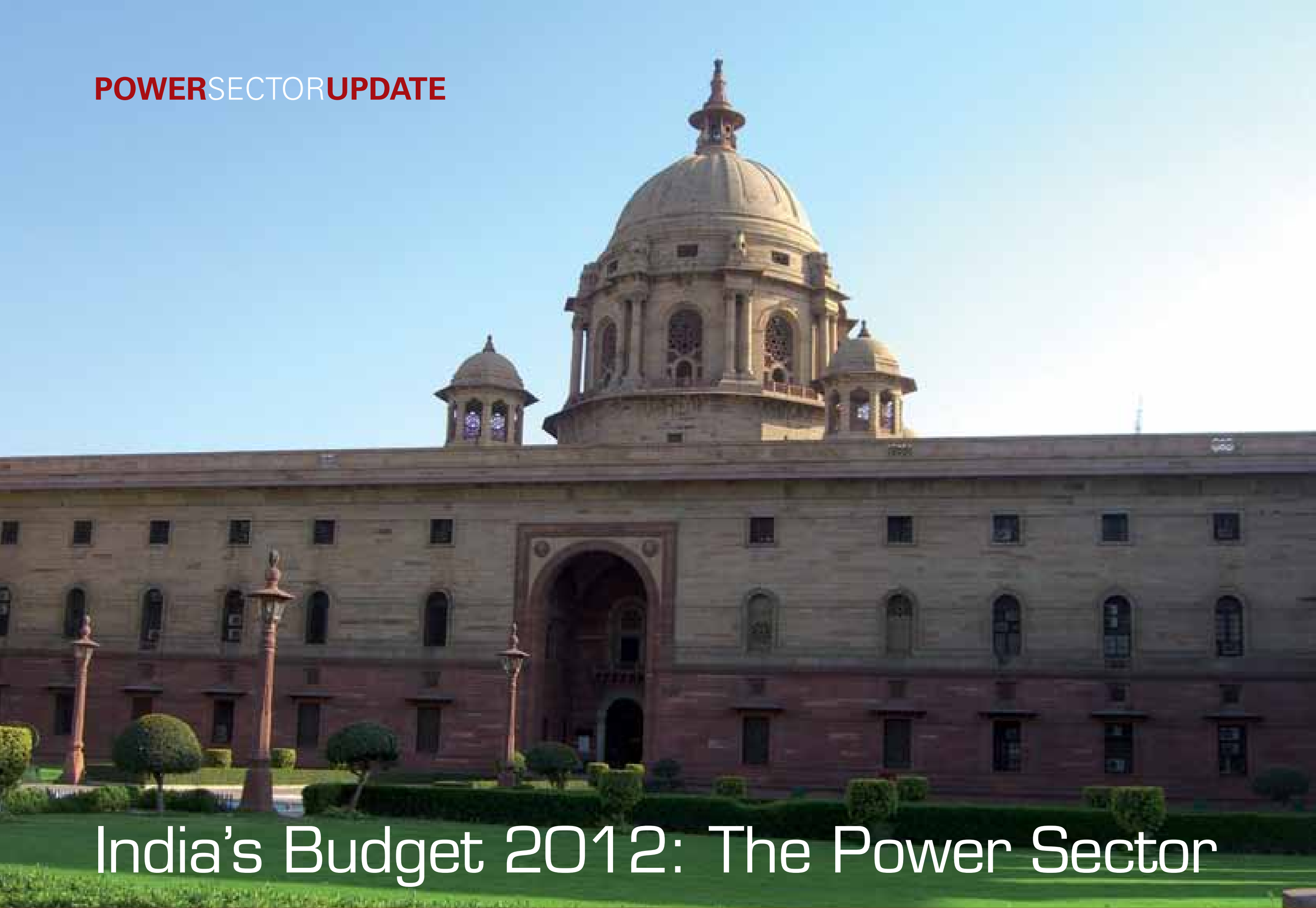


India's Budget 2012: The Power Sector

SUJIT GHOSH, BMR ADVISORS AND BHARAT VASANDANI, ENERGETICA INDIA

The Indian Government came out with Budget 2012. The power industry going through a crisis and never ending demand had certain expectations from the government; especially keeping in mind the focus on climate change. Were these expectations fulfilled? Energetica India looks at the wishes/expectations from the industry and puts down the budget for the power sector.

