Appellate Tribunal for Electricity
(Appellate Jurisdiction)

Dated: 2nd December, 2013

Present: Hon'ble Mr. Justice M. Karpaga Vinayagam, Chairperson

Hon'ble Mr. V J Talwar, Technical Member

APPEAL NO. 138 OF 2012

IN THE MATTER OF:

Reliance Infrastructure Limited (Generation) Appellant

VERSUS

Maharashtra Electricity Regulatory Commission Respondent

APPEAL NO. 139 OF 2012

IN THE MATTER OF:

Reliance Infrastructure Limited (Transmission) Appellant

VERSUS

Maharashtra Electricity Regulatory Commission Respondent

Counsel for Appellant: Mr J J Bhatt
Ms Anjuli Chandrarurkar
Mr Hasan Murtaja

Counsel for the Respondent Mr Buddy Ranganathan

JUDGMENT

PER HON'BLE MR. JUSTICE M. KARPAGA VINAYAGAM, CHAIRPERSON

1. Reliance Infrastructure Limited (RInfra) is the Appellant herein. The Appellant has filed Appeal No. 138 of 2012 against the Order dated 16.5.2012 passed by the Maharashtra Electricity Regulatory Commission (hereinafter called the **State Commission**) in case No. 163 of 2011approving the Annual Revenue Requirements of the Appellant for the Year 2011-12 for the **Generation business.** The State Commission has also trued up the finances of the Appellant for the year 2009-10 and

conducted the Annual Performance Review for the year 2010-11.

2. The Appellant has filed Appeal No. 139 of 2011against the Order dated 16.5.2012 passed by the Maharashtra Electricity Regulatory Commission in case No. 167 of 2011 approving the Annual Revenue Requirements of the Appellant for the Year 2011-12 for **Transmission Business**. The State Commission has also trued up the finances of the Appellant for the year 2009-10 and conducted the Annual Performance Review for the year 2010-11.

3. The Appellant has filed these Appeals raising two issues viz., :

   i. Treatment of Income Tax.

   ii. "Resetting of Interest on Normative Loan Capital

4. **Since these issues are common in both these Appeals, this common judgment is being rendered.**

5. The first issue is **related to treatment of Income Tax during FY 2009-10 and FY 2010-11.**

6. According to the Appellant, the State Commission, while computing the income tax liability of the Appellant for the years 2009-10 and 2010-11, did not implement the

directions of this Tribunal in various Appeals viz., Appeal No. 251 of 2006, Appeal No. 90 of 2007 etc and as a result, the Appellant has been put to great loss.

7. While refuting the above submission, the State Commission has contended that it has implemented all the directions of the Tribunal relating to Income Tax liability in letter and spirit.

8. The learned Senior Counsel for the Appellant on this issue has made the following submissions in regard to the Income Tax for FY 2009-10.

   i) The question that falls for consideration of this Tribunal relates to the treatment of income tax in respect of the regulated businesses of a company vis-à-vis the liability of the Company as a whole when the company has a basket of regulated and unregulated business whose profit is liable to payment of income tax.

   ii) The relevant Regulation of MERC (Terms and Conditions of Tariff) Regulations, 2005 regarding to the treatment of Income Tax is Regulation 34.2 which reads as under: -

      “34.2 Income-tax

34.2.1 Income-tax on the income of the Generating Business of the Generating Company shall be allowed for inclusion in the annual fixed charges:

Provided that any change in such income-tax liability on account of assessment under the Income-tax Act, 1961, as certified by the statutory auditors, shall be allowed to be adjusted each year in the annual fixed charges:

Provided further that any change in such income-tax liability on account of change in income of the Generating Business of the Generating Company from the approved forecast shall be attributed to the same controllable or uncontrollable factors as have resulted in the change in income and shall be dealt with accordingly:

Provided further that the generating station-wise profit before tax as estimated for a financial year in advance shall constitute the basis for the distribution of the corporate tax liability to all generating stations of a Generating Company:

34.2.2 The benefits of any income-tax holiday, credit for unabsorbed losses or unabsorbed depreciation shall be taken into account in calculation of the income-tax liability of the generating station of the Generating Company:

Provided that where such benefits cannot be directly attributed to a generating station, they shall be allocated across the generating stations

of a Generating Company in the proportion of the generating station-wise profit before tax."

iii) Thus, the said Regulation clearly shows that Income Tax is to be allowed for inclusion in the Annual Fixed Charges on the income of the generating business of a generating company. Apart from generating business, there are identical provisions for transmission and distribution business segments of the licensee. The said Regulation clearly shows that such generating business has to be treated on a standalone basis, irrespective of the fact whether the Company has only one regulated business or basket of both regulated and non-regulated business segments.

iv) The question of treatment of Income Tax has fallen for consideration by this Tribunal in several cases. In Appeal No.251 of 2006 (Reliance Energy Ltd. V MERC & Ors.), this Tribunal has observed as under:

"……..The consumers in the licensee's area must be kept in a water tight compartment from the risks of other business of the licensee and the Income Tax payable thereon. Under no circumstance, consumers of the licensee should be made to bear the Income Tax accrued in other businesses of the licensee. Income Tax assessment has to be made on standalone basis for the licensed business so that

consumers are fully insulated and protected from the Income Tax payable from other businesses. We, therefore, allow the appeal in this respect….”

v) In Appeal No.90 of 2007 (Reliance Energy Ltd. V MERC & Anr.) this Tribunal has observed as under: -

“*50. The criteria is that in spite of the enabling provision of the Income Tax Act the liability of the income tax out of other businesses cannot be allowed to be passed on to the consumers of the distribution licensee. It is equally just, fair and equitable that the reverse also does not happen i.e. the liability of income tax pertaining to the distribution business is not passed on to the other businesses.*

51. In view of the foregoing discussions we decide that ***the*** income ***tax to be allowed must be worked out on the basis of the income tax payable solely on account of the distribution business of the licensee****. We, therefore, decide accordingly and allow the appeal in this view of the matter.”* (emphasis supplied).

vi) In the order dated 28.05.09 in respect of truing up of FY 2007-08 and in respect of the APR for FY 2008-09 in Case No 120 of 2008 filed by the Appellants, the principle that was followed by the State Commission was to take the profit, if any, before tax of each segment and to calculate the applicable tax and allocate the said amount as expenses of the segment. Thus, the State Commission had allowed tax on a

standalone basis in respect of each regulated segment of the Appellants without considering the non-regulated business of the Appellant. The relevant extract of the said order dated 28.05.2009 in Case No. 120 of 2008 is enclosed as **Annexure "3"** hereto.

vii) By a judgment in Appeal No.174 of 2009 (Tata Power Company Ltd. Vs. MERC), this Tribunal was pleased to hold as under: -

"11. The issue of income tax relates to the fact that the State Commission deals with regulatory accounts of each licensed business. The State Commission is required to adjust the regulatory accounts' income to the taxation accounts. This could be done in 2 alternative methods. One by Profit Before Tax method and second by the method of Return on Equity. Profit Before Tax method is followed while truing up as details of all the elements are available by then. The second method is followed while submitting the details for APR or for tariff determination, as all adjustment details are not available at the point of submission. Therefore, for truing up, the Appellant has estimated the income tax liability by using the first method. While the State Commission has attempted to follow the first method, it has wrongly taken Return on Equity as profit before tax instead of computing the regulatory profit before tax by the method of revenue – permissible expenses. The difference in starting point itself is Rs.

35 crores. If the State Commission wanted to start with Return on Equity, then it must have added the incentives and efficiency gains and grossed it up for tax to arrive at base income. Instead the State Commission has done neither but has ended up with hybrid of the two. The Appellant has explained the concept of grossing up in the following manner:

To get a Net amount equal to ROE + Incentive + Efficiency gains retained, what is the tax that is to be allowed in the ARR. An hypothetical example will help.

To get a net amount of Rs. 100, a Base income of Rs. 150 is to be taken (@ 33.33% tax rate)

However if only 33% of Rs. 100 is given, then income tax authorities are going to charge tax on Rs. 133 (which is Rs. 44) and hence utility would be left with only Rs. 89 instead of the Rs. 100 it is entitled to. The formula to arrive at Rs. 150 is = (Net amount/(1-tax rate). In the current example

	Correct		*Wrong*
Base Amount	*150*	*133*	*133*
Tax payable @ 300%	*50*		*44*
Net Amount (ROE + Incentive+ eff gains	*100*	*100*	*89*

12. Since the starting point is wrong, the tax entitlement which was worked out has dropped by Rs. 13 crores.

13. As per Regulation 50.1 Return on Equity is to be calculated @ 14% on the approved equity capital. Income tax on the income of the transmission business of the transmission licensee shall be allowed for inclusion in the annual fixed charges, i.e. given pass through effect as per Regulation 50.2.1. The Regulation 50.1 and 50.2.1 are extracted herein below.

" 50.1 Return on Equity

50.1.1 The Transmission Licensee shall be allowed a return at the rate of 14% per annum in Indian Rupee terms, on the amount of approved equity capital".

