines etc. is only included in the profit and loss account of interconnection provider.

3.22.3.2The Authority also noted that the access facilities could either be taken on lease or built by the operator. It does not mean that cost incurred when lines are taken on lease be deducted from gross revenue to calculate AGR. Pass through revenue is always a part of collected revenue from the customer but the costs linked to effective network functioning are not linked to the revenue collected from the customer.

3.22.3.3 The Authority is of the view that expenditure on effective network operation viz. port charges etc cannot be considered similar as interconnection usage charge as interconnection usage charge is revenue collected from the customer by one service provider for using telecom network of another service provider. The interconnection usage charge is eventually passed on to another operator. It is in this background that exclusion of interconnection usage charge is specifically provided in the migration package and also in the respective service licences. The 'Migration Package' and Licence Agreement do not have any

understandably any provision for exclusion of any other cost item including for those items which are paid to the other service provider.

3.22.3.4 The Authority is also of the view that other items of cost like roaming signaling charges are a fixed monthly charge and is not incidental to carriage of calls. These are fixed costs and are not in the nature of pass through charges, therefore not deductible from the Gross Revenues.

3.22.3.5 The Authority also examined the contention of petitioners that Service providers are providing content services and cost of content is in the nature of a pass through item and should be considered as pass through in the AGR. The Authority is of the view that input cost of content services is in the nature of cost and therefore not deductible from the Gross Revenue for the purpose of calculation of AGR.

3.22.3.6 Therefore, the Authority recommends that costs on account of port charges, interconnection setup charges, leased line, sharing of infrastructure, roaming signaling charges and content charges should form part of AGR.

3.23 Exclusion of bad debts, waivers, discounts from AGR

3.23.1 Petitioners' Contention: Petitioners submitted that waivers and discounts given to subscribers should not be included in the AGR as they are not realized by the operators. Therefore to impose licence fee on notional income is not justified. It was suggested that licence fee should be payable on net realization of revenues and any amount which is being discounted, rebated or waived off to the end customer are in the nature of revenue reversal should be deducted from AGR.

3.23.2 DoT's View: The DoT is of the opinion that service providers follow an accrual system of accounting in accordance with accounting standards. The revenues are accordingly recognized on accrual basis and not on realization basis. Besides, debts are cost of operators, bad debts results from inefficiency of operators and therefore Government cannot absorb such costs. Moreover the Government cannot encourage inefficiency.

3.23.3.1 Analysis and Recommendation of the Authority: The Authority noted that bad debts is a normal cost attached to the business and is also one of the standard items of expenditure in the profit and loss account. These costs are part of the business and such risks including recovery of such costs is built in the tariff structure. Therefore inherent possibility of its occurrence is part of the business model. The Authority, therefore, is strongly of the opinion that there was no justification for excluding bad debts from the AGR.

3.23.3.2 In view of the above, the Authority, recommends, that bad debts should not be excluded from the AGR.

3.24 Inclusion of items of revenue on accrual basis but exclusion of items of cost on actual payment basis

3.24.1.1 Petitioners' Contention: Petitioners submitted before the Authority that the revenue included in AGR on accrual basis and hence even unbilled revenue for last month of the financial year is included in AGR. Income from IUC/ADC by Licencee companies is also included in AGR on accrual basis. However, corresponding deductions are allowed on actual payment basis.

3.24.1.2 The Petitioner's also contended that service tax is included in the revenue on accrual basis but deducted on actual payment basis. Since inclusion of these items in the revenue is on accrual basis but exclusion on actual payment basis, there would always be a difference between revenues booked and paid. As a result most service providers end up paying licence fee even on the uncollected portion of the service tax.

3.24.2 DoT's View: Service tax is not a capital receipt, nor it is a notional item and that service tax is billed as soon as the service get provisioned and accounted for. It is required to be remitted to the Government with such periodicity as has been prescribed. Therefore the existing practice followed by DoT is correct.

3.24.3.1 Analysis and Recommendation of the Authority: The Authority is of the view that service tax is not revenue for the service provider but service provider is only a collecting agency on behalf of the Government. The inclusion and exclusion of this item should be on accrual basis.

3.24.3.2 The Authority is also of the view that interconnection usage charge is a pass through revenue and the service provider is only collecting interconnection usage charge on behalf of other service providers, therefore, the inclusion and exclusion of this item should be on accrual basis.

3.24.3.3 The other advantage of allowing accounting of service tax and interconnection usage charge on accrual basis is that these would be easily verifiable from the annual accounts of the service providers.

3.24.3.4 The Authority therefore, recommends that:

- **Service tax should be shown on accrual basis both for inclusion and exclusion from the gross revenue for the purpose of AGR.**
- **Interconnection Usage Charge should also be shown on accrual basis both for inclusion and exclusion from the gross revenue for the purpose of AGR.**

3.25 The Authority is of the understanding that the recommendations made in this chapter if accepted would be effective from a prospective date.