Pre-Budget 2012

The issues that are grappling the Indian Power sector are many. Each niche within the power sector space was expecting some encouraging news from the Government's 2012 Budget. So, Energetica India asked the power professionals/companies on their wish-list/expectations.

And here is what they had to say:

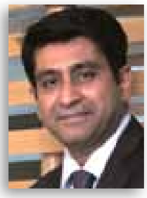
Ernst & Young (E&Y)

Mr.Sanjay Chakrabarti,

Partner, Cleantech; E&Y

Budget Wishes/Expectations:

1. Restructuring of State Electricity Boards.
2. Include Renewable Energy in the Priority Sector.
3. Investment allowance and its impact on the renewable energy sector, especially on the wind retail market.



Mr.Sujit Ghosh, is a Tax Partner at **BMR** and leads the Power & Utilities Practice. He is also an arguing counsel on tax matters before various courts and tribunals: sujit.ghosh@bmrlegal.in

TÜV SÜD South Asia Pvt Ltd

Mr.Bratin Roy

Assistant Vice President – Environment and Energy Services, South Asia

Budget Wishes/Expectations:

1. Financial Institutions to be more liberal for investors in Solar Power project with low interest rate. Indian banks could be directed to invest a certain percentage in renewable energy.
2. Single window clearance for development of Solar Project in every state.
3. Create infrastructure like solar park in Gujarat in all over the country, specifically with high radiation zones such as Rajasthan, Maharashtra & Tamil Nadu.