" 50.2. Income Tax:

50.2.1 Income-Tax on the income of the Transmission Business of the Transmission Licensee shall be allowed for inclusion in the aggregate revenue requirement."

14. The regulations provide that transmission licensee like the Appellant shall include the estimate of income tax liability of its transmission business along with the application for determination of tariff based on the provisions of Income Tax Act, 1961. Regulation 50.2.3 provide that benefits of any income tax holding credit for unabsorbed losses or unabsorbed depreciation, etc. shall be taken into account in calculation of the income tax liability. Thus the intent of the Regulations is that the actual income tax paid by the transmission licensee in the business of transmission is included in the ARR and the

licensee does not gain or lose on account of income tax which is a pass through in tariff.

15. The grievance of the Appellant is that in making this adjustment to arrive at the income tax they have not been allowed as a pass through. According to the Appellant, State Commission has committed a demonstrable mistake in denying this point. In the present case, instead of computing the Profit before Tax as comprising of total revenue minus allowable expenditure, the State Commission has taken the Return on Equity as the start point, thereby wrongly reducing the taxable income by Rs. 38 crores and consequently the tax entitlement worked out has dropped by Rs. 13 crores. On this point, this Tribunal in its judgment reported in 2009 ELR (APTEL) 560 has held as follows:

"11. The appellant claimed an amount of Rs. 22.79 crores as PLF incentive for the FY 2006-07. The Commission permitted an amount of Rs. 21.83 crores as PLF incentive and considered the said amount as part of the revenue for FY 2007. However, coming to the income tax liability on the amount of incentive allowed the Commission had the following to say:

As regards tax on income arising out of sharing of gains due to better performance and PLF incentive, the Commission is of the view that the expenses incurred for achieving better performance (such as A&G, R&M, etc.) including higher PLF has already been allowed as pass through by the Commission and allowing tax on income arising out of better performance will put additional burden to consumers.

Hence, the Commission has not considered the tax on income arising out of sharing of gains due to better performance and PLF incentive income.

Based on above principles, the Commission has estimated the income tax of REL-G on standalone basis by considering the income and expenses as per approved ARR after truing up for FY 2006-07, as Rs. 7.69 crores."

12) As can be seen from the portion of the impugned order, quoted above, the Commission has disallowed the tax arising out of the better performance on the ground that the same would be an additional burden on the consumers. The Commission itself has not quoted any Regulation under which income tax on the incentive allowed can be denied to a generating company. The Regulation 34.2.1 of the MERC Tariff Regulations, which deals with income tax does not make any exception for the income arising out of incentive. Therefore, as per the Regulation the appellant is entitled to recover the income tax payable on the change in income on account of PLF incentive. Therefore, we find merit in the appellant's prayer for income tax on incentive to be given to it as a pass through.

13. The other two prayers related to employees expense and R&M of fuel gas de-sulphurization plant have not been granted.

15. We allow the appeal in part with the following directions:

c) The income tax payable on the PLF incentive will be treated as pass through"

16. Without following this principle laid down by this Tribunal and departing from its past practice which was based on the first method, namely profit before tax, the State Commission started the computation with Return on Equity and adjusted for items of first method, thereby further depressing the income tax allowable. As provided in the Regulations 50.1 and 50.2, 14% Return on Equity is provided after giving the pass through of income tax effect on the income of the transmission business in the annual fixed charges.

17. The State Commission considered the Return on Equity as Profit Before Tax for the purpose of income tax. Such computation is based on working out tax which disregards annual income arising from incentives and efficiency gains. The Regulations of the State Commission envisage reimbursement of actual income tax. Therefore, it is to be concluded that the deviation made by the State Commission is without any reason, thereby denying the rightful entitlement of income tax.

18. While the State Commission has computed the tax by considering the Return on Equity equal to profit before tax, it has ignored the fact that such allowed income tax would also be considered as revenue gains and the Appellant would have to pay tax on the same. In order to rectify the same, the State Commission ought to have grossed up the tax computed by it and pass the same to the Appellant.

Thus the claim of the State Commission that it has reimbursed the actual tax and hence there is no case for allowing post tax Return on Equity is not correct. Therefore, it would be appropriate to direct the State Commission to compute income tax entitlement of the Appellant by replacing Return on Equity by regulatory profit before tax on the basis of income less permissible expenses. Accordingly ordered.

…………

…..

(iii) In the claim towards payment of Income Tax, the Appellant computed the income tax as Rs. 37.09 crores as against Rs. 33.33 crores approved by the State Commission in its earlier order in respect of FY 2007-08. The income tax liability was computed by the Appellant by considering the actual Profit Before Tax in its transmission business and then adjusting the same. Regulation 50.2 has provided that the actual income shall form the basis for computation of income tax. The State Commission has computed the entitlement of income tax claim recovery from its consumers as Rs. 23.30 crores only. In the present case, instead of computing the Profit Before Tax method as comprising of total revenue minus allowable expenditure, the State Commission has taken the Return on Equity as the start point, thereby wrongfully reducing the taxable income by Rs. 38 crores and consequently the tax entitlement

worked out has dropped by Rs. 13 crores. As provided in the Regulations 50.1 and 50.2, 14% Return on Equity is provided after giving the pass through of income tax effect on the income of the transmission business in the Annual Fixed Charges. The State Commission ought to have included incentives and efficiency gains with ROE and grossed up the tax computed by it and passed on the same to the Appellant. Therefore, the State Commission is directed to pass the income tax entitlement of Appellant by replacing Return on Equity by regulatory Profit Before Tax based on income less permissible expenses."

viii) This Tribunal thus directed the State Commission to pass Income-Tax entitlement of the Appellant therein by replacing 'return on equity' by 'regulatory profit before tax based on income less permissible expenses' worked out for regulated business on standalone basis. The ratio of this Tribunal in Appeal No.251 of 2006 and Appeal No. 90 of 2007 has been reiterated in the said judgment. However, the State Commission has quoted a single sentence from paragraph 14 of the said judgment entirely out of context, to support its findings in the impugned order which is in challenge before this Tribunal. The same is totally contrary to the ratio of the said judgment and clearly this Tribunal has proceeded on the basis that the income tax payable in respect of a regulated

business of the licensee being the transmission licensee should be taken in the ARR and such licensee does not gain or lose on account of income tax which is a pass through in tariff.

ix) Thereafter by an order dated 29.07.2011 in Case No 72 of 2010, in respect of the distribution segment of the Appellants, while truing up of FY 2008-09, State Commission No.1 laid down same method of considering profit before tax (i.e. regulatory income less permissible expenses) and applicable tax rate on the same. State Commissionfollowed the method of considering regulated income and regulated expenditure for determining Income Tax. In respect of APR of FY 2009-10 and ARR for FY 2010-11, the State Commission by the same order applied the profit before tax (i.e. Grossing Up Return on Equity) principle based on the judgment of this Tribunal in Case No.174 of 2009. The impugned order is contrary to the ratio of various judgments of this Tribunal in this regard as well as the 1st Respondent's own interpretation and finding in the said Order dated 29.07.2011 in Case No. 72 of 2010 which has attained finality. Thus, the findings of the State Commission in the impugned order are

contrary to its own accepted methodology with respect to allowance of Income Tax.

x) Thereafter this Tribunal was pleased to render the judgment in Appeal No.68 of 2009 (Torrent Power Ltd. V GERC) based on Regulations of GERC being Regulations Nos.7 and 66 and Regulations of CERC. This Tribunal was pleased to hold as under: -

"52. A conjoint reading of the Regulation 7, Regulation 66 of the State Commission and Section 195(A) of the Income Tax Act, 1961 leaves no doubt that the recovery of income tax paid as an expense from the beneficiaries requires to be grossed up in such a manner as to ensure that the actual tax paid is fully recovered through tariff. Grossing up of the return would ensure that after paying the tax, the admissible post tax return is assured to the Appellant. In this way the Appellant would neither benefit nor loose on account of tax payable which is a pass through in the tariff. This would ensure that the Appellant earns permissible return of 14% stipulated in Regulation 66 of the Regulations and mandate of Section 195A of the Income Tax Act is also complied with. The National Tariff Policy stipulates that the Regulatory Commission may adopt rate of return as notified by the Central Commission with appropriate modifications taking into view the higher risk involved in distribution and that a uniform approach is desired in respect of return on investment.

53. We agree with the contention of the Respondent Commission that CERC Regulations, 2009 are not applicable in this case of the Appellant. However, the provisions of CERC Tariff Regulations, 2004 will be of relevance. The relevant clause regarding tax on income of these CERC Regulations is extracted below:

" 7. Tax on Income: (1) Tax on the income streams of the generating company or the transmission licensee, as the case may be, from its core business shall be computed as an expense and shall be recovered from the beneficiaries.

(2) Any under-recoveries or over-recoveries of tax on income shall be adjusted every year on the basis of income-tax assessment under the Income Tax Act, 1961, as certified by the statutory auditors.

