

COMMENTS
ON THE
CONSULTATION PAPER
ON
DEFINITION OF REVENUE BASE (AGR)
FOR THE RECKONING OF LICENSE FEE AND SPECTRUM USAGE CHARGES

1. Introduction

- 1.1 This note provides the recommendations of Dua Consulting on the Consultation Paper on Definition of Revenue Base (AGR) for the Reckoning of License Fee and Spectrum Usage Charges dated July 31, 2014 ("**Consultation Paper**") issued by the Telecom Regulatory Authority of India ("**TRAI**" or the "**Regulator**").
- 1.2 The National Telecom Policy 2012 (NTP 2012) was enacted with the primary objective of "maximizing public good by making available affordable, reliable and secure telecommunication and broadband services across the entire country." There is an emphasis placed within the policy to 'strike a balance between the interests of users/consumers, service providers and government revenue.'
- 1.3 The necessity of striking such a balance becomes all the more imperative whilst examining the definition of revenue base for reckoning of license fee and Spectrum Usage Charges (SUC).
- 1.4 The AGR definition issue has become a sensitive and complex issue over the years and has subject to diverse interpretations, with the ongoing long stand litigation on the subject.
- 1.5 As one may recall, licenses were issued during 1994-98 (under the National Telecom Policy 1994) for various telecoms services, under which the licensees would pay license fee at fixed rates based on their bids. However, this led to a situation where licenses defaulted in the payment of the licensee fee and the industry had to make representations in an effort to survive the burden of this license levy.
- 1.6 Subsequently, the National Telecom Policy 1999 (NTP-99) was announced under which apart from introducing the one time entry fee, the revenue sharing regime was also introduced where the licensees were required to pay license fee based on a revenue share instead of a fixed quantum of license fee.

- 1.7 The components of gross revenue has been questioned by the operators from time to time, the Regulator has provided several recommendations on the subject and the definition and its components have also been interpreted by various courts in India from time to time. The judgment of the Supreme Court of India in October, 2011 followed by the introduction of the National Telecom Policy of 2012 amplified the ambiguity around the definitions of license fees and spectrum usage charge
- 1.8 There have been several discussions, debates within the industry as well as at a judicial level to examine as to what components of an operators income constitutes gross revenue for the purpose of arriving at the Adjusted Gross Revenue payable to the licensor. We are not going to delve any further into the background and the genesis of the licensee fee and spectrum usage charges as the same has been stated explicitly in the Consultation Paper. Our recommendations on the Consultation Paper are provided below.

2. Recommendations of Dua Consulting

- 2.1 We believe that the object of any regulation or law should be such that it is clear, unambiguous and can be easily enforced. The Government must look at the best way forward and one which would be least controversial. Given the multitude of litigations that have surfaced in various Courts on the interpretation of the definition of AGR, it will be easier for the Government to regulate the industry on the basis of GR instead of AGR, as the GR will ensure a more clear-cut definition with the necessary deductions that are accounted for, by the auditors in the P&L statement of the operators. This will ensure determination of the revenue base purely on the basis of an auditor's scrutiny and that leads to transparency and efficiency in the systems.
- 2.2 There are primarily three charges which are levied on the basis of the revenue basis. And these are: License Fee, the USOF contribution and the Spectrum Usage Charge (SUC). We firmly believe that GR must be used as the benchmark for determination of these charges.
- 2.3 If definitions can be kept clear, that would in turn, also reduce the disputes that surround this issue. One needs to have absolute clarity over the provisioning of the services. Any input which is required to provide the services, should be deductible from the gross revenue, to arrive at the AGR.