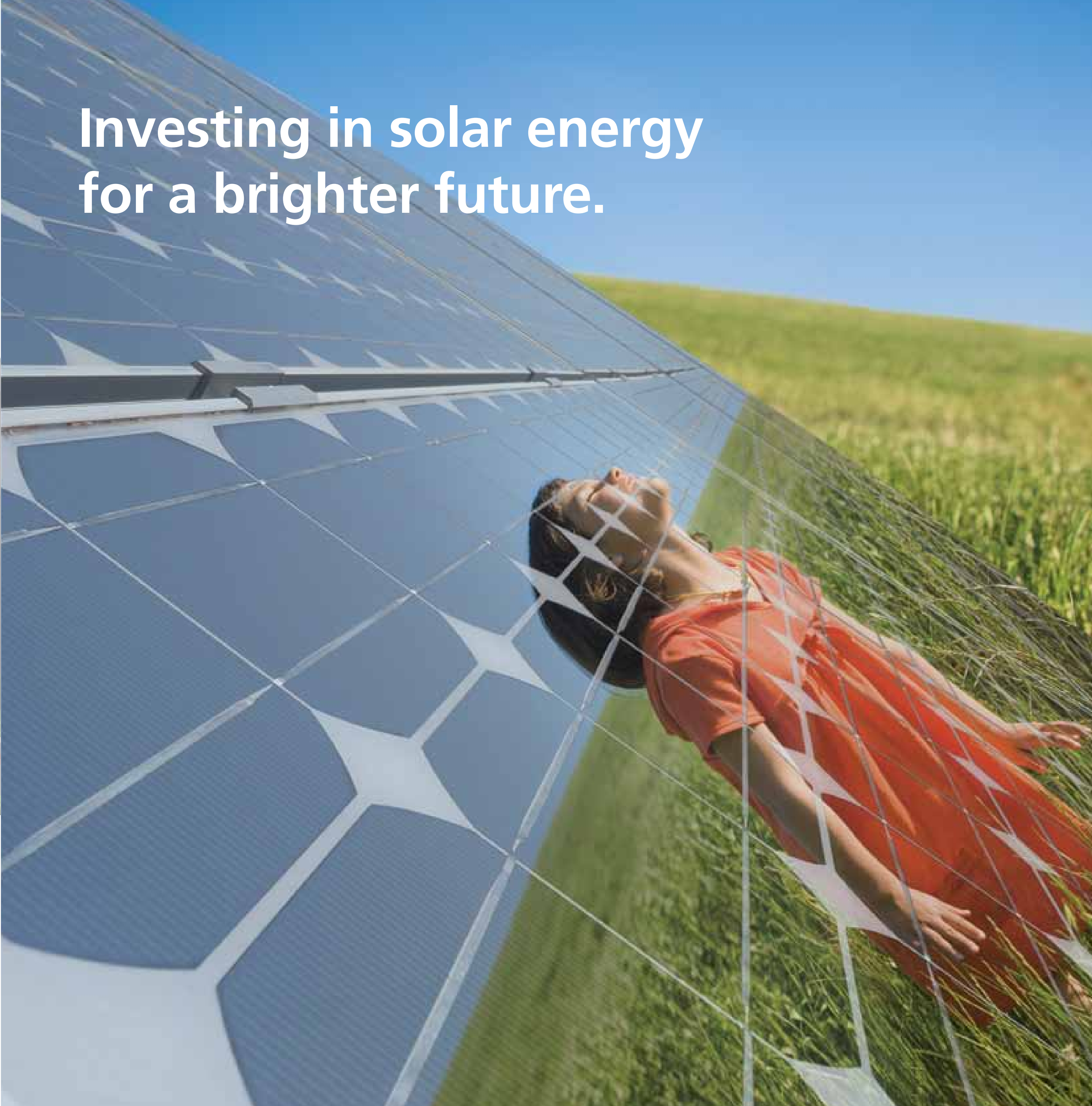
Gamesa Wind Turbine Pvt Ltd

Mr.Ramesh Kymal

Chairman & Managing Director

Budget Wishes/Expectations:

1. The Union Ministry of Finance and Ministry of Non Renewable Energy should extend the Generation Based Incentive (GBI) Scheme with an incentive of INR 1.2/KWh with no cap. (Currently INR 0.5/KWh with a cumulative cap of INR 62L per MW over 10 years).
2. Tax holidays under section 80IA should be continued in 2012-13 and in DTC as well. This is essential to promote investment in essential infrastructure such as Power. Any additional burden will only


Investing in solar energy
for a brighter future.

pass on to the end consumer.

3. Priority lending to Renewable Energy projects should be considered. Also, government could consider a Special Purpose Vehicle Finance/Guarantee lending to Renewable Energy sector including Transmission infrastructure for renewable energy projects.

Juwi India

Mr.Rajesh Bhat

Managing Director

Budget Wishes/Expectations:

1. Assurance from Government for minimum assured size of 2-3 Gwp of solar per year; to bring down the cost to grid parity.
2. Industry needs low cost funds for solar power or renewable energy projects
3. Foreign investment in solar power projects should be encouraged with sell-off or repatriation of funds in 6 months time.
4. Feed-in-tariff to be fixed based on market scenario till market stabilizes with good developers, quality EPC companies, and good local manufacturing companies including ingots.
5. Cut in import duty on Power Equipment.
6. Single window clearance for power projects.

Akshaya Solar Power (India) Pvt Ltd

Mr.Peddiraju Bhupathiraju

Managing Director

Budget Wishes/Expectations:

1. There is no excise and import duty on solar panels. But there is Central Excise and Import Duty on raw materials used in solar panel. Hence solar manufacturers in India are not able to compete in the international market.
2. Removal of Sales Tax on all renewable energy products in all states.

AWS

Mr.Markus Amendt

Managing Director

Budget Wishes/Expectations:

1. Implementation of a strict local content regulation for cells and thinfilm modules.
2. Policies to support solar manufacturing.
3. Mechanism to speed up the solar progress, otherwise India will loose the competition with China.

Emerson Industrial Automation

Name : Mr.Dhiraj Kumar

Country Sales Manager

Budget Wishes/Expectations:

1. Government should issue strict guidelines for quality certification for Solar PV Inverter supplies, similar to being done for Solar Module.
2. Immediate & strict implementation of Renewable Purchase Obligation (RPO) & Perform Achieve Trade (PAT) scheme by BEE.
3. Permission to use Crystalline Silicone modules from outside India for NVVN projects.
4. BEE accreditation of organization (currently being done for individual auditors) for energy assessment of process industries.

PentaFour Group

Mr.R.Karthik

Chief Executive Office

Budget Wishes/Expectations:

1. Guarantee the minimum floor price for Renewable Energy Certificate (REC) based projects for a longer duration.
2. The JNNSM can address the bigger projects and the REC concept can be a great vehicle for retail involvement by setting up roof top solar with PPA with the State plus REC revenue.

Envirodyne Energy Systems Pvt Ltd & TiSun Edes Solar India Pvt Ltd

Mr.Lakhi Khatwani

Managing Director

Budget Wishes/Expectations:w

1. Immediate implementation of PV Roof Top policy.
2. Provide liberal assistance for development work in solar energy.
3. Removing of subsidy on Solar Water Heaters as its payback period is very low.