Provided that tax on any income stream other than the core business shall not constitute a pass through component in tariff and tax on such other income shall be payable by the generating company or transmission licensee, as the case may be.

Provided further that the generating station-wise profit before tax in the case of the generating company and the region-wise profit before tax in case of the transmission licensee as estimated for a year in advance shall constitute the basis for distribution of the corporate tax liability to all the generating stations and regions.

Provided further that the benefits of tax-holiday as applicable in accordance with the provisions of the Income-Tax Act, 1961 shall be passed on to the beneficiaries.

Provided further that in the absence of any other equitable basis the credit for carry forward losses and unabsorbed depreciation shall be given in the proportion as provided in the second proviso to this regulation.

Provided further that income-tax allocated to the thermal generating station shall be charged to the beneficiaries in the same proportion as annual fixed charges, the income-tax allocated to the hydro generating station shall be charged to the beneficiaries in the same proportion as annual capacity charges and in case of interstate transmission, the sharing of income-tax shall be in the same proportion as annual transmission charges."

54. The above provisions of Regulations, 2004 also make it clear that income tax payable on the income from the core business of the company is to be treated as an expense and recovered from the tariff payable by beneficiaries. The income earned by the licensee is net of tax and the tax payable is treated as a separate expenditure recoverable from the beneficiaries."

xi) Thus, paragraph 54 clearly shows that this Tribunal has held that as per the CERC Regulations income tax payable on the income from the core business of

the Company is to be treated as an expense and recovered from tariff payable by the beneficiaries. The Appellant in Appeal No. 68 of 2009 was a company having regulated business alone.

xii) By a judgment dated 05.01.2011 delivered by this Tribunal in Review Petition No.9 of 2010 in Appeal No.68 of 2009 (GERC vs Torrent Power Ltd.), this Tribunal was pleased to hold as under:

"13. The Tribunal's judgment dated 23.03.2010 in para 52 clearly shows that the Tribunal has considered Regulation 7 and Regulation 66 and Section 195 (A) of the Income Tax Act to arrive at the decision that grossing up of the tax has to be carried out to ensure that after paying the tax, the admissible post tax return is assured to the Appellant (Respondent in Review Petition), Torrent Power Limited. The Tribunal has also held in the judgment that the Appellant, Torrent Power Limited should neither benefit nor loose on account of tax payable which is a pass through in the tariff. Thus, there is no question of the generating company making profit on account of income tax. The excess recovery of income tax if any has to be reimbursed by the generating company to the distribution company as per the Regulations of the State Commission. In this case the excess recovery of income tax if any has to be adjusted in the true up of the financials. Thus the judgment dated 23.3.2010 needs no review."

xiii) Thus in Review the said judgment was maintained and the Review Petition was dismissed.

xiv) Thereafter by an order in Case No.122 of 2011 dated 27.02.2012, State Commission undertook truing up for FY 2009-10 and provisional truing up for FY 2010-11. The issue of Income Tax was kept in abeyance on the ground that particulars sought for by State Commission were not supplied by the Appellants and consequently in income tax allowance was treated as zero. Since it was the grievance of State Commission that required information was not given, the Appellants by letter dated 11.04.2012 gave the information (Annexure 11, pg.164). A perusal of the said letter dated 11.04.2012 would show that the Income-Tax Return acknowledgement for AY 2010-11 was given along with the said letter. The allocation statement tendered across the bar in the course of arguments by State Commission was given as a part of the filing made in Case No. 122 of 2011 by the Appellants.

xv) Thereafter the Appellants filed a petition being Case No 163 of 2011 before State Commission for approval of ARR for FY 11-12. In course of consideration of the said petition, State Commission

suo-moto chose to decide upon the truing up issue of income tax relating to FY 2009-10 and FY 2010-11. In the course of the process of deciding the said issue, State Commission stated in paragraph 4.2.10 at page 110 of Memo of Appeal in the impugned order that "*in consultation with professional consultants, it had decided to consider actual tax computation statement*" of the Appellants. The relevant paragraph is reproduced herewith.

"4.2.10. The Commission has studied the issue in consultation with professional consultants and has decided to consider the actual tax computation statement of the petitioner supporting returns of income filed as submitted by it as the base for true-up Petitions. The segmental allocation of taxable income and tax thereon is being done on line by line basis based on segmental allocation of income and expenses as certified by the petitioners' Statutory Auditors. The same is annexed as 'Annexure A: Segmental Allocation'"

xvi) By the aforesaid impugned order State Commission purported to adopt an entirely new method for allocating income tax in respect of the company as a whole. In calculating the taxable income of the company as a whole State Commissionfirst arrived at income or loss of each of the four segments of the company, namely, RInfra-G, RInfra-D, RInfra-T and

others. The business of Generation (RInfra-G), the business of Distribution (RInfra-D) and the business of Transmission (RInfra-T) are regulated businesses. The fourth segment under the heading "Others" is a non-regulated business segment. State Commission arrived at the total taxable income of the company in the following manner: -

Rs. (In crores)	Business Segment
670.07	Income of non-regulated other business
14.30	Income from regulated RInfra-T business
Less: 377.25	Loss from regulated RInfra-D business
Less: 17.18	Loss of regulated RInfra-G business
Net Taxable income of the entire company 289.95	

State Commission then proceeded to calculate what would be the tax on the income of each of the segments and arrived at the following figures: -

i) Rs.227.76 crores on the income of Rs.670.07 crores on Other businesses.

ii) Rs.4.86 crores on income from Rs.14.30 crores on the regulated RInfra Transmission business.

iii) A negative figure of Rs.128.23 on a loss of Rs.377.25 crores loss of RInfra Distribution business.

iv) A negative figure of Rs.5.84 crores on a loss of Rs.17.18 crores of RInfra Generation business.

xvii) The aforesaid approach of the State Commission, apart from being violative of the principles of natural justice on account of having consulted consultants and taken their opinion and based the order on such opinion behind the back of the Appellants is also legally invalid. A perusal of the Table at page 126 of the impugned order would show that after arriving at a loss for the generation and distribution segment the same is described as negative taxable income and tax at 33.99% is sought to be levied on the said loss, contrary to all settled principles, and such negative tax is sought to be deducted from the ARR of the Appellants thereby reducing the ARR. The said “taxable income” and “tax on the same”, has been done by way of a horizontal computation by taking into consideration the total taxable income and the total tax paid by the corporate entity (having regulated and unregulated business). This is clearly contrary to the settled principle that the computation of tax is required to be done on a standalone basis

segment wise. In the event of there being a loss there is no question of payment of any income tax much less a negative figure.

xviii) Further, a perusal of paragraph 4.2.15 at pg.112 would show that State Commissionhas withheld 20% of tax amount purportedly towards likely reduction in claim after purportedly furnishing relevant details thereby increasing the negative "Income-Tax" from Rs.5.84 crore to Rs.7.01 crore –This approach is clearly contrary to the various decisions of this Tribunal and in fact would result in the increased tax liability of the unregulated business and is without any basis.

xix) The Appellants have depicted in a Table handed over hereto, that the methodology followed in the impugned order, would result in sharing the risk and return of unregulated business by the regulated business if a reverse situation is assumed. This is the methodology which is challenged by the Appellants.

xx) The Regulations provide for the method of calculating Income Tax for each segment on stand alone basis. If on a stand alone basis the income of a regulated segment is liable to be taxed, the same amount is to

be added to the expenditure of such business segment.

xxi) So far as the submission of the Appellants before State Commission in respect of RInfra-G for the relevant year was concerned, the Appellants had submitted that it had a profit before tax of Rs.149.61 crores on which in respectful submissions of the Appellants, ought to have been allowed a tax @ 33.99% amounting to Rs.58.85 crores. After certain adjustments in respect of MAT credit ascertained by Respondent No.1, the net tax in respect of the generation segment was claimed at Rs.25.70 crores, which it was submitted, ought to have been added to the Appellants' ARR (the calculation in this regard was a part of the submission made on 04.11.2011 in Case No. 122 of 2011 pertaining to truing up of FY 2009-10 being Annexure 3 to the Appellants Rejoinder in Appeal No. 138 of 2012, pg.27 @ 29). The State Commission on its own calculations without putting the same to the Appellants on some basis came to a loss figure of Rs.17.18 crores. It is submitted that the contention of the Appellants is that the calculations done by State Commission were never put to the Appellants.

xxii) The entire aforesaid exercise apart from being violative of principle of natural justice, is contrary to the Regulations and various judgments of this Tribunal. The alleged principle that *"the intent of the regulations is that the actual income tax paid by the transmission licensee in the business of transmission is included in the ARR and the licensee does not gain or loss on account of income tax which is a pass through in tariff"* is sought to be read out of context from the various judgments. The judgments clearly show that the Regulations have to be followed. The Regulations are so framed as to mandate a methodology of calculation by which the licensee does not gain or lose on account of income tax. There is no scope to apply such an alleged "fundamental principle" de hors the Regulations. In any event, even in the facts of the present case, the licensee will not gain if the methodology propounded by the Appellants is followed.