- 2.4 The treatment of the various heads of expenses should be such that can easily be determined from the books of accounts. Adjustments for AGR computation purposes can be fairly complicated. One needs to be able to clearly earmark the deductible/non deductible expenses and the holding/non holding expenses.
- 2.5 Another fundamental issue which must be borne in mind is that there must not be double charging of revenue. For example, a NLD service provider who is not an integrated player, would either have its own capacities or hire capacities. When the NLD player hires that capacity it is a payout for him. Deductions should apply for telecom resources which are shared from other service providers.
- 2.6 The approach, which the Government may wish to adopt, is to GR as the basis of License Fee and SUC collection. It can set a target in mind, in terms of the revenue it wishes to generate, and accordingly fix a percentage on that basis. The Government can set this revenue target based on its requirements to meet various socio-economic objectives.
- 2.7 In this regard, the Government may also wish to look at arriving at this percentage on the basis of the GR- AGR ratio and calculate the percentage accordingly. We have illustrated with figures from the TRAI financial data pertaining to GR and AGR for the 1st quarter in the FY 2014-15 that this ratio hovers in the range of 1.4 and 1.9. Accordingly, the percentage should be revised by that reasonable and proportionate basis. The percentage should be reviewed on the basis of the Government's revenue target for the sector. The accrual to the Government's coffers cannot continue in perpetuity for what may be an outcome driven by efficiencies generated by the telcos. Revenue neutrality, index to inflation, revenue target benchmarks are these important considerations that may be looked at while determining the percentage basis.
- 2.8 Also, the industry, on its part, is anyhow obligated to pay its taxes- be it service tax, education cess, etc. Any such deductions on these counts for the purposes of AGR computation would be a futile exercise. Instead, the company's books can come up for scrutiny if these heads are looked at, in some manner.

3. Responses to Issues for Consultation

3.1 Q1: Is there a need to review/ revise the definition of GR and AGR in the different licences at this stage? Justify with reasons. What definition should be adopted for GR in the Unified Licence in the interest of uniformity?

Dua Consulting Response: There is an urgent need to revisit the definition of GR and AGR under the various licensing regimes in order to ensure clarity and reduce the disputes which are pending before various judicial forums. It will also result in the ease of enforcing any regulation on computation of SUC and license fee.

The definition of GR under the Unified License should be on the basis of the revenue earned from the licensed telecom services. We believe the policymakers should look at GR as the primary basis of calculating SUC and license fee, due to its ease of computation from the books of accounts, of the companies as well as the ease of enforceability.

3.2 Q2: What should be the guiding principles for designing the framework of the revenue sharing regime? Is the present regime easy to interpret, simple to verify, comprehensive and does it minimize scope for the exercise of discretion by the assessing authority? What other considerations need to be incorporated?

Q3: In the interest of simplicity, verifiability, and ease of administration, should the rate of LF be reviewed instead of changing the definitions of GR and AGR, especially with regard to the component of USO levy?

Dua Consulting Response: We believe that the foremost principle which the regulator must bear in mind, is that the revenue base be examined from the perspective of GR instead AGR, keeping the relevant deductions in place. In this regard, the Government may wish to look at arriving at this percentage on the basis of the GR: AGR ratio and calculate the percentage accordingly.

Another fundamental issue which must be borne in mind is that there must not be double charging of revenue. For example, a NLD service provider who is not an integrated player, would either have its own capacities or hire capacities. When the

NLD player hires that capacity it is a payout for him. Deductions should apply for telecom resources which are shared from other service providers.

The scope for ambiguity in interpretation on the type of services which would and would not be considered for the revenue base to be a part of the computation of the license fee and SUC must be clear cut.

3.3 Q4: If the definitions are to be reviewed/ revised, should the revenue base for levy of licence fee and spectrum usage charges include the entire income of the licensee or only income accruing from licensed activities? What are the accounting rules and conventions supporting the inclusion or exclusion of income from activities that may not require licence?

Dua Consulting Response: The revenue base for the levy of license fee and spectrum usage charges must only cover the income arising out of the licensed scope of activities. Other form of income, which may lead to a dual charging, should be avoided.

3.4 Q5: Should LF be levied as a percentage of GR in place of AGR in the interest of simplicity and ease of application? What should be the percentage of LF in such a case?