The above were the wishes/expectations from the industry. Now we understand the actual Budget w.r.t Power Sector.

Budget 2012 for India's Power Sector

Energy sector is one of the key strategic areas for India and the expectations from the budget for this sector were high. The Budget has somewhat managed to push the thrust required for sustained growth.

Policy announcements

- Viability gap funding extended to oil and gas/ LNG storage facilities and oil and gas pipelines.
- To overcome fuel supply constraints in the power sector, Coal India Limited directed to sign fuel supply agreements with power plants that have entered into long term Power Purchase Agreements with distribution companies; such power plants should be commissioned on or before March 31, 2015.
- External Commercial Borrowings (ECB) allowed to partly finance rupee debt of existing power projects.
- Issue of tax free bonds for power sector increased to INR 100 billion.

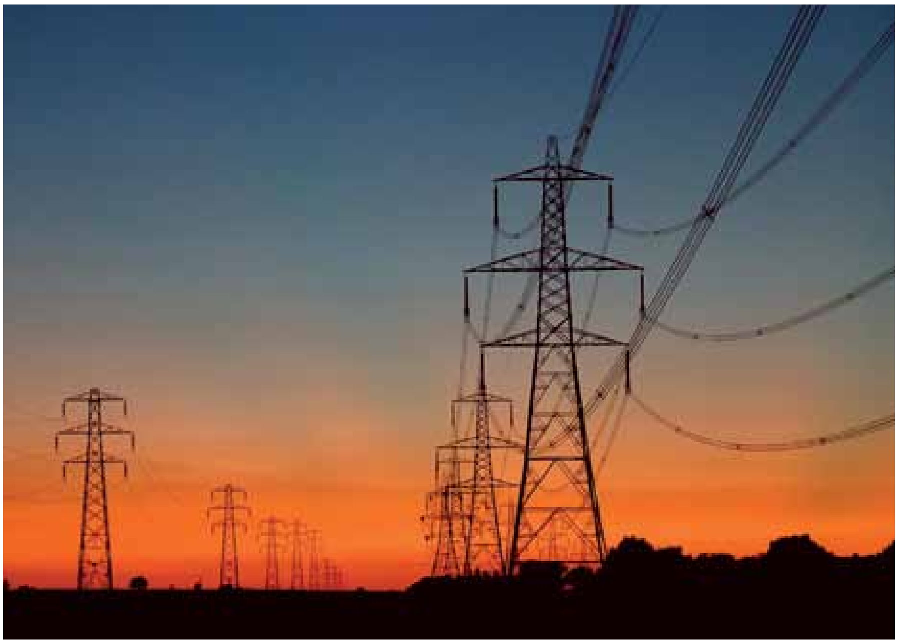
Direct Tax Proposals

Oil & Gas

- Income received by foreign companies in Indian currency in India from sale of crude oil will be exempt, subject to following conditions:
- Consideration received is pursuant to an agreement / arrangement entered into with or approved by Central Government;
- Foreign company and the agreement / arrangement is notified by Central Government having regard to the national interest; and
- Foreign company does not undertake any other activity in India other than receipt of consideration from oil sale.

Power

- The period for commencing operations for claiming tax holiday has been extended by one year to March 31, 2013;
- Benefit of additional depreciation at 20 percent extended to power generation companies;
- Interest payable on ECBs between July 1, 2012 to July 1, 2015 by an Indian company engaged in the business of generation or distribution or transmission of power, under a loan agreement approved by the Central Government, and subject to a maximum rate of interest approved under such agreement, subject to tax at the concessional rate of 5 percent.



Indirect Tax Proposals

Oil & Gas

- Cess levied under Oil Industry (Development) Act, 1974, as a duty of excise on crude and petroleum increased from INR 2,500 per tonne to INR 4,500 per tonne effective immediately. Cess continues to remain exempt for crude oil imported into India.
- Reduced rate of Cess of INR 1,600 for specified fields appears to have been retained.
- Exemption from basic customs duty ("BCD") has been provided to Natural Gas / Liquefied Natural Gas imported for power generation by a power generating company as opposed to the earlier rate of 5 percent.
- Direct import of ATF by Indian carriers as actual users allowed. This is likely to help eliminate VAT cost when a State trading Enterprise imports and sells to the actual users.
- Countervailing Duty (CVD) payable on import of dredgers on the following value:
  - If the dredger is imported against a lease agreement, the CVD is to apply on the total lease value of the contract
  - If the dredger is imported by the owner, CVD to apply on 120th of the value of dredger for each month or part thereof for which the dredger has been granted license by the Director General of Shipping for stay in India
  - Important to note that CVD is to apply at 6 percent while BCD and Additional Customs Duty (ACD) remain unchanged at Nil rate

