



Verizon Response to TRAI Consultation Paper no 9/2014 on Definition of Revenue Base (AGR) for the Reckoning of License Fee and Spectrum Usage Charges

Verizon Communications India Private Limited (“VCIPL”) is pleased to submit its comments to the Telecom Regulatory Authority of India (TRAI) in response to the Consultation Paper No.09/2014 issued by TRAI dated 31st July 2014.

By way of background, our Company VCIPL has been awarded NLD/ILD/ISP-A license by the Department of Telecommunication. VCIPL is a unit of Verizon Communications Inc which is a global IT & Telecom solutions provider catering to large and medium business and government agencies and serves 98 percent of the Fortune 500 companies. It provides enterprise data services to multinationals, enterprise customers, and the BPO and ITES sector customers who have connectivity requirements in multiple locations across the globe.

The current licensing framework envisages payment of license fee based on the revenue share basis. The revenue will be the gross revenue accruing to the licensee by way of operation of service mandated under the license but permitted to be reduced by charges like interconnection usage charge, roaming revenue payable to other service providers, service tax and other statutory levies paid to government and also revenue generated through sale of handset etc. The definition of revenue has been under constant review by the licensor, TRAI, TDSAT and the Supreme Court of India. The need for review of definition of AGR is propelled by various other considerations including the fact that the definition of AGR as currently incorporated in the various telecom licenses has been litigated by the Telecom Service Providers (TSP’s). There has also been an ongoing debate within the industry & with the regulator wrt to the inclusion of various components of revenue in the reckoning of AGR as well as the legality of the definition before TDSAT.

Additionally there have been significant regulatory Developments that have further propelled the need for such a review.

National Telecom Policy NTP-2012 & Unified Licensing Regime (UL)

The announcement of National Telecom Policy, 2012 (NTP 12) in May 31, 2012 is also an important factor that is relevant to the discussion about the need for review of definition of AGR. The NTP-2012 envisioned introduction of a UL, driven by the fast pace of technological developments which is blurring boundaries between traditional telecom services, rendering service based divisions of Telecommunications redundant. The new licensing regime

envisages the separation of network operations and delivery of services which would entail a review of the revenue base for the purpose of levy of License fee. The NTP-2012 also recognized the need to rationalize taxes, duties, and levies affecting the telecom sector thus paving way for the review.

Another important consideration is the emerging technology trends towards a Converged Scenario in Telecom services with Convergence in “carriage” of telecommunications, Convergence of media and convergence of IP based transmission for Voice, data and Video and the resultant need for a review of the definition of the AGR for reckoning of license fee for such converged services .

More recently TRAI has released pre consultation for industry inputs wrt delinking of licensing of networks from delivery of services by way of virtual network operators, etc and thus all these recent development are germane to the consultation exercise on AGR.

In the international arena, there are number of countries that have been gradually reviewing the revenue share definition due to technological developments, and to ensure long-term sustainability of telecom service providers and optimum utilization of resources. We also believe that the outcome of the present consultation paper on AGR would bring the desired clarity & certainty to the widely debated issue and foster an investor friendly environment for attracting additional investments in the Telecom sector apart from generating manifold employment opportunities in various segments of the sector as also envisioned by the government new liberalized FDI policy for telecom sector issued in August 2013.

ISSUES FOR CONSULTATION-:

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

VC IPL Response: Yes, there is a need to review the definition of GR and AGR in the different licenses. There are various reasons for the same. The guidelines relating to definition of AGR and the computation of the License fee under the existing license predominantly address the requirements wrt service providers providing switched voice services. However there is a need to address the requirements of Telecom Service Providers (TSP's) providing enterprise data services which is fuelling the demand for data and connectivity throughout the country and abroad.

At present, deduction on account of pass through charges paid to other TSP for providing switched voice services is allowed whereas the same is disallowed in case of leased /input bandwidth procured for providing services by enterprise data service providers.

To unleash the next wave of telecom data revolution in India, the needs of the telecom enterprise sector will need to be addressed with sound regulatory policy with focus on data services to start the data revolution and propel the Indian telecom industry's competitiveness on a global scale.