Chapter 4: Summary of Recommendations

4.1 Revenue items

4.1.1 Income from Dividend

The Authority recommends that income from dividend even though part of the revenue, cannot be said to represent revenue from the licensed activity and therefore should not be included in the AGR. As dividend income is separately stated in the annual accounts of service providers, there would be no difficulty in verifying its correctness.

(Recommended: Not to be included in AGR)

4.1.2 Income from Interest

The Authority recommends that that interest on refundable deposits be calculated at a rate of SBI's term deposit rate for six months' deposits. For licence fee payable in first half of the financial year, the prevalent interest rate on 1st April and for payments in second half of the financial year the prevalent interest rate on 1st of October can be made applicable. Any fund raised and income earned on the strength of telecom service viz. linkage with tariff will also have similar treatment for inclusion in AGR. The Authority also recommends that only interest so calculated on the refundable deposits should be added to the AGR instead of entire amount of interest earned.

(Recommended: Only interest calculated on refundable deposits to be added to the AGR)

4.1.3 Capital gains on account of profit on sale of assets and securities

The Authority recommends that revenue on account of sale of immovable property, securities, warrants or debt instruments, other items of fixed

assets should not be part of AGR unless there is verifiable data that the receipts have come from 'establishing, maintaining and working of telecommunication'.

4.1.4 Gains from foreign exchange fluctuations

The Authority recommends that any revenue arising out of upward valuation or devaluation on account of fluctuation of foreign exchange should not be part of AGR.

(Recommended: Not to be included in AGR)

4.1.5 Reversal of Provisions and Vendor's Credit

The Authority recommends that

- Revenue arising out of reversal of provisions like bad debts and taxes should not form part of AGR.
- Revenue arising from reversal of vendors' credit should form part of AGR.

(Recommended: Provision Not to be included in AGR,
Vendor's Credit to be included in AGR)

4.1.6 Income from property rent

The Authority recommends that revenue from property rent should be excluded from AGR provided it is clearly established that the property is no where connected to 'establishing, maintaining and working of telecommunication'.

4.1.7 Income from rent/lease of passive infrastructure like towers, dark fibre

The Authority recommends that revenue from rent of towers, dark fibre, should be part of the AGR.

(Recommended: To be included in AGR)

4.1.8 Other income on account of insurance claim, sale of scraps, management consultancy fee, forfeiture earnest money etc and revenue received on behalf of third party.

The Authority recommends that

- Revenue streams like sale of tenders, directories, forms, forfeiture of deposits/earnest money, management fees, consultancy fees, and training charges from the telecom service should form part of the AGR.
- Revenue from sale of fixed assets which is in the nature of capital receipts and insurance claims should not be part of AGR.
- Payments received on behalf of third party should form part of AGR.
- Other items falling under categories of miscellaneous/other income will have to be decided for taking a view regarding its inclusion or exclusion on a case to case basis.

4.1.9 Income from sale of equipment including handsets

The Authority recommends that:

- Revenue from discernible and stand alone sale of handset or telecom equipment which is not bundled with telecom service should be excluded from the AGR.

- Sale of handsets or telecom equipment bundled with telecom service should be part of AGR.

(Recommended: Not to be included in the AGR if discernible and standalone sale of handset or telecom equipment)

4.1.10 Receipt from USO Fund and ADC

The Authority recommends that:

- As DoT has already taken a view that receipts from USO will not be part of AGR, the Authority recommends that necessary amendments should also be carried out in the Licence to make it clear that revenues received from USO fund do not form part of AGR. This fund is mainly utilized for the implementation of Government's recognised projects and policy inducement.
- Receipts of revenue on account of ADC should be part of AGR.

(**Recommended: USO not to be included in AGR**
ADC to be included in AGR)

4.1.11 Inclusion of revenue from one Licensed activity in the revenue of another Licensed activity

The Authority in light of the existing provisions of the Licence recommends that revenue from TV uplinking service and internet service should be part of the AGR.

(Recommended: To be included in AGR)

Specific Items

4.2.1 Payment for port charges ,leased line charges, bandwidth charges, rent for sharing of space, power and any other payments to any other Licencee

The Authority recommends that costs on account of port charges, interconnection setup charges, leased line, sharing of infrastructure, roaming signaling charges should not be deducted from AGR.

(Recommended: To be included in AGR)

4.2.2 Write off of Bad debts or waiver/adjustments/discounts

The Authority recommends that bad debts should not be excluded from the AGR.

(Recommended: To be included in AGR)

4.3 Inclusion of items on accrual basis but exclusion on actual payment basis- IUC and service tax

The Authority recommends that:

- Service tax should be shown on accrual basis both for inclusion and exclusion from the gross revenue for the purpose of AGR.
- Interconnection Usage Charge should also be shown on accrual basis both for inclusion and exclusion from the gross revenue for the purpose of AGR.

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