Dua Consulting Response: We do see merit in the LF levy being based as a percentage of GR in place of AGR. It does lead to simplicity and ease of enforcing relevant regulation in this regard. It also ensures transparency in examining the books of accounts, of the telcos.

In this regard, primacy can be placed on the GR: AGR ratio to arrive at the basis of the levy. Our examination of the recently released financial data pertaining to GR and AGR for the Quarter ending June 2014 of the FY 2014-15 revealed the following trends:

As a reference point, to understand the GR: AGR ratio, we examined the numbers of Bharti Airtel, Vodafone and Idea Cellular for the Mumbai, Kolkata and Punjab circles.

Table 1: GR, AGR (in Rs. crores) and Respective Ratios

Circle & Operator	Gross Revenue	AGR	GR: AGR Ratio
Bharti Airtel- Mumbai	637	325	1.96
Vodafone- Mumbai	1020	641	1.59
Idea- Mumbai	272	122	2.23
Bharti Airtel- Kolkata	306	158	1.94
Vodafone- Kolkata	353	246	1.43
Idea- Kolkata	58.5	9.33	6.27
Bharti Airtel- Punjab	570	402	1.42
Vodafone- Punjab	305.5	200	1.53
Idea- Punjab	366	277	1.32

As illustrated by the figures above, the GR: AGR ratio for a major metro circle such as Mumbai hovers around an average of 1.9, whereas for the Punjab circle, it is around 1.4. Accordingly, one can gauge this ratio to determine the percentage point difference in computing the levy of LF and SUC on the basis of GR instead of AGR.

3.5 Q6: Should the revenue base for calculating LF and SUC include 'other operating revenue' and 'other income'? Give reasons.

Q7: Specifically, how should the income earned by TSPs from the following heads be treated? Please give reasons in support of your views.

(a) Income from dividend;

(b) Income from interest;

(c) Gains on account of profit on assets and securities;

(d) Income from property rent;

(e) Income from rent/ lease of passive infrastructure (towers, dark fibre, etc.);

(f) Income from sale of equipment including handsets;

(g) Other income on account of insurance claims, consultancy fees, foreign exchange gains etc.;

Dua Consulting Response: We do not find it appropriate to include other operating revenue' and 'other income', for calculating LF and SUC. The telecom licenses are issued only to carry out licensed services/activities and hence, only those revenues should be taken into consideration.

Accordingly, the heads mentioned under Q7 should not be taken into consideration as well, given that they are not license-specific activities *per se*.

3.6 Q8: What categories of revenue/income transactions qualify for inclusion in the revenue base of TSPs on 'net' basis? Please support your view with accounting/ legal rules or conventions.

Dua Consulting Response: The emphasis should be placed on the revenue/income earned from the licensed scope of activities. The licenses issued to these operators are under the provisions of Indian Telegraph Act, 1885.

3.7 Q9: What are the mechanisms available for proper verification from the financial statements of TSPs of items/ income proposed to be excluded from the revenue base, especially for TSPs engaged in multiple businesses? Would new verification mechanisms be required?

Dua Consulting Response:The present regime which mandates licensees to submit license-wise annual audited AGR statements to the Licensor may be continued with.

3.8 Q10: What is the impact of new and innovative business practices adopted by telecom service providers and licensees on the definition of GR? What impact will exempting other income from the revenue base have on the verification mechanism to be adopted by the licensor?

Dua Consulting Response: We do not see much impact caused by new and innovative business practices as long as we have clear cut definitions to cover what is included and not included within the fold of GR and AGR.

- 3.9 Q11: Do the potential benefits accruing to TSPs by moving from a simpler to a more complex definition of the revenue base (providing for additional exclusions) justify the additional costs of strengthening the assessment, accounting and monitoring system? Should the definition of AGR remain unchanged once the revenue base is reduced by providing for additional exclusions from the top line?**

Dua Consulting Response: There should be additional costs of strengthening the assessment, accounting and monitoring system to ensure greater transparency. Moving the GR and AGR regime by providing for exclusions which are clear cut and ensures clarity will reduce the multitude of litigations which are pending before various Courts.