9. The Appellant's submission in regard to Income Tax for FY 10-11 are as follows:-

i) For FY 2010-11, State Commission arrived at a segmental profit for generation segment to Rs.111.67 crores. The said figure was also worked out by State

Commission on its own, ex-parte, in consultation with its ‘professional consultants’. Thereafter since the Company as a whole had paid tax under MAT, State Commission arrived at the proportionate allocable MAT tax to the generation business segment on the assumption that because the company as a whole has paid MAT, each and every segment would also deemed to have paid tax at the same rate. This, in the respectful submission of the Appellants, is contrary to the provisions of sub-section 5 of section 80 IA of the Income Tax Act, 1961. Having arrived at the assumed tax liability under MAT figure, State Commission arrived at the MAT credit for the year for generation segment and added to the MAT credit available for utilization in ensuing years. State Commission and its consultants completely overlooked the fact that tax holiday under Section 80IA and Section 115JB (i.e. for paying tax under MAT) can be claimed for consecutive 10 years, which expired in FY 2008-09 (which is recognized by the Commission in its Order dated 08.09.2011 in Case No 99 of 2010) and once arrived at the MAT credit for such period, this need to be utilized over next 5 years.

ii) In present case, State Commission arrived at the MAT credit of Rs Rs.34.08 crores to be utilized in years after FY 2008-09. There was no question of getting any MAT credit further. Having not only assumed the figure of 34.08 crores of MAT credit for the past year, State Commission erred in assuming a figure of Rs.17.80 crores for FY 2010-11 and further erred in adding the aforesaid and showing a MAT credit 51.88 crores to be adjusted in future years.

iii) The aforesaid is contrary to all judgments, regulations and principles of accounting.

10. The learned Counsel for the State Commission in respect of FY 2009-10, 2011-12 has extensively quoted the impugned orders. He also made the following reply.

i) The State Commission has followed the principles laid down in the various judgments of this Tribunal which would have a bearing on the present issues. The State Commission has after applying all the principles laid down by this Tribunal from time to time has dealt with the Income Tax issues.

ii) Some of the broad principles which have been laid down by this Tribunal in a series of judgments could be summarized inter alia, as under:-

(1) Each regulatory business is to be treated as if in a water tight compartment and the consumers of the regulated business must not be exposed to the risks of the non-regulated business.

(2) Return on Equity is not the only income of the utility. There are other incomes such as interest, incentives, etc and non-tariff income etc. Hence the Commission ought not to proceed on the basis that RoE is the only income of the utility. The Commission must consider income minus allowable expenses of the regulated business.

(3) The Income Tax must be grossed up to ensure that the tax implication which itself is regarded as an inflow in the ARR and attracts tax. hence such impact must also be passed through in the tariff.

(4) Last but not the least, and in fact the most important of all, the utility cannot profit on tax i.e. whatever tax is actually paid by the utility must be reimbursed to it.

iii) All the applicable principles laid down above have been given effect to in the impugned order. However

the issue of grossing up has not arisen in the impugned order since the issue of grossing up would be considered by the Commission as and when the net revenue gap in the current impugned order is in fact recovered as tariff and offered to tax in the subsequent tariff order.

iv) The treatment undertaken by the State Commission in the impugned order will show that:

(a) The Commission has allocated every line item of the actual Tax Computation of the company as a whole for each of the identifiable elements to the Regulated and Unregulated Businesses so that there is no profiting on tax.

(b) Each regulated business G, T and D has been treated as a separate independent water tight compartment and the tax effect of each of the compartments has been assessed.

(c) The Commission has considered the income and expenses of the 3 segments basis the allocation statement submitted by the Appellant itself.

(d) The Commission has not treated RoE as the only income of the utility;

(e) The basis of allocation is given in the notes below the table in the Order.

(f) In the final tax computation, what has been found on the basis of the allocated computation is that the G and D Segments have had a “tax-loss”, i.e. the loss incurred by G & D has been set off (“consumed”) by/against the “tax-profits” made by T and Other segments.

(g) Meaning thereby that because of the “tax-loss” of G and D, the Company as a whole has been assessed to less tax than what it would have paid but for the setting off of such tax-loss.

(h) In the words of the Order, such tax-loss has been used as a “tax-shield” by which the Company as a whole has paid less tax than what it would normally have paid but for the use of such “tax-shield”.

(i) The benefit of such “tax-loss” (in G & D) taken by the Company as a whole cannot be carried forward to the next or subsequent years in the tax computation by the company as a whole, since such “tax-loss” is not reflected in the Income Tax Return filed by the Company.

In the words of the Order, such tax-loss (which in ordinary circumstances at a company level would have been available to the company for the future years) has been "irretrievably consumed" in this year itself.

(j) Hence the benefit accruing to the company as a whole, i.e. the lesser tax on account of the "tax-shield", which the non-regulated and T segment have enjoyed at the cost of the G & D segments must be ploughed back (in the words of the Order "compensated") to the G & D segments.

This treatment is needed to ensure that

(i) each of the segments is treated as a water-tight compartment;

(ii) neither of the segments is either exposed to the risks or derives a benefit at the cost of the other segments;

(iii) There is no profit on tax because unless the tax shield arising from loss making segments which is irretrievably consumed by the other segments is compensated to loss making segments there will be profit on tax to the extent of the tax impact of

segments which exceeds tax impact of company as a whole

v) the principles as mandated by this Tribunal are implemented in their true letter and spirit;

vi) The State Commission has allowed the actual tax impact ascribable to the company as a whole. Hence there is no profit on tax that would accrue to any of the utility.

vii) The summation of the actual tax impact of each of the 3 regulated business plus the tax impact of the non regulated business equals the total tax actually paid by the Company as a whole and hence the dispensation of the Commission is in accordance with the principle laid down by this Tribunal that the utility ought not to profit from tax.

viii) The Appellant has sought to rely upon an earlier Order of the Commission dated 29th July 2011 wherein the Order is stated to disclose another treatment. In this connection it is submitted that:-

(i) The validity of this Order ought to be tested on the reasoning of this Order which is impugned in the present appeal.

(ii) As held by this Tribunal there is no res-judicata as between different tariff years, hence the Commission was always at liberty to take a view which may be

different from the earlier view. The only question ought to be as to whether the present view is legally sustainable or not.

(iii) In fact the present Order is prefaced with a detailed discussion of the various principles enunciated by this Tribunal on the range of Income Tax issues.

(iv) Even the earlier Order computes the Income Tax of the regulated segment (distribution) on a standalone basis.

ix) The only contention raised by the Appellant throughout is that the State Commission has allegedly violated the principle of natural justice in arriving at the above dispensation. It is submitted that the mere fact that the allocation of Incomes and Expenses as also the allocation of the various tax computation items have been made on the basis of the certificates submitted by the Appellant itself. Further such certificates have been issued by the Statutory Auditor of the Appellant itself. If the Commission has used such statutory auditor’s certificates as a basis for the allocation, the question of violation of natural justice can never arise.

x) Though the Appellant has sought to rely upon the earlier judgments of this Tribunal, at no point of time has the

Appellant been able to identify as to which dispensation, or which part of the Commission's Order is considered in violation of which principle laid down by this Tribunal.

(i) The principle set down even in Appeal No. 90 of 2007 has been implemented in letter and spirit

(ii) The entire judgment of the Tribunal has to be understood in light of the opening lines of the findings which read thus:-

"*49. The Commission, in line with this Tribunal order dated April 04, 2007, has ruled that the actual income tax payable by the licensee for the distribution business considered on a standalone basis will be allowed. The Commission has also ruled that the income tax will be trued up once the actual audited tax figures are furnished. We hold the view that the Commission has to ensure that the consumers in the licensee's area are always protected from the burden of the income tax on account of other businesses of the licensee.*.

(iii) The State Commission has in the impugned Order done precisely what this Tribunal was pleased to direct, i.e. (a) take the actual income tax paid and (b) ensure that unregulated and T business (as also the

company as a whole) do not enjoy a benefit at the cost of the consumers of G and D.

(iv) By the impugned dispensation, the Commission has

(a) started with the allowable Incomes and expenses,

(b) reconciled the same with the Income tax paid to ensure that there is no profiting on tax and

(c) computed the Income tax “payable” by the G and D segments to ensure that the benefit given by G & D to T and Unregulated segments is equalized.

(d) The amount “payable” by each segment from within the total tax “paid” is computed such as the total tax “paid” by the company is not exceeded. Hence there is no profit on tax.

