

Denial of CENVAT Credit on the Basic Infrastructure of Telecom (Communication Towers) by Hon'ble Mumbai High Court and Tribunal -A Major Setback for the Entire Telecom Industry



This article attempts to bring on board the legitimate requirement of the telecom industry (eligibility for CENVAT credit on telecom towers used for rendition of telecom services) that is unsympathetically denied by the quasi-judicial/judicial machinery over time based on consistent disregard of the factual veracity of this competitive industry without which no economy can survive. Time and again, without attempting to reform or correct the anomalies of the law, decisions are rendered against the industry and undue tax losses/litigation costs are imposed on telecom operators, requiring immediate attention of the law makers.

Background

The critical issue that this article covers relates to the eligibility for getting CENVAT credit on duties and taxes paid on the erection of telecom towers/shelters, etc. to the telecom operators providing telecommunication services in India. The telecom

industry is the backbone of the entire infrastructure of any nation in present times as without robust, capable and vigorous communication networks, the entire economic system of the nation would come to a standstill. Acknowledging this crucial fact, our government has, in fact, in the past decade or more taken initiatives to liberalise the policies for this sector, and has also taken multiple initiatives for the growth of this vital sector, but ironically the tax positions (direct as well as indirect tax) taken years ago were not reformed considering the current scenario. Further, the sluggish pace of decision making at different judicial forums on these critical issues has led to an unenthusiastic situation for the telecom industry as a whole.



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Telecom operators provide telecommunication services in different parts of the country (termed as telecom circles in the telecom industry) as per their respective spectrum and license capacity. All telecom operators depend on the basic infrastructure of telecom towers (passive infrastructure) in addition to other active telecom infrastructure of OFC cables, *etc.* This basic passive infrastructure is generally owned partly by the telecom operators and partly, they are dependent on other operators (taken on lease) for covering their entire service area for providing telecommunication services.

Technical Background

As we may be aware, the mobile telecommunications industry provides cellular telephone services through the use of active and passive infrastructure. The active infrastructure, as it implies, consists of the core elements of cellular telephony like Mobile Switching Centre (MSC), Base Transceiver Station (BTS), Base Station Controller (BSC), and microwave and GSM/CDMA antennae. On the other hand, passive infrastructure consists of elements that enable the active infrastructure to operate. Telecom towers are used for raising antennae to predetermined and technically viable heights for optimum coverage of the cellular network. The towers are, archetypally erected at the site itself and also comprise poles for mounting the antennae, shelters and housing for electrical and telecom equipment.

If spectrum is the oxygen for any telecom operator, then telecom towers are the backbone of telecom services on which telecom service stand and are delivered. To build a long-term sustainable and competitive telecom business, operators need a clear cut tax rationale on the eligibility of CENVAT credit from the law makers, more so as huge expenditure is incurred by the operators in terms of duties and taxes in building these telecom towers.

The basic infrastructure of GSM/CDMA is similar to all other cellular radio networks. The system consists of a network of contiguous radio cells providing complete coverage of a service area. Each cell has a BTS operating on a dedicated set of radio channels that use different frequencies than those used in adjacent cells. A group of BTS is controlled by a base station controller (BSC) for functions such as handover and power control. A group of BSCs is served by an MSC that routes calls to and from the public switched telephone network (PSTN), ISDN and public data network (PDN).

MSC is the heart of a cellular radio system. It is responsible for routing or switching of calls from the originator to their destination. MSC is responsible for call set up, termination of the call, management of inter-MSC handover and supplementary services, and for collecting, charging and accounting information. MSC also acts as the interface between the CDMA network and the PSTN and PDN. Thus, a BTS is the first link in the whole system. It houses the radio transceivers and handles the radio link with the mobile phone of the subscriber. The need of BTS towards providing cellular telephone service is paramount. BTS is the equipment required/used to transmit the CDMA signal.

Further, GSM/CDMA and microwave antennae are required to receive and transmit the radio frequency generated by GSM/CDMA transceivers in BTS in free space directed towards the mobile station. Microwave antenna is a dish type antenna installed on the tower to transmit information from the microwave radio towards other such dish installed on the other side of the linking side.

Towers along with antennae are installed for the transmission of microwaves. For proper and regular transmission, the path between two towers has to be clear. If antennae are put at lower height, then the microwaves shall either get obstructed by buildings, trees, *etc.* So, for creating obstruction free path for the microwaves, antennas are kept at a higher platform with the help of towers. Therefore, towers help in providing obstruction free telephone services.