Conventional Power

- The default project import rate of customs duty for import of equipments for non-Mega power projects stands increased to around 23 percent from the prebudget rate of around 21 percent.
- In the run-up to the Budget levy of customs duty on import of equipments for mega and ultra-mega power projects was widely apprehended owing to strong advocacy from domestic equipment manufacturers as well as the specific recommendations to that effect from the Maira Committee constituted by the Planning Commission. However, the Government has decided to continue with the import duty exemption for the time being thereby maintaining the status quo. While this is a positive development for large domestic power generators, this, coupled with price arbitrage and VAT/Central Sales Tax impact vis a vis domestic equipments may make it even more uncompetitive for domestic power equipment manufacturers.
- Customs duty on imported coal has been reduced to Nil BCD and concessional rate of 1 percent CVD. Coal is also eligible for nil ACD. Accordingly, the effective rate of customs duty on import of steam coal (used for steam generation and thus used in thermal power plants), till March 31 2014, is around 1.03 percent only. This is a significant positive development and would help mitigate the price shocks suffered by Indian power generators dependent on imported coal in the short term.
- For domestic procurement of coal the excise duty rate would remain 1.03 percent if no CENVAT credit is availed in respect of inputs and inputs services used in production / manufacture of coal. This is a departure from the earlier position in so far as earlier the restriction on credit availment also extended to capital goods. Now, the concessional rate of 1.03 percent would be available even if credit is availed on capital goods. This, coupled with the fact that the project import rate of customs duty for import of equipments for coal mines stands reduced to around 17 percent (owing to a complete exemption from basic customs duty – the non-creditable component of customs duty) from the pre-budget rate of around 21 percent, would be a significantly beneficial provision and reduce the cost of domestic procurement of coal.
- However, if the credit availment restriction is not met, the excise duty on domestic coal would be 6.18 percent as opposed to 5.15 percent (prior to Budget 2012);
- Similarly, for Liquefied Natural Gas ("LNG") when imported for generation of electricity by a 'Generating Company' (as defined under the Electricity Act, 2003), an exemption has been introduced from basic customs duty. Exemption would also be available from CVD and ACD component of customs duty. Thus a complete customs duty exemption is now available for LNG imported for generation of electricity by a 'Generating Company'. This exemption is however not available for captive power generation by a 'Captive Generating Plant' as defined under the Electricity Act, 2003. While, at the first brush, this indeed appears to be a positive development for domestic power generators relying

upon imported LNG, the following practical issues are foreseen:

- The typical business model adopted for import of LNG for use in power generation involves import of LNG by a specialist entity that then regasifies the LNG into R-LNG and subsequently sells it to the power generators. The availability of the above exemption in such a model is doubtful because the immediate use for the imported LNG is re-gasification into R-LNG and power generation is only the ultimate use and that too in a different physical form.
- In light of the above, it may lead to a scenario where the existing business model gets altered and a business model involving direct import of LNG by a power generator followed by a tolling arrangement between the said generator and a toller for regasification of the LNG for usage in power generation comes into existence.
- In a scenario, where the entire LNG is not intended for use in power generation by a IPP, whether a segregation needs to be maintained at the LNG terminal stage between LNG intended for use in power generation by a IPP, LNG intended to be used for captive power generation and LNG intended to be used for other purposes in order to claim the foregoing customs exemption.