11. In respect of FY 2010-11, the learned Counsel for the State Commission has made the following reply:-

i) One consistent principle which is the fundamental basis for all the aforesaid judgments is that the utility ought not to profit from tax. Income Tax has to be treated as an actual expense which this Tribunal has been pleased to direct must be permitted to be

recovered. Hence the utility is not permitted to recover an inflated amount in the name of Income Tax which is more than the tax actually paid and/or ascribable to each of the related segments. If any such inflated recovery in the name of Income Tax is recovered, the same would amounts unjust enrichment.

ii) The Regulations of the Commission also bring out that the "Income Tax on the income of the ……..business of the …….company shall be allowed for inclusion in the Annual Fixed Charges…..". Hence what is to be recovered is the tax and not what the utility claims as an artificially inflated amount in the name of Income Tax.

iii) It is further respectfully submitted that as a matter of fact none of the aforesaid Judgments have dealt with the issue of MAT Vs Normal Tax. Hence there is no question of having violated any of the prior judgment of this Tribunal. If the company as a whole has paid tax on MAT the Appellant could not be permitted to claim tax on normal basis for each of its Regulated businesses and thereby claim to recover something more than the actual tax paid by the Company and ascribable to the regulated business.

iv) The calculations contained in the impugned order would clearly show that:-

(1) Each of the business segments has been considered as a different compartment;

(2) The amount of net profit and income tax etc as per the books of the assessee has been allocated to each of the business segments of the Appellant on the basis of the allocation statement of the Appellants themselves.

(3) Equally the tax actually paid has also been allocated on the basis of the allocation statement provided by the Appellant itself to each of the business segments.

(4) The total tax actually paid by the Company as a whole has been reconciled with the allocation of the tax ascribable to each of the business segments of the Appellant. This would ensure the tax actually paid by the Company as a whole tallies with what is ascribable to each of the business segments.

v) The Income Tax treatment in the impugned order on MAT vis a vis Normal Tax is completely in keeping

with the principles laid low by this Tribunal and not in violation of any of the judgments of this Tribunal.

12. We have carefully considered the submissions made by both the parties.

13. The issue before us is related to treatment of income tax for the company having regulated as well as unregulated business in respect of FY 2009-10 and 2010-11. The Appellant has contended that the state Commission has not followed the principles laid down by this Tribunal is various judgments. The learned Counsel for the State Commission has submitted that the State Commission has implemented the directions of this Tribunal in letter and spirit.

14. We have dealt with this issue of treatment of income tax in detail in a similar matter in Appeal No. 104 of 2012 and batch in the matter of Tata Power Company having regulated and unregulated business. The relevant extracts of our judgment dated 28.11.2013 in Appeal No. 104 of 2012 and batch is given below:

"………

38. *The contention of the State Commission that the utility cannot profit on tax appears to be attractive and logical on first rush of blood. But, seeing it along with the first principle that the assessment of*

regulated business should be done on standalone basis, there appears to be some contradiction, especially, in the present context when the company has been assessed on MAT. This aspect is elaborated in the ensuing paragraphs.

39. *Before we go into the veracity of the above statement, let us examine the context in which the Tribunal has observed this aspect.*

40. *Let us now examine the context of RP-9 of 2010, which is reproduced below:*

"9. Regarding income tax, the State Commission has contended that the Tribunal has not considered Regulation 66 (20) and the same has to be considered alongwith Regulation 7 to have harmonious interpretation of the Regulations. Let us first examine Regulation 7 and Regulation 66 (20) of the State Commission's Regulations. The relevant portion of the Regulation is reproduced below:

"7. Tax on income:

(1) Tax on the income streams of the generating company or the transmission licensee or the distribution licensee, as the case may be, from its core business, shall be computed as an expense and shall be recovered from the beneficiaries.

(2) Under-recovery or over-recovery of any amount from the beneficiaries or the consumers on account of such tax

having been passed on to them shall be adjusted every year on the basis of income-tax assessment under the Income-Tax Act, 1961, as certified by the statutory auditors. The generating company, or the transmission or distribution licensee, as the case may be, may make such adjustments directly and without making any application to the State Commission in this regard.

Provided that on any income stream other than the core business shall not constitute a pass through component in tariff and tax on such other income shall be borne by the generating company or transmission licensee or the distribution licensee, as the case may be.

66. Principles, terms and conditions for determination of tariff with their application for distribution licensee

(20) Expenses arising from and ancillary or incidental to other business of licensee for which income have been included, but limited to amount of income so included.

xxxxxxxxxxxxxxxxxxxxxxxxxxxxxx

The State Commission may also allow reasonable expenditure to be incurred actually and properly on the following:

(i) All taxes on income and profit calculated on permissible return as allowed by the State Commission relating to business of electricity and also subject to the condition that the amount of taxes is actually paid as tax after taking into account refunds into consideration".

10. Regulation 7 clearly stipulated that the tax on income stream of the generating company from its core business shall be computed as expense and shall be recovered from the beneficiaries. The adjustment for under or over recovery of any amount from beneficiary has to be made by the generating company directly on the basis of income tax assessment under the Income Tax Act as certified by the statutory auditors. Regulation 66(20) only restricts the income tax to be allowed on the permissible return subject to actual payment.

11. This is the only difference in the State Commission's Regulations with reference to the Regulations of 2004 of the Central State Commission in respect of Income Tax. The Central State Commission's Regulations of 2004 allow income tax as pass through even on income over and above the permissible return on equity due to better performance over the generation norms. However, the State Commission's Regulations allow the income tax on the permissible return. The principle of grossed up tax is applicable to both as decided by

this Tribunal in the impugned judgment and in various other cases referred to by the Respondent.

12. Conjoint reading of the Regulations of the State State Commission will imply that income tax has to be Page 14 of 17 RP 9 0f 2010 in Appeal No. 68 of 2009 taken as expense subject to adjustment as per actuals as per audited accounts by the statutory auditors and to the extent of permissible return. However, tax on income on permissible return has to be 'pass through'. Thus the intent of the Regulations is that income on permissible return on core business in the hands of the generating company has to be net of tax. Thus the entire tax inclusive of grossed up tax is relatable to the core activity of the generating company. However, if there is any over-recovery of tax, the generating company has to reimburse the same as the same is adjustable as per actuals as per audited accounts by the statutory auditors.

13. The Tribunal's judgment dated 23.03.2010 in para 52 clearly shows that the Tribunal has considered Regulation 7 and Regulation 66 and Section 195 (A) of the Income Tax Act to arrive at the decision that grossing up of the tax has to be carried out to ensure that after paying the tax, the admissible post tax return is assured to the Appellant (Respondent in Review Petition), Torrent Power Limited. ***The Tribunal has also held in the judgment that the Appellant, Torrent Power Limited should neither benefit nor loose on***

account of tax payable which is a pass through in the tariff. Thus, there is no question of the generating company making profit on account of income tax. The excess recovery of income tax if any has to be reimbursed by the generating company to the distribution company as per the Regulations of the State Commission. *In this case the excess recovery of income tax if any has to be adjusted in the true up of the financials. Thus the judgment dated 23.3.2010 needs no review."*

41. *The judgment referred to in para above in the Tribunal's judgment in Appeal No. 68 of 2009, which was challenged in Review Petition No. 9 of 2010. The relevant portion of this judgment is reproduced below:*

"52. A conjoint reading of the Regulation 7, Regulation 66 of the State Commission and Section 195(A) of the Income Tax Act, 1961 leaves no doubt that the recovery of income tax paid as an expense from the beneficiaries requires to be grossed up in such a manner as to ensure that the actual tax paid is fully recovered through tariff. ***Grossing up of the return would ensure that after paying the tax, the admissible post tax return is assured to the Appellant. In this way the Appellant would neither benefit nor loose on account of tax payable which is a pass through in the tariff.*** *This would ensure that the Appellant earns permissible return of 14% stipulated in Regulation 66 of the Regulations and mandate of Section 195A of the Income Tax Act is also complied with. The National Tariff Policy*

stipulates that the Regulatory State Commission may adopt rate of return as notified by the Central State Commission with appropriate modifications taking into view the higher risk involved in distribution and that a uniform approach is desired in respect of return on investment.