Recognizing the emergence of new IP based services, the various anomalies in the current definition of GR and AGR under the telecom licenses need to be reviewed. We understand that the Department of Telecom is presently working on the phase-II of the Unified License and thus from a timing perspective it is an excellent opportunity for addressing the previous aberration in the definition of GR/AGR that exists in the current licenses in the phase II of Unified License.

Under the terms and conditions of the existing license there is an issue of multi stage assessment of license fee ie issue of Double levy of license fee.

Multi stage assessment of License fee

Telecom licensees are subject to the double-assessment of license fees because input costs, such as charges for interconnection, local loops and bandwidth cost which themselves already reflect in the license fee, are not deductible from the adjusted gross revenue on which the license fee is calculated. While facilities-based operators using their own networks need only pay the license fee once, wholesale services that ILDOs, NLDOs, and ISPs buy from other operators as part of their own service offerings are subject to the license fee twice – once when they are sold from the first network owner to the second

operator, and then again when the second operator sells them to the end user. As a consequence of levying a license fee at every point in the supply chain, a telecom operator that buys wholesale inputs from other licensed operators is placed at a significant competitive disadvantage against operators that do not need to obtain these inputs.

The Authority has examined this issue at para 3.33 pg no 45 of the consultation paper and has made the following observations:-

Quote

...that leased line charges, port charges etc paid by one operator to other operator should not be allowed as deductible under pass through charges to arrive at AGR as they are part of costs linked to network functioning whereas pass through are revenues collected from customers by one service provider for using the telecom network of another service provider

The authority also observed that LF paid to DoT is not a direct or indirect tax/cess levied by government of India under any statute/law. It is a contractual obligation on the TSP as per the license agreement.

The authority also noted that these access facilities either can be taken on lease or built by operator based on commercial considerations.

Unquote

In response to the observations made by authority on the double taxation we hereby submit the following arguments for kind consideration of the authority

- It is important to mention that the Unified Licensing Regime envisages migration towards a flexible and technology neutral licensing framework paving the way for the migration to IP based networks. Such a migration would also entail making the segregation between traditional telecom networks as redundant. This would also bring about convergence of networks which allows different services such as voice, video & data etc to be offered and merged together on a single unified network. In such a converged scenario it would be difficult to associate cost linked with a particular service or network function. Such a convergence of the networks would also mean that the telecom service provider (TSPs) would be converging its network infrastructure which may currently be segregated and consolidate it in such a way as to provide enormous bandwidth and reduce its operating cost. Thus the observation by Honble authority wrt bandwidth /lease charges being part of the cost associated with network functioning in a converged network scenario would not be relevant.

- The Authority has mentioned that the License fee paid by the licensee to DoT is a contractual obligation on the TSP as per the License agreement. However such a contractual arrangement can be reviewed & amended based on mutual arrangements and in line with emerging technology trends & requirements. In fact the terms and conditions of the current telecom License agreement have been reviewed and amended many times by the Licensor to reflect the changing requirements.

In a related context, the terms and conditions for IPLC resellers license which were issued by DoT in 2008, reflects the same understanding wrt input bandwidth deduction as below

ANNEXURE-A

Format of Statement of Revenue and LICENCE Fee

----- (Name and address of OPERATOR)

Resale of IPLC Service

Statement of revenue and LICENCE Fee for the Quarter -----

Of the financial year -----

(amount in Rupees)

B DEDUCT:

Charges actually paid to other
telecom service providers for
procurement of bandwidth, last
mile connectivity used for
provision of end to end IPLC;

(Note: Any charges paid for

multiplexing, de-multiplexing,
billing system and related
customer management are not
to be deducted.) (Operatorwise)

(Copy of agreement to
be provided in the first
quarter.)

2 Service Tax paid to the
Government

3 Sales Tax paid to the
Government

BB TOTAL DEDUCTIBLE

REVENUE (1-3B)

CC ADJUSTED GROSS

REVENUE (AA-BB)

REVENUE SHARE @ -----

----- OF ADJUSTED GROSS

REVENUE

- Lastly the authority has mentioned that the access facilities either can be taken on lease or built by the operator based on the commercial considerations. It is well recognized that pursuant to opening up of the telecom sector to private players, significant investments have been made in creation of telecom infrastructure which is necessary for providing a variety and quality of telecommunication services required and expected by the customers. Thus it is not the case that further investments are needed to create duplicative infrastructure. However building access facilities entails significant capex and the Honble authority has from time to

time issued recommendations aimed at encouraging sharing of infrastructure between the service providers as creation of duplicative infrastructure not only makes the investment inefficient but also leads to incidence of higher cost being on passed to end customer by the service provider.