Towers and antennae help in avoiding earth's curvature. It is a known fact that the earth is round. So when two towers are put at a distance, then the path of microwaves can be obstructed even by the curvature of the earth. So, antennae must often be installed on towers to raise them high enough to avoid the natural curvature of the earth. The situation can be well understood from the following diagram:



So, if the towers are not high enough then the path of microwaves can get obstructed by the earth's curvature.

Facts

Telecom operators have made huge investments year after year in building up telecom towers and related infrastructure for rendition of seamless telecom services that includes huge capital expenditure along with taxes paid in the form of excise duty, customs and service tax. In order to provide telecommunication services, the operators are inter-alia engaged in taking tower sites on lease and in certain cases, are also engaged in setting up of infrastructure for the provision of telecommunication services to their subscribers. A tower site is an integrated system that comprises various electronic and other goods, combined together to work as a plant in any interdependent and integrated manner. These operators have availed CENVAT credit of duty paid on capital goods, inputs and input services in connection with towers/shelters and other tower components as well as input services used in the erection of towers, *etc.* in accordance with Rule 3 of the CENVAT credit Rules. All these availments of CENVAT credit have also been duly disclosed by the respective operators to the tax authorities in the periodic service tax returns. However, while telecom operators have regularly disclosed the complete facts for CENVAT credit they have availed, operators have been denied at all levels by the tax authority/courts of this legitimate right.



BTS and parts thereof along with prefabricated building structures qualify as 'capital goods' under Rule 2 (a) of the CENVAT credit Rules. The goods form an integral part of the 'Base Transceiver Station System,' that is classifiable under Tariff heading 8525, and therefore should be covered under the extended definition of 'capital goods.' The antennae fall under Chapter 85 of the First Schedule to the Central Excise Tariff Act, 1985.

Despite the complete and periodic disclosure by all the telecom operators of the CENVAT availment of the taxes so paid by them on capital goods purchases, related inputs/input services used in connection with the setting up/erection and commissioning of the telecom towers along with required shelters, *etc.*, tax and judicial authorities at all levels (First Appellate level to High Court level) have disallowed CENVAT on the ground that the aforesaid goods and services do not qualify as 'inputs or capital goods' and 'input services' for the telecom operators as per the definition under the Rules. The authorities have disregarded the fact that these capital goods so purchased/used with related inputs and input services are principally required to render telecom services, and in the absence of this basic infrastructure, telecom services cannot be delivered.

Legal History

This paper provides below the relevant legal provisions that actually govern the issue under discussion here:

The definition of 'capital goods' under the Rules reads as:

"Rule 2(a) Capital goods means:

(A) *The following goods, namely-*

- (i) *All goods falling under Chapter 82, Chapter 84, Chapter 85, Chapter 90, Heading No. 68.02 and sub Heading No. 6801.10 of the First Schedule to the Excise Tariff Act;*
- (ii) *Pollution control equipment;*
- (iii) *Components, spares and accessories of the goods specified at (i) and (ii);*
- (iv) *Moulds and dies, jigs and fixtures;*
- (v) *Refractories and refractory materials;*
- (vi) *Tubes and pipes and fittings thereof; and*
- (vii) *Storage tank,*

used -

- (1) *in the factory of the manufacturer of the final products, but does not include any equipment or appliance used in office; or*
- (2) *for providing output service.*

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Findings of The Mumbai High Court and Tribunal

In the recent decision by the Hon'ble Mumbai High Court, and then Mumbai Tribunal in the CENVAT issue, the benefit of credit to telecom service providers on towers and shelters has been denied. Hon'ble Mumbai High Court in deciding the issue in the case of *Bharti* is of the view that the credit on such goods (either as such or in CKD-SKD condition) should not be available, since they are not specifically covered under the definition of capital goods as defined under Rule 2(a) of CENVAT credit Rules. The definition *inter-alia* prescribes specific chapter headings under the Central Excise Tariff Act, 1985 for which credit can be taken. The goods in question do not fall under these chapter-headings. Further, the 'Base Transceiver Station' cannot be regarded as a composite system comprising these goods, since each component thereof has its own independent function. The said goods would not qualify as a 'component' of BTS for the purpose of availing credit as capital goods.

The Hon'ble Court has further asserted that towers and shelters, being fastened and fixed to earth for erection/installation purposes become immovable in nature thereby losing the basic characteristics of excisable 'goods'. Credit of duty paid on such goods can thus not be availed by treating them as 'inputs'.