42. *Conjoint reading of the aforesaid order along with the judgment in Appeal No. 68 of 2009 would make it clear that the issue before this Tribunal was grossing up of income tax and observation of the Tribunal that the utility would not gain or loose in the context of grossing up of income tax.*

43. *Thus, the reliance of the State Commission on aforesaid judgment is misplaced. However, it cannot be denied that the utility must not profit on income tax.*

44. *The State Commission's Regulations 34.2.2. provides that the benefits of any income-tax holiday, credit for unabsorbed losses or unabsorbed depreciation shall be taken into account in calculation of the income-tax liability of the generating station of the Generating Company, provided that where such benefits cannot be directly attributed to a generating station, they shall be allocated across the generating stations of a Generating Company in the proportion of the generating station-wise profit before tax. Thus, the regulations provide for station-wise allocation of benefit arising out of tax holiday etc. The same would be applicable for inter-business assessment. The benefit of tax holidays or accelerated depreciation would be available to the concerned business only.*

45. *CERC 2004 Regulations provided for station wise allocation of benefits of tax holidays and accelerated depreciation etc. Such a dispensation was a must for CERC as the beneficiaries of CPUs like NTPC, NHPC etc. were different. Benefit accrued to one power station must be shared by the beneficiaries of that power station alone. For example the power from Badarpur Power station is allocated fully to Delhi. Any benefit under Income Tax laws must be passed on to Delhi alone. NTPC, like the Appellant herein, files one income tax return. CERC had been assessing Income Tax liability of each power station on standalone basis and would pass through the income tax levied on each power station to its beneficiaries in the proportion of their share in the installed capacity.*

46. *It would pertinent to note that perhaps realizing the difficulty being faced in station-wise allocation of benefits, the Central Commission has changed the concept of post-tax RoE to pre-tax RoE. The Central Commission's 2009 Regulations provide for pre-tax RoE grossed up for income tax. As per 2009 Regulations, the utility would get pre-tax RoE irrespective of whether the utility pays the income tax or not. Thus, the concept that the utility must not gain on tax has been given a good bye under CERC 2009 Regulations. MERC MYT Regulations 2011 also specified pre-tax RoE on the lines of CERC 2009 Regulations.*

47. *Let us now examine the context in which the Tribunal has observed in Appeal No. 251 of 2006 that the income tax assessment of an utility must be done on standalone basis. The relevant extract of the judgment is quoted below:*

"32. We see force in the arguments put forth by the counsel for the appellant as truing up for the years 2004-05 and 2005-06 has to be carried out only as per the Sixth Schedule. ***The consumers in the licensee's area must be kept in a water tight compartment from the risks of other business of the licensee and the Income Tax payable thereon. Under no circumstance, consumers of the licensee should be made to bear the Income Tax accrued in other businesses of the licensee. Income Tax assessment has to be made on stand alone basis for the licensed business so that consumers are fully insulated and protected from the Income Tax payable from other businesses."***

48. *Perusal of the above would indicate that there is no conjunction in first two lines. Still, there cannot be two opinions that the consumers of regulated business must be insulated from the risks of the other business and income tax assessment of the utility should be done on standalone basis. This direction of the Tribunal is in line with the State Commission's Regulations 34.2.2 (for Generation business) and similar Regulations for Transmission and Distribution business. The converse of the Tribunal's direction that under no circumstances, the consumers of the licensee should be made to bear the Income Tax accrued in other businesses of the licensee is also*

true i.e. under no circumstances the consumers of the licensee should be benefitted from the permissible deductions in the form of accelerated depreciation and from Tax holidays given to other businesses (unregulated by MERC) of the utility. That is the only way to treat the regulated and other business unregulated in water tight compartments.

49. *The real issue to be resolved in the present case is to see what is the correct methodology for giving effect to the following two Judgments of this Tribunal and whether the State Commission has correctly implemented them:*

50. *Paragraph 32 of the Judgment in Appeal No. 251 of 2006 reads as under:*

"The consumers in the licensee's area must be kept in a water tight compartment from the risks of other business of the licensee and the Income Tax payable thereon. Under no circumstance, consumers of the licensee should be made to bear the Income Tax accrued in other businesses of the licensee. Income Tax assessment has to be made on stand alone basis for the licensed business so that consumers are fully insulated and protected from the Income Tax payable from other businesses."

51. *Paragraph 14 of the Judgement in Appeal No. 174 of 2009 reads as under:*

"Thus the intent of the Regulations is that the actual income tax paid by the transmission licensee in the business of transmission is included in the ARR and

the licensee does not gain or lose on account of income tax which is a pass through in tariff."

52. *The Judgment in Appeal No. 251 of 2006 is based on the principle that regulated business in question that is within the jurisdiction of the Regulatory State Commission, should neither subsidise nor get subsidy from other businesses whether unregulated or regulated by the same or different regulator. In other words, the Judgment mandates that the taxable income of the regulated business within the jurisdiction of the Regulatory State Commission should be computed on stand alone basis, irrespective of what is the impact of this business or other businesses on the overall tax liability. There is a possibility of distortion when the impact of regulated business or other businesses on total tax liability is considered or the overall tax liability is allocated for determining the tax liability for regulated business.*

53. *For example, when on standalone basis the regulated business has taxable income to be taxed at normal rates, there may be losses/tax exemptions in other businesses which may result in overall taxable income being less than the regulated taxable income and, hence, actual tax liability for all businesses being less than that of regulated business on standalone basis. In case, actual tax liability is allowed by the regulator whether in full or in proportion of profit of regulated business, it obviously amounts to less than due tax allowance for regulated business due to exemptions/losses of other business being utilised for subsiding the regulated business,*

which is not permissible as per the above Judgment. The impact is more pronounced when the overall taxable income becomes so small or even negative that the tax rate applicable is MAT, which not only artificially reduces the tax liability for regulated business due to lower rate, but also creates an incorrect impression that this tax allowed at MAT rate is to be reversed in future as MAT credit allocating MAT credit. This is obviously not permissible and for giving effect to the said Judgment in Appeal No. 251 of 2006 tax computation for regulated business has to be done on standalone basis at normal rates even though it may result into tax allowance higher than actual tax payment for overall business.

54. *The above example, however, raises a doubt whether it will be in contradiction to the Judgment in Appeal No. 174 of 2009, where the ratio was that income tax cannot be used as a means of earning profit in regulated business. That is to say that income tax to be allowed should be equal to, i.e. neither more nor less than actual tax liability. It appears that the interpretation in the above example allows tax higher than actual tax liability, which is in contradiction to Judgment in Appeal No. 174 of 2009.*

55. *However, a careful analysis of the above example with the ratio of the Judgment in Appeal No. 174 of 2009 would reveal that this Judgment is specifying tax allow ability for regulated business only and does not in any manner deal with implications on tax for regulated business due to other businesses. Further, the ratio is with regard to tax liability on the regulatory*

income, computed with permissible profits and applicable tax depreciation to be considered as taxable income, and not on the actual taxable income. Hence, any notional or actual income even within regulated business that is not permissible to be considered as regulatory taxable income cannot be allowed as it would amount to allowance of more than warranted regulatory tax liability/profits. As such, the above example when seen only with reference to the regulated business allows just the real tax payable for regulated business without taking or giving any support from other businesses and, hence, does not amount to making profit from tax. The tax benefit of exemptions/losses in other businesses should only be available to those businesses. In case, the situation would have been reverse in the above example, i.e. the regulated business had exemptions/losses then the tax benefit of such exemptions should have been attributable only to regulated business. As such, there is no conflict in the above two Judgments and both can be implemented simultaneously with regulated business being treated separately on a standalone basis and tax liability computed as per applicable tax laws for that business only considering notional regulatory taxable income. This concept is followed by regulators for all items of ARR/Revenue which are considered on normative basis, where irrespective of actual expense/revenue normative expense/revenue is considered for tariff purposes. Accordingly, there is no requirement of allocating the overall tax liability on regulated and unregulated businesses.

56. *It is also to be noted that for difference in book depreciation and tax depreciation, the tax laws provide for creating Deferred Tax Liability (DTL) which gets amortised with time when tax depreciation becomes lower than book depreciation. However, in regulated business DTL is not considered as it is not the current tax liability. Thus, in case the benefit of accelerated tax depreciation for one year in regulated business may result in lower overall tax on overall book profit (due to MAT) and may seem to subsidise other businesses. However, in subsequent years the overall tax liability may be more than tax on overall book profit, which would seem to given subsidy from other businesses to regulated business. In both these situations, the methodology of standalone tax computation and allowance would give correct picture.*

57. *In the present case, the State Commission has worked out the book profit of each segment separately. It observed that the Appellant has paid MAT. It did not worked why and how the tax liability of the company, under normal income tax rates, got reduced to such a level that it came under MAT. Was it due to regulated business or unregulated business? Was the regulated business enjoying any tax holiday or accelerated depreciation or other tax deductions? Book Profit calculations in the Impugned order do not reflect any such deductions in the regulated businesses of G, T & D. Obviously, it was due to other business (unregulated by MERC) of the Appellant which caused massive permissible deductions. The benefit of such deduction must be*

shared by the beneficiaries of such business only and not by the consumers of regulated business. Presently, those businesses may be getting tax rebates due to tax holidays or accelerated depreciation. But in the future at the end of tax holidays and reduced depreciation, these deductions would not be available to those companies and their tax liability would increase. Under those circumstances, the tax burden of the unregulated business would not be allowed to be shared by regulated business of MERC.

58. *The Tribunal in Appeal No. 251 of 2006 has laid down the ratio that the income tax assessment of the licensee must be done on standalone basis. In Appeal No. 173 of 2011 the Tribunal has provided the methodology for assessing the income tax liability of the licensee. The State Commission did not follow these directions and got carried away with the observations that the utility must not gain or loose on account of income tax made in the context of grossing up of income tax. It simply allocated the actual tax paid by the Appellant, for the company as a whole, in proportion to their respective book profit."*

15. The principle laid down by this Tribunal in Appeal No. 104 of 2012 would apply to the present case as well. Hence, the State Commission is directed to reassess the income tax liability of the Appellant in respect of FY 2009-10 and 2010-11 in terms of our above findings and pass the consequential orders.