Thus the cost associated with network functioning is embedded in the TSP's service/product cost which is also on passed to the end user by the TSP to recover the cost incurred on creation of the network facility. Therefore the end user is ultimately bearing the pass through charges paid by the telecom service provider for using the telecom network of another service provider.

Recommendations:

- To avoid this anti-competitive double assessment of licensing fees on various telecom licensees, specifically, there is a need to amend the terms and conditions of telecom licenses so as to permit deduction of the cost of any telecom services purchased as inputs from the adjusted gross revenue.
- The methodology used to calculate license fees for operators should be reviewed to ensure that India's license fee regime allows all providers to compete on an equal basis, as the present methodology does not adequately promote competition because it operates as a multi-stage and cumulative assessment and therefore imposes greater burdens on TSP's who procure input bandwidth for providing telecom services to their end users.

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?

VC IPL Response: The guiding principle should be that revenue from all activities which requires a telecom license to undertake should only qualify for a revenue sharing regime. Revenue from other activities which do not require a telecom license or do not come under the ambit of Indian Telegraph Act (ITS) 1885 should not be subjected to any revenue share.

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?

VC IPL response: We believe that there is a need to review the definition of GR and AGR as well as the rate of license fee especially the USO levy which is a major portion of the LF (5%). The telecom sector continues to grapple with multiple levies and high revenue sharing license fee which is highest among any other sectors in India and many other neighboring countries. The license fee was earlier increased from 6% to 8% in 2012. The 8% includes 5% USO levy and 3% Administrative Fee. USO Fund continues to be underutilized and has built

up a significant corpus. Thus the 5% USO levy needs to be reduced to 1% - 3%, which is comparable to international best practices.

Therefore it is the need of the hour to gradually reduce the license fee starting with immediate phase wise reduction of USO levy. This will certainly help the sector improve its financial viability by reduction of cost leading to affordability at the hands of the consumers.

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 licenced activities? What are the accounting rules and conventions supporting the inclusion or exclusion of income from activities that may not require licence?

VC IPL Response: The revenue base should take into account only those activities which require a telecom license to undertake as envisaged under ITA 1885 . For eg: Interest income not related to licensable activity should be excluded from license fee levy

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?

VC IPL Response: The license fee should be levied as a percentage of AGR to factor the various underlying legitimate inter operator payments whereby the consumer can get access to various services.

For eg as previously mentioned, Presently, Telecom licensees are subject to the double-assessment of license fees because input costs, such as charges for port charges , local loops charges and bandwidth cost which themselves already reflect the license fee, are not deductible from the gross revenue (GR) to work out the adjusted gross revenue (AGR) on which the license fee is calculated.

Therefore AGR based model as against GR should be adopted.

Cost reimbursement or cost credit should not be viewed as revenue by DOT; these are purely cost adjustment presented under the expense category in the audited financial statements

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

VC IPL Response: The revenue should only factor income or sources of revenue which are derived based on activities requiring a telecom license. All other income which are derived from activities not requiring a telecom license should be excluded.

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;

Needs to be excluded from the revenue base for LF purposes.

(b) Income from interest;

Needs to be excluded from the revenue base for LF purposes.

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

Needs to be excluded from the revenue base for LF purposes.

(d) Income from property rent;

Needs to be excluded from the revenue base for LF purposes.

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

Needs to be excluded from the revenue base for LF purposes.

(f) Income from sale of equipment including handsets;

Needs to be excluded from the revenue base for LF purposes.

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

Needs to be excluded from the revenue base for LF purposes.

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.

VC IPL Response: In our view incase Forex gain/loss is considered as licensable, then any FX gain/loss should be allowed to be netted. Forex gain should not be viewed in isolation by DOT for license fee calculation purposes. This is in line with the audited financial statements accounting treatment of Forex gain/loss whereby they are presented as net

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?

VC IPL Response: In our view the audited financial statement of TSP's are sufficient mechanisms for proper verification.

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?

No Comments

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?