In this context, the Hon'ble Mumbai High Court differentiating from the AP High Court decision in *Sai Sahmita Storages [2011 (23) STR 341]* where credit was allowed on cement and TMT bars used for creating a storage facility on the basis that without such goods the service of storage and warehousing could not have been provided. The Hon'ble AP High Court found proximate linkage between the setting up of a warehouse and the provision of warehousing services. The Hon'ble Mumbai High Court did not



agree with the applicability of this proposition on the basis that the said ruling has been rendered in the context of a different taxable service. The argument that towers and shelters are used for providing telecommunication services as the antennae and BTS are fitted into the tower and shelter, respectively and therefore, tower and parts thereof and shelter qualify as 'inputs' under Rule 2(k) of the CENVAT credit Rules was also rejected on the basis that "they are not directly used for the output services".

Conclusion

It is apparent from the contextual background and detailed facts as discussed above that there has been disregard of the factual reality and peculiar nature of the telecom business for which tax laws were not reformed for years in the rapidly changing business environment. The High Court's observation that towers once fixed on earth become immovable and lose the basic character of excisable goods and are hence not eligible for CENVAT credit for the taxes paid while purchased in a disintegrated form is unsubstantiated as the two different views—one, for the telecom service provider and the other, for passive infrastructure owner (not a telecom service provider who is allowed to take CENVAT credit of telecom towers) on different footing are not

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plausible. Further, the Tribunal and High Court's contention that these goods are not "specifically" provided as capital goods in excise Chapter heading 85 and therefore telecom operators are not allowed to treat them as capital goods and take CENVAT credit appears to be skewed towards revenue at the cost of the telecom industry that is already very competitive, and heavily debt ridden. No attempt is being directed to suitably reform age old laws and give expected relief to the industry and dispose of undue tax litigations. Year after year, authorities from multiple forums have only followed each other and delivered consistently similar findings on the issue. The fundamental proposition that cellular telephony services could not be provided without the telecom towers has been marginalised.

The Hon'ble High Court's interpretation of "exact nexus" of goods/services used and output services is unfavorable even when globally it is a widely acceptable fact that telecom service cannot be provided without telecom towers. If the Court and/or Tribunal center their decision on the argument that the towers which are made from different steel angles and other related parts classified as capital goods have no direct nexus with rendition of the output services and rule that credit on such goods (either as such or in CKD-SKD condition) should not be available, since they are not specifically covered under the definition of capital goods as defined under Rule 2(a) of CENVAT credit Rules, then it appears that there is immediate need to remove these anomalies by law makers which are otherwise forcing Tribunals and Judiciary to render such decisions. These rulings appear to be against the basic principles of law and natural justice. If this 'exact nexus' is adopted across sectors, it may lead to a substantial rise in indirect tax litigation.

In that status quo as adopted even by the higher authorities (High court and Tribunal), if we estimate the quantum of tax credit availed by various players across the telecom spectrum, this decision of the Hon'ble Mumbai High Court and Tribunal may be estimated to have put at risk an amount of more than ₹4,000 crore.

It is worth mentioning here that most operators go for capital equipment financing or external commercial borrowings (ECBs) when importing telecom equipment like Mobile Switching Centre (MSC), Base Transceiver Station (BTS), Base Station Controller (BSC), and microwave and GSM/CDMA antennae, etc. which are eligible as capital goods

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under FEMA regulations. It is ironic that the same telecom equipment as stated above including GSM / CDMA antennae are treated as capital goods under one law (FEMA) and as non- capital goods under the other law (Central Excise) both of which are regulated and controlled by the Ministry of Finance, Government of India.

The lawmakers could thus provide more clarity in the existing excise tariff Chapter 85 to unambiguously include telecom towers and shelters as capital goods or amend the definition of capital goods/inputs suitably as required. The definition of capital goods needs a careful, suitable amendment as it was done in the past a number of times. For instance, if a JCB or other construction machinery is classified as capital goods under the excise tariff for the construction service provider, similarly, telecom towers are to be defined as capital goods in the definition of capital goods for telecom service provider- one of the largest revenue earners (service tax) for the governing revenue authority "Central Board of Excise and Customs". Further, the government is pushing its sincere efforts on tax neutrality by bringing the long awaited GST in the country and this welcome change in the existing law by amending the capital goods definition would serve a step forward in this direction. This action of law makers would save undue tax litigation which presently all are presuming that the Apex Court would decide in a more appropriate manner else the telecom industry would again be grappling for years with unwanted tax disputes/unwarranted costs. ■