16. The second issue before us for consideration is resetting of interest on normative loan capital

17. The Appellant's submission on this issue are as follows:-

   i) The relevant Regulations are Regulation 31.3, 32 and 34 of MERC (Terms and Conditions of Tariff) Regulations, 2005.

      1.1 Regulation 31 deals with Debt-equity ratio and, inter alia, provides that approved capital expenditure incurred by a distribution licensee shall be assumed to be financed at normative debt: equity ratio of 70:30.

      1.2 Regulation 32 deals with repayment schedule for loan and the amount of normative repayment for a year is provided as being equal to the amount of depreciation on the fixed asset to which such loan relates.

      1.3 Regulation 34 deals with calculation of annual fixed charges which includes Interest on loan capital as provided for in Regulation 34.3. Regulation 34.3.2 assumes that there would be a normative loan capital and provides that interest on the same would be based on the approved interest rate and the

normative repayment schedule in accordance with Regulation 32.

ii) The Appellant, in respect of capital expenditure incurred in its business financed by equity and internal approvals from the treasury of the Company, proposes in its Tariff filings, interest on 70% that is permissible debt interest for the calculation of annual fixed charges under Regulation 34. The issue that arises in the present Appeal relates to the grant of such interest under Regulation 34.3 in respect of such normative loan which is a correct representation of the prevailing market rate.

iii) Thus the impugned order approves normative interest rate for FY 2011-12 of 11.5% for capitalization considering the average of the base interest rate across various banks and a spread of 2.23% on the base interest rate which would be available to the Appellant.

iv) However, the Commission has disallowed interest rates to be revised for loans approved prior to FY 2011-12 prospectively for reasons set out in para 3.11.9 which are as follows:

   i) interest rates have been varying every year since FY 2004-05;

ii) Commission has not carried out downward revision when prevailing interest rates were low;

v) In line with the same principle the Commission does not find merit in revising interest rates of loans approved prior to FY 2011-12.

vi) The State Commission in the impugned order has reset the interest rate to 11.5% for new normative loans approved during FY 11-12. State Commissionhas thus recognized the fluctuating economic conditions causing fluctuations in interest rates as submitted by the Appellant. State Commissionfurther held that the rationale and methodology provided by the Appellant for arriving at interest rate on normative loan for FY 2011-12 at 11.5% is reasonable. It is submitted that the Appellant had sought for 11.5% interest rate on all normative debts whether outstanding as on 1-4-2011 or freshly drawn (corresponding) to capitalization during FY 2011-12 on the same rationale. The State Commission has agreed to this rationale given by the Appellant for loans which are freshly drawn during FY 2011-12.

vii) However, the State Commission after having agreed that interest rates have undergone a change, has not approved interest on outstanding normative loans as on 1-4-2011, though they were taken in the past, (when the

Appellant was not claiming any change in the interest rate retrospectively and cannot claim) has denied such change in the interest rate only on the ground that it "*had not carried out any downward revision of interest rate when prevailing interest rates at the time of approving new loans in the past year were low*". It is submitted that the Appellant cannot be denied resetting of interest rate on outstanding past loans on the basis of this finding which, in any event, is not based on any material. In this regard without prejudice, it is submitted that no upward revision has also been given, and any adjustment for the past period, if necessary may be carried out to reflect the market rate. It is submitted that the Commission itself has accepted the various factors that have led to an increase in the interest rate.

viii) This Tribunal in Appeal No. 52 of 2008 in the case of New Delhi Power Limited vs. DERC and ors. Has held as follows :

"35. Under those circumstances, the Delhi Commission is directed to allow interest on notional loan for this particular year based on the market related interest rate prevailing in that year i.e. either the interest rate approved in FY 2004-05 duly adjusted for change in the State Bank

of India prime lending rate or 9.2% per annum based on the loan obtained by the Appellant. The said claim may be considered by the State Commission along with carrying cost. Accordingly this issue is answered in favour of the Appellant."

ix) The said judgment clearly related to "notional loan" and the ratio laid down by the Tribunal would squarely apply to present case.

x) The Appellant, in its petition, made detailed submissions as to how interest rates which form one of the terms on which loans have been granted, approved once cannot be assumed to remain constant year on year. The normal borrowing terms and conditions for utility projects allow interest rate to be reset by the lenders on a periodic basis based on market conditions. Even though the debt approved for the Appellant is only normative i.e. not actually borrowed, the capital invested by the Appellant is a fund that must necessarily attract a cost, which is reflective of market rate of interest and would have otherwise earned such interest had the same been invested elsewhere. As mentioned hereinabove in the Order dated 27-2-2012, the Commission itself has changed the repayment period thereby clearly changing the terms on which the

normative loan was assumed as well as approved to have been given by the Appellant. On the same basis there was no bar in changing the interest rate under any Regulation.

xi) When the entities whose interest became the basis for allowance of normative interest rate for the Appellant, are being allowed revision of rates, the Appellants have been denied a reset merely on the ground that decision taken in previous tariff orders cannot be reviewed. This is clearly discriminatory. It is submitted that clearly the benchmark while approving rates was of MSEB successor entities' (i.e., MSEDCL, MSPGCL and MSETCL) approved rates; this issue is not at all addressed. The Appellant submits that it appears that the interest rates of MSEB successor entities'(i.e., MSEDCL, MSPGCL and MSETCL), were floating.

xii) State Commissionhas itself approved interest rate of 11.5% for fresh normative debt in FY 2011-12. Thus, Respondent No. 1 recognizes that the cost of debt has increased from 9% (approved till FY 2010-11) to 11.5%. It is naturally not possible that an increase in cost of debt can only apply to debt taken afresh and not apply to debt taken in the past, when all debt sanctioned to utility projects always entails floating interest rate. The

Appellant submits that in its Rejoinder at Annexure "1", pg.21, the Appellant has referred to a Master Circular on Interest Rates issued by RBI, directing the banks, inter alia, that they should invariably incorporate a proviso in their loan agreement, that interest payable by the borrowers shall be subject to the changes in the interest rate made by RBI from time to time. It is submitted that while State Commissionhas denied the benefit of resetting of interest rate on the alleged ground that it has already approved interest rates and has not revised any rates downwards (which is once again without any basis or reasoning), the Commission has not even considered the aforesaid submission of the Appellant.

xiii) The rationale of State Commission that the Appellant cannot seek a review of the decision on the fixed interest rates already taken in the earlier orders is not justified inasmuch as Respondent No. 1 in its order passed in Case No.120 of 2008 itself approved, modified and reset the interest rate of normative loans of FY 2008-09 at 9% from the previously approved rate of 8%.

xiv) The State Commission in various tariff orders itself has approved expenses reflecting the prevailing market

conditions by factoring in the escalation based on various indices (i.e. CPI and WPI). The Commission itself has each year applied different inflation rates while allowing O&M expenses.

xv) The State Commission has wrongly denied resetting of interest rate on outstanding normative loan on the ground that such interest was incorporated to create a level playing field between entities that have different capital structures. It appears that this is with reference to the interest originally allowed based on loans taken by MSEDCL and MSPGCL. It appears that such terms of actual loans themselves have undergone a change which the said entities are getting but the Appellant has been denied the increase sought for.

xvi) In the Reply the State Commission has wrongly claimed that a comparison has been made by the Appellant with regard to working capital loan when there is no such ground in the Appeal. Further, the Appellant has nowhere claimed enhancement of interest rate "*ab initio*" but only prospectively for outstanding loans as on 1-4-2011 in view of the rationale given in the Petition which is accepted by the Respondent for the current normative loans.

xvii) Thus the Appellant in Appeal No. 138 of 2011 as well as Appeal Nos. 139 of 2012 have prayed for a direction that Respondent No. 1 to reset interest rate of 11.5% on outstanding loans at the beginning of FY 2011-12 i.e. 01.04.2011.

37. The learned Counsel for the State Commission has made the following reply:-

i) The issue arises from the fact that for each year since 2005-06 the capitalization of the Appellant has, in terms of the Regulations, been deemed to have been financed through Debt and Equity in the ratio of 70:30.

ii) Since no actual debt had been raised, it had been deemed that the debt component was treated as a normative loan and the interest allowable on such normative loan was given as an expense in the ARR.

iii) Since there was no actual loan, the interest was given on the normative loan at the rate normally prevailing at the relevant time, on long term loans. Loans for fixed assets on long term basis would normally have lower rates of interest as compared to short term loans for working capital etc.

iv) As admitted by the Appellant in its written submissions, for each year thereafter, the Commission has been continuing

the interest rates for the previous years at the rate originally given for the normative loan in the year of capitalization. The rates were, in fact, not decreased, even though in later years the interest rates had actually fallen.

v) However in the year in question, the Appellant is seeking to get a higher rate of interest on the ground that prevailing interest rates in the current year have gone up. The Appellant has not taken any new loans. It has not taken any loans to re-finance the old normative loans (though even an increased rate on such refinance loans ought to be disallowed).

vi) What the Appellant is basically claiming is that for the normative loans taken in the previous year,

(i) it ought to be deemed that such normative loans were taken on a floating rate of interest;

(ii) It ought to be deemed that the normative loans were not taken on a fixed rate of interest.