- 3.10 Q12: Should minimum presumptive AGR be applicable to licensee? How should minimum presumptive AGR be arrived at?**

Q13: Should minimum presumptive AGR be made applicable to access licensee only or to all licensees?

Dua Consulting Response: We do not see the need for a minimum presumptive AGR to be applicable for any category of licensees.

- 3.11 Q14: Should intra circle roaming charges paid to another TSP be treated as a component of PTC? If so, why?**

Dua Consulting Response: Yes, In our view intra circle roaming charges paid to another TSP should be treated as a component of PTC, as the same is very much a part of the income/revenue in the hands of another telco considered for AGR computation purposes.

- 3.12 Q15: How should the permissible deductions be designed keeping in view future requirements? Specifically, what treatment should be given to charges paid to IP-I providers in the context of the possibility of bringing them under the licensing regime in future?**

Dua Consulting Response: In our view, the permissible deductions should cover all charges payable to another telecom service provider. There must not be double

charging of revenue. For example, a NLD service provider who is not an integrated player would either have its own capacities or hire capacities. When the NLD player hires that capacity it is a payout for him. Deductions should apply for telecom resources which are shared from other service providers.

3.13 Q16: Should the items discussed in paragraph 3.35 be considered as component of PTC and allowed as deductions from the GR to arrive at AGR for the purpose of computation of license fee? Please provide an explanation for each item separately.

Q17: If answer to Q16 above is in the affirmative, please suggest the mechanism/ audit trail for verification.

Q18: Is there any other item, which can be considered for incorporation as PTC?

Dua Consulting Response: Yes, in our view the above items mentioned in paragraph 3.35 should be considered as a component of PTC.

The mechanism for verification should be as per the present system of licensees submitting license-wise audited AGR statement along with details of Revenue, deductions and License-fee, on an annual basis.

3.14 Q19: Please suggest the amendments, if any, required in the existing formats of statement of revenue and license fee to be submitted by service providers.

Q20: Is there a need to develop one format under unified license for combined reporting of revenue and license fee of all the telecom services or separate reporting for each telecom service as in present license system (as per respective license) should continue? If yes, please provide a template.

Dua Consulting Response: As long as the revenue earned from licensed scope of activities is covered in the formats of statement of revenue and license-fee, there should not be any modifications/amendments required to that.

A single format may not necessary. The present dispensation may be continued with.

- 3.15 Q21: In case any new items, over and above the existing deductions, are allowed as deduction for the purpose of computation of AGR, please state what should be the verification trail for that and what supporting documents can be accepted as a valid evidence to allow the items as deduction.**

The present system wherein licensees submitting license-wise audited AGR statement along with details of Revenue, deductions and License-fee, on an annual and quarter-wise basis is sufficient, should any new items be allowed for deduction, for the sake of simplicity.

- 3.16 Q22: Is there a need for audit of quarterly statement of Revenue and License Fee showing the computation of revenue and license fee?**

Q23: If response to Q22 is in the affirmative, should the audit of quarterly statement of Revenue and License Fee be conducted by the statutory auditor appointed under section 139 of Companies Act, 2013 or by an auditor, other than statutory auditor, qualified to act as auditor under section 139 & section 148 of Companies Act, 2013 or by any one of them?

Dua Consulting Response: No. In our considered opinion there is no pressing requirement for a quarterly audit of Revenue and License Fee.

- 3.17 Q24: Is it desirable to introduce deduction of LF at source as far as PTC payable by one TSP/licensee to another are concerned, in the interest of easy verification of deductions?**

Dua Consulting Response: No we do not find any merit in introducing deduction of LF on payment being made by one TSP to another TSP.

- 3.18 Q25: Is there any other issue that has a bearing on the reckoning of GR/AGR? Give details.**

Dua Consulting Response: We would like the regulator to place special emphasis on our response to Q5 wherein we see a great deal of merit in the LF levy being based as a percentage of GR in place of AGR. An illustration has also been given to show the various scenarios of GR to AGR ratios.