- The proposed introduction of negative list based approach to taxation of services long with general increase in the median rates of excise and service tax from 10 percent to 12 percent would lead to an enhancement of non creditable input side taxes for a power project (since a power project doesn't have any output excise duty or service tax) and consequently a higher cost of power generation. Thus, while the proposed introduction of negative list based approach to taxation of services may be a significant step from a tax policy reform perspective, this would qualify as an adverse development for independent power generation.
- Transmission or distribution of electricity by an electricity transmission or distribution utility has been placed in the proposed negative list of services. It is interesting to note that distribution of electricity essentially amounts to pure sale of goods (viz electricity) and thus should get excluded from the very definition of 'Services'. Instead, it has been included in the negative list thereby granting it the status of 'services' – this appears to be an anomaly.
- Uranium concentrate, sintered natural uranium dioxide, sintered uranium dioxide pellets for generation of nuclear power have been exempted from basic customs duty. Given the excise exemption, nuclear fuel for generation of nuclear power would be completely exempt from customs duty. This would be a boost for nuclear power sector in India.
- It is proposed that for 'works contract services' rendered by an individual, a firm or an LLP and received by a body corporate, 50 percent of the service tax would be paid by the service recipient and 50 percent by the service provider. This proposal, when implemented, would increase the tax compliance burden of power project owners and would need to be examined thoroughly.
- BCD applicable on the import of boiler quality tubes and pipes for manufacture of boilers has been reduced from 10 percent to 7.5 percent subject to end use condition.

<u>Renewable Energy</u>

- Exemption from ACD on equipments required for setting up of solar thermal projects.
- Concessional BCD of 5 percent on solar lanterns or solar lamps.
- Exemption from customs duty on:
  - Vacuum tube solar collectors, concentrating solar collectors, plastic collectors or stirling engines for manufacture of solar energy equipment;
  - Linear actuators for tracking systems, fresnel lenses or sun sensors for manufacture of concentrating solar collectors.
- Concessional BCD of 5 percent extended to import of raw materials for the manufacture of intermediates, parts and sub-parts of blades for rotors for wind energy generators.
- BCD exemption on import of tri band phosphor for use in the manufacture of Compact Fluorescent Lamps.
- Benefit of nil BCD and 6 percent concessional CVD extended to Engine for HV (Atkinson cycle), transaxle for HV (splitpower device), Power Control unit (inverter, AC/DC converter, condenser), Control ECU for HV, Generator, Brake system for recovering, Energy Monitor and Electric Compressor for manufacture of hybrid vehicles.
- Benefit of Nil BCD, concessional CVD of 6 percent and nil ACD on lithium ion batteries for the manufacture of battery packs for supply to electric or hybrid vehicle manufactures.
- Excise duty on LED lamps reduced from 10 percent to 6 percent. 6 percent excise duty applicable on LED required for manufacture of such lamps.
- Reduction in excise duty from 10 percent to 6 percent till March 31, 2013 on:
  - Replacement batteries for supply to electric vehicle manufacturers who are registered with IREDA or any State Nodal Agency notified for the purpose by the Ministry of New & Renewable Energy for Central finance assistance (CFA).
  - Manufacture of specified parts of hybrid vehicles.

Post- Budget 2012 Reactions

Company Gamesa Wind Turbine Pvt Ltd

Mr.Ramesh Kymal

Chairman & Managing Director

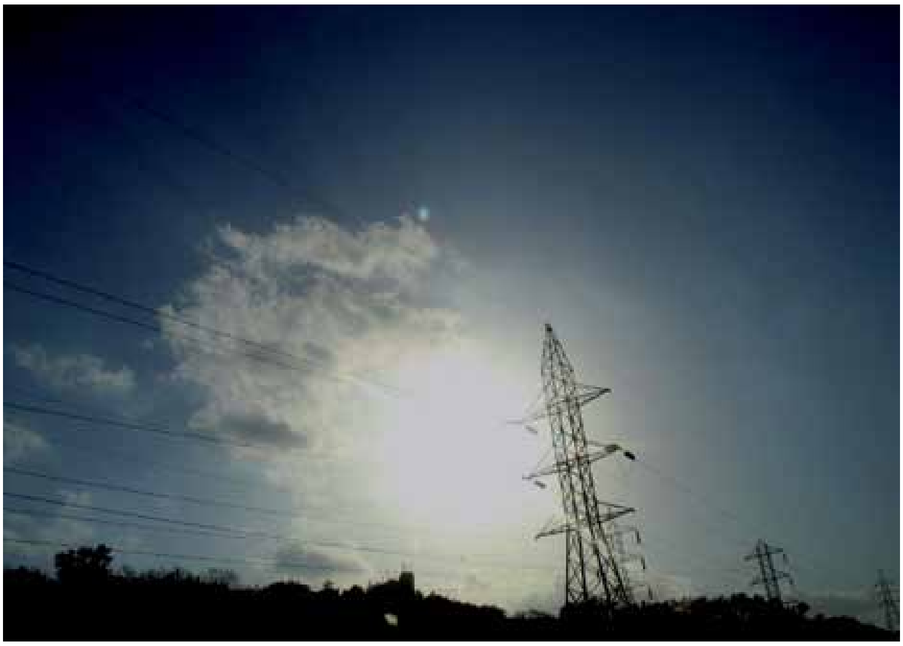
"The Union Budget has been a disappointment for the wind energy sector at a time when the wind energy was generating a sizable share of 5 per cent of electricity at the All India level. Even after our representation to the Union Planning Commission and the Union Ministry of New and Renewable Energy, the wind energy sector did not see any priority sector lending and reduction in the interest rates making the wind energy projects unviable with the present tariff rates. We have been let down. We are looking for a level playing field with the conventional power, but we find is that the subsidies for Oil is increasing and duty free coal is being allowed. We had great expectations in the Budget for coming out with investor-friendly initiatives towards the wind energy sector but we feel that our high expectations have been belied".