VC IPL Response: The current framework for audit and assessment is sufficient and there is no requirement for any additional over the top monitoring. The definition of AGR should align with the principle stated in aforesaid paragraphs.

Q12: Should minimum presumptive AGR be applicable to licensees? How should minimum presumptive AGR be arrived at?

VC IPL Response: We do not support any type of presumptive AGR framework.

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

VC IPL Response: We do not support any type of presumptive AGR framework.

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

VC IPL Response: We have not specific comments. However, principally in inter operator payments should be allowed as a PTC being the underlying cost.

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?

VC IPL Response: Principally in inter operator payments should be allowed as a PTC being the underlying cost.

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

VC IPL Response: We support deduction of Items indicated in paragraph 3. 35 from GR to arrive at AGR, since these are necessary inputs to complete the end services. With respect Receipts from USO fund, it is a grant from government it cannot be considered as revenue. Therefore, it is recommended that these should be allowed as deduction

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

VC IPL Response: We note that presently Telecom licensees submit license-wise audited AGR statement along with details of Revenue, deductions and License-fee, on yearly basis. A reconciliation statement is also submitted, duly audited by statutory auditors of the licensee company, over and above, Licensee are also liable for number of other audits i.e. TRAI's audit, DoT's Special audit and C&AG's audit etc ,therefore, we believe that there is no need for any further mechanism/audit trail for verification in this regard.

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

VC IPL Response: The suggestions made in the preceding paras regarding allowance of input cost deduction need to be considered

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

The existing formats should be revised to reflect the principle stated above in terms of what should and should not form part of revenue base. Specifically in the context of deduction on account of charges paid for input bandwidth the format in the existing resellers IPLC license can be followed which is reproduced below.

Source: DOT Website

[http://www.dot.gov.in/sites/default/files/License for Resale of IPLC Services 1.pdf](http://www.dot.gov.in/sites/default/files/License%20for%20Resale%20of%20IPLC%20Services%201.pdf)

ANNEXURE-A

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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.

VC IPL response: We would not recommend one format under the current unified license as it still carries service specific distinctions and somehow does not reflect true and complete unification as envisaged under NTP-2012. We understand work on Phase II of unified license is underway. Unifying the definition could be considered if a unified licensee is allowed to

provide any service using any infrastructure or technology which goes beyond the traditional service specific distinctions.

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 item as deduction.

VC IPL Response: Inter operator agreements should be considered sufficient and valid evidence for allowing pass through charges paid by one operator to another as deduction.

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

VC IPL Response: No there is no need for audit of quarterly statement of revenue and license fee showing the computation of revenue and license fee as the current framework of yearly audit is robust enough to address the requirements.

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?

VC IPL Response: Not applicable in view of the above

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?

VC IPL Response: No there is no need for deduction of LF at source.

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

VC IPL Response: For the sake of repetition, as already mentioned a major area of concern for TSP's which has a significant bearing on the reckoning of the GR/AGR is Forex fluctuation. Foreign exchange fluctuation is one of such activity which is not directly part of the licensee's Telecom license activity. Entities do not necessarily require a telecom license to deal with Foreign Exchange and therefore should be excluded from the purview of computing AGR. We would like to submit that any income earned on account of foreign exchange fluctuations should be kept out of the purview of AGR.

We believe that forex gains or loss is on account of revaluation of foreign exchange reserve, provisions made for overseas vendor/partners & suppliers etc arising out of various transactions. These forex Gains and losses are notional and remain unrealized. Hence, this need not be included in the calculation of AGR.

Further, forex gain can arise not only from provisioning of telecom service but also from non-telecom service and hence these gains cannot be considered as gains from telecom services and included for the purpose of levy revenue share. In addition, these fluctuations are so dynamic by way of their nature, that they cannot be easily predicted from an accounting perspective. Because of all these reasons we would request DoT not to consider revenue share on the gains on account of Forex fluctuations. We are of the opinion that if at all this should be considered then both the revenue gain and loss must be considered. We would therefore kindly request the government to consider either both ie Forex gains and Forex Loss as part of AGR assessments or both should be out of the purview of the assessment of AGR for purpose of payment of license fee. We would also further wish to bring to your kind notice that as per Accounting Standard 11 of the Institute of Chartered Accountant of India the Foreign Exchange Fluctuations whether Profit or Loss are part of the Revenue.