(iii) It ought to be deemed that the interest on such normative loans are to be re-set in the year in question;

(iv) It ought to be deemed that the interest on such loans has to be re-set only when the interest rate goes up but not when the interest rate goes down.

vii) The claim of the Appellant was disallowed by the Commission in the Impugned Order as under:-

"…

3.11.9. The Commission has already approved interest rates for normative loans considered for each year since FY 2004-05. The interest rates have been varying every year since FY 2004-05. The Commission had not carried out any downward revision of the interest rates when the prevailing interest rates at the time of approving new loans in the past years were low. In line with the same principle, the Commission does not find any merit in revising the interest rates of loans approved prior to FY 2011-12.

……"

viii) Hence, as held by the Commission, the Appellant ought not to be permitted to proverbially "eat its cake and have it too". Not having suffered the reduced interest rates in previous years, the Appellant has enjoyed the bounty of the old rates fixed in the respective years. Now since the rates have hardened, the Appellant is seeking to revise the same.

38. In the light of the above rival submissions made by both the parties, let us deal with this issue.

39. In fact, this issue has already been decided in favour of Appellant in Appeal no. 52 of 2008. The relevant extracts of judgment in Appeal No. 52 of 2008 is quoted below:

> *"28. The next issue is with reference to the lower interest rate allowed on notional loan. According to the Appellant, the State Commission has allowed the interest rate on notional loan for financing of capital expenditure for FY 2006-07 only @ 8.5% p.a. instead of 9.2% p.a. It is further contended by the Appellant that the interest rate of notional loan works out to 9.2% p.a. for the FY 2006-07 and the same should be used for calculation of rate of debt on the notional loan for MYT period.*
>
> *29. According to the State Commission, the State Commission has allowed the actual interest rate of loan taken by the Appellant towards re-financing of the Delhi Power Company Limited in 2007. It is further contended by the State Commission that the State Commission has allowed the interest on notional loan in 2007 @ 8.5% which was in addition to the interest allowed on Delhi Power Company Limited re-financed loan and since the Appellant has not taken any loan in 2007 the interest allowed @ 8.5% was assumed as a notional loan. The relevant extracts of the impugned order in effect disallowing appropriate interest is as follows:*
>
> *"3.80. For 2007, the State Commission has approved the total debt financing of Rs. 125.62 Cr. For Capital expenditure as per the means of finance approved for 2007. The Petitioner has not taken any debt in*

2007. The State Commission approves normative loan of Rs. 125.62 Cr. The State Commission approves interest rate of 8.5% on the normative loan with moratorium period of one year repayment period of 10 years."

30. The investments referred to by the Delhi State Commission to support the lower rate are investments relating to contingency reserves and not the surplus funds available with North Delhi Power Limited contingency reserve invested in Government securities and RBI bonds as per the Regulation 4.20. Such securities are risk free securities and carry lower interest rate than other investment instruments such as Mutual Funds, Equity etc. Therefore, the State Commission's comparison with the Government securities is misconceived.

31, Further, this issue is governed by the principle settled by this Tribunal in its judgment dated 30.07.2010 in Appeal No. 153/09 in which it has been held that:

"47. The State Commission instead of applying the principle of allowing the prevailing market rate for debt for the carrying cost, has allowed the rate of 9% on the strength of the Tribunal judgment even though the present interest rate has increased significantly. As pointed out by the Counsel for the Appellant, the State Commission in the earlier case had decided tariff on 9.06.2004 and that on commercial borrowings on interest rate of 9% had been applied considering the then prevalent prime lending rates. ***Therefore, the State Commission before fixing***

the rate of carrying cost has to find out the actual interest rates per the prevailing lending rates. Admittedly, this has not been done.

50. The working capital is being allowed by the State Commission on normative basis in line with the MYT Regulations. These Regulations would imply that it is controllable parameters which is not to be trued up. Any loss/saving in interest on working capital is to the account of the distribution company. When there is some savings on this account, the State Commission cannot deny the benefit of the same to the distribution company to enable it to utilize the same to meet the other requirements. As a matter of fact, the Appellant claim is in line with the State Commission view that the carrying cost is to be allowed in the ratio of 70:30.

51. It cannot be disputed that the State Commission shall be guided by the principles that reward efficiency in performance as provided under section 61(e) of the Electricity Act, 2003. Similarly, the said section provide that State Commission shall be guided by the National Electricity Policy and Tariff Policy. Therefore, the State Commission should have allowed the carrying cost at he prevailing market lending rate for the carrying cost so that the efficiency of the distribution company is not affected. The State Commission is required to take the truing up exercise to fill up the gap between the actual expenses at the end of the year and anticipated expenses in the beginning of the year. The Tribunal in various judgments rendered by it held in Appeal No. 36 of

*2008 in the judgment dated 06.10.2009 reported in 2009 ELR *APTEL) 880 has held that "the true up exercise is to be done to mitigate the difference between the projection and actuals and true up mechanism should not be used as a shelter to deter the recovery of legitimate expenses/revenue gap by over-projecting revenue for the next tariff",* ***Therefore, the fixation of 9% carrying cost, in our view, is not appropriate. Therefore, the State Commission is hereby directed to reconsider the rate of carrying cost at the prevailing market rate and the carrying cost also to be allowed."***

32. The above observation would reveal that the Delhi State Commission has approved the interest rate of 8.5% for notional loan for 2007 since the Appellant has not taken any new loan for capital expenditure for the said year. The only loan taken by the Appellant for the FY 2007 was for re-financing of old Delhi Power Company Limited loan. It is pointed out that in the previous tariff orders for 2002-03, 2003-04, 2004-05 and 2005-07, the Delhi State Commission had adopted the principle that while computing the rate of interest on notional loan, the State Commission is to be guided by the interest rate on actual loan availed during the year or the prevailing interest rate if no new loan is contracted during the year.

33. It is not debated that the rate of 8.5% considered by the Delhi State Commission was based on the loan taken by the Appellant in the FY 2004-05. It is noticed that the interest rates have subsequently

increased which is evident from the movement in the prime lending rate fixed by the State Bank of India. The Delhi State Commission has not considered the cost of re-financed Delhi Power Company Limited loan for allowing interest on notional loan. ***The purpose of allowing interest rate on notional loan with that of interest rates of loans actually drawn is to ensure that the costs allowed are in line with the actual cost of loans available in the market.***

34. The State Commission has ignored the re-financing of Rs. 552 crores of loan. The case of the Appellant before the Delhi State Commission that the interest rate to be worked out on a loan must be raised on the prevalent market rates. The Delhi State Commission has ignored the fact that the capital interest rate to be applied is for the period 2006-07. The total impact of such lower allowance is 0.44 Crores for the FY 2006-07 and Rs. 0.99 crores from the FY 2007-08 onwards.

35. Under those circumstances, ***the Delhi State Commission is directed to allow interest on notional loan for this particular year based on the market related interest rate prevailing in that year i.e. either the interest rate approved in FY 2004-05 duly adjusted for change in the State Bank of India prime lending rate or 9.2% per annum based on the loan obtained by the Appellant.*** *The said claim may be considered by the State Commission along with carrying cost. Accordingly this issue is answered in favour of the Appellant.*

40. Since the issue has already been decided in Appeal No.52 of 2008, the same is decided in this Appeal also in favour of the Appellant. The State Commission is directed to pass the consequential orders in terms of our findings above.

41. Summary of the findings:-

a. **The Tribunal in Appeal No. 251 of 2006 has laid down the ratio that the income tax assessment of the licensee must be done on standalone basis. In Appeal No. 173 of 2011 the Tribunal has provided the methodology for assessing the income tax liability of the licensee. The State** Commission **did not follow these directions and got carried away with the observations that the utility must not gain or loose on account of income tax made in the context of grossing up of income tax. It simply allocated the actual tax paid by the Appellant, for the company as a whole, in proportion to their respective book profit. The Commission is directed to reassess the income tax liability on stand-alone basis and issue the consequential relief to the Appellant. The issue is decided in favor of the Appellant. The issue decided in favor of the Appellant.**

b. **Since the issue has already been decided in Appeal No.52 of 2008, the same is decided in this Appeal also in favor of the Appellant.**

42. In view of above, the Appeal is allowed. However, no order as to costs. The State Commission is directed to pass consequential orders in terms of our above directions.

(V J Talwar) ***(Justice M. Karpaga Vinayagam)***
Technical Member ***Chairperson***

Dated: 2nd December, 2013

√REPORTABLE/~~NON-REPORTABALE~~