Company GE Energy India
Mr.Banmali Agrawala
President and CEO

"We applaud the government on the positive steps taken. The budget has rightfully laid emphasis on efficient government spending in sectors that have a long term impact on the economy like infrastructure, with focus on improvements in areas like power. Progressive measures like increasing the tax-free bond limit for power sector, reduction of withholding tax from 20% to 5%, exemption on customs duties for import of thermal fuels for power plants will go a long way in reducing the financial burden on the sector, which will benefit both the suppliers as well as the consumers of power."

Company Suzlon Group
Mr.Tulsi Tanti
Founder, Chairman & Managing Director

"I think we can view it as pragmatic; this year's budget is balanced and realistic. The power sector continues to sail on calm waters – as all major provisions for the sector remained unchanged. However, for the first time the budget accorded importance to the principles imbibed under the National Action Plan on Climate Change, by allocating resources to the missions created under the NAPCC and giving a strong mention to initiatives on renewable energy. The Government's unwavering support to building a low carbon economy is absolutely commendable. The allowance of ECB for the power sector is most welcome as it addresses the burgeoning energy needs of India. Along with the significant improvement in tax free bonds for infrastructure funding, the reforms pave the way to lower cost of fund, making projects more viable for investors. Increased liquidity, for putting up power projects is much needed and appreciated. Overall it attempts to balance fiscal consolidation, and at the same time, counteract the slowdown of our country's GDP growth."



Ernst & Young (E&Y)

The Government has clearly recognized the need for providing impetus to the power producers (including renewable energy) which is evident from the budget proposals of the Finance Minister. The Government seems to have adopted a multi pronged strategy for providing stimulus to the power sector:

- Easy access to funds by allowing replacement of existing rupee loans with overseas loans with an additional benefit of lower withholding taxes on interest on such overseas loans.
- Extension of tax holiday benefits to power producers for one more year.
- Allowing additional tax depreciation of 20% on new assets.
- Extension of weighted deduction on Research & Development expenditure which could be of interest to power equipment manufacturers.
- Removing the cascading effect of Dividend Distribution Tax ('DDT') which hitherto was a hurdle in repatriation of funds for companies engaged in power sector.

Further, by providing exemption from customs duties on select solar power equipments, the government has clearly indicated its desire to incentivize the sector. In summary, the government has given fresh and productive relief to the power sector in this budget.

Company PentaFour
Mr.R.Karthik
CEO

"Today, on micro turbines, there is a huge potential for generation on individual homes and flats to industries to villages and remote areas. This sector needs to be given full support and currently surviving on MNRE subsidy of 50 - 75%. The 5% duty (BCD) could have been waived as this duty will be counterproductive.

Moreover, tax benefits need to be given to individuals adopting micro turbines in their houses and also in industries in excess of 100% of the net costs(after subsidy) as this will not only encourage the installations and provide much needed power but also can have an impact of reduction on subsidies. Today, it is easy to have a tax related subsidy benefit rather than a cash subsidy as tax rebates prove easier to implement vs cash subsidies. Maybe a right balance between cash subsidies and tax rebates will help.

The same logic will also apply to roof top solar especially from 100w to 100kw requirements.

Policy on budget could have addressed this important aspect rather than shooting it on the leg. Also if tax benefits are given to an individual for adaptation of efficient storage devices, the adaptation will be faster".