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Tribunal elucidates the concept of 'market value' for claiming tax holiday by captive power units

Facts:

Shree Cement Ltd. (the taxpayer) manufactured cement in Rajasthan by sourcing power from its captive power unit and the State Electricity Grid. The taxpayer claimed tax holiday under section 80-IA(8) of the Income-tax Act, 1961 in respect of its captive power unit. For the purpose of claiming tax holiday, the taxpayer considered the rate at which power was sold by an independent power supplier to Distribution Power Companies in Rajasthan, and also Power Exchange Prices, i.e., the taxpayer considered external comparable prices as the 'market value' for claiming the tax holiday.

It is worth noting that in its original return, the taxpayer had selected the rate at which its cement unit purchased electricity from the State Electricity Grid ('Grid rate' or internal comparable price) as 'market value'. However, in its revised return, the taxpayer enhanced its tax holiday claim under section 80-IA(8), by replacing the internal comparable price (Grid rate) with external comparable prices as 'market value'.

The Tax Officer (TO) disallowed the enhanced tax holiday claim and considered the Grid rate as the 'best' market value, which was upheld by the Commissioner of Income-tax (Appeals). Aggrieved, the taxpayer appealed before the Income-tax Appellate Tribunal (the Tribunal).

Tribunal's ruling[1]:

The Tribunal deleted the disallowance made by the TO and held as follows:

- Once the revised return was validly filed by the taxpayer and accepted by the TO, the original return became *non-est,* as it was completely substituted by the revised return.
- The value adopted by the taxpayer, be it value as per independent third party trading transactions, or as per the Power Exchange, or the Grid rate, or any other independent transaction (for the relevant period and relevant area) constituted 'market value' in terms of explanation to section 80-IA(8).

  However, the value at which the State Grid or a third party purchased power from the captive power unit (which is the surplus power not required by the cement unit) did not constitute 'market value' in

terms of explanation to section 80-IA(8). Here, it was the 'principle' which was the deciding factor.

- The Revenue sought to infer that the Grid rate was the 'best' market value in the present context. However, there was no concept of 'best' market value in law, and the taxpayer could not be compelled to select only such value as market value. Any such attempt by the Revenue was clearly beyond the explicit provisions of section 80-IA(8).
- Where a basket of market values was available for the relevant period and relevant geographical area where the eligible tax holiday unit was situated, the law did not put any restriction on the taxpayer as to which market value to adopt. It was entirely the taxpayer's discretion to adopt any one of them as market value. The option favourable to the taxpayer could be adopted. If the value adopted by the taxpayer corresponded to 'market value' as per explanation to section 80-IA(8), it was not permissible for the Revenue to recompute profits and gains of the eligible unit by substituting the same with any other 'market value'.
- Specifically in this case, the taxpayer had adopted actual transactions undertaken by independent entities, and the volume of transactions was also substantial, which showed that the taxpayer had not handpicked transactions.

PwC observations:

The Tribunal has, in the context of power generating units, elucidated the concept of 'market value' in terms of explanation to section 80-IA(8). It has negated the 'best' market value concept adopted by the Revenue. Further, the discretion to adopt any market value (so long as it is a 'market value'), without restrictions, has been granted to the taxpayer. These are undoubtedly significant outcomes of this decision and that too in favour of the taxpayer. Having said that, our comments on some of the specific points made by the Tribunal are as follows:

- The Tribunal has held that the rate at which the State Grid purchases power from the captive power unit of the taxpayer cannot be considered as 'market value', and that this is based on 'principle'. The 'principle' referred to in the decision is not explained. However, the 'principle' could be that the rate of 'surplus power supplies' cannot be compared to the rate of 'supplies made pursuant to regular demand' from the cement unit. This is a general economic principle typically followed in pricing, i.e., suppliers tend to price surplus products or services more liberally than products or services which are in demand, and hence the Tribunal may have considered them to be incomparable.
- When explaining what constitutes 'market value' in terms of explanation to section 80-IA(8), the Tribunal has approved of market values pertaining to a relevant 'period'. This is an important observation in light of the fact that section 80-IA(8) refers to market value on the 'date' of transfer. By sanctioning the use of market values pertaining to a relevant 'period', rather than being fixated to a 'date', the Tribunal has allowed a liberal and far more practical interpretation of this particular provision of the section.
- Notably, this Tribunal ruling relates to an assessment year before introduction of domestic transfer pricing provisions to tax holiday units. From assessment year 2013-14 onwards, the below mentioned principles laid down by the Tribunal in this case would need to be aligned with the transfer pricing provisions, and with principles and ratios laid down in transfer pricing jurisprudence:
    1. The Tribunal in this case has held that where a basket of market values are available, then it is at the discretion of the taxpayer to adopt any one of them, which is favourable to the taxpayer. However, transfer pricing provisions, for the purpose of determination of arm's length price, prescribe the 'arithmetic mean' of all comparable prices, rather than any 'one price' which is most favourable.
    2. Further, the Tribunal in this case has upheld the use of an external comparable, and has stated that as long as it constitutes a 'market value' in terms of explanation to section 80-IA(8), the Revenue is not permitted to substitute the same with the internal comparable. However, in some of the judicial precedents in the context of an international transfer pricing scenario, Tribunals have preferred internal comparables over external comparables.

1. Reliance was placed on judicial precedents in the cases of Aztec Software & Technology Services Ltd. *v.* ACIT [2007] 107 ITD 141[Bang][SB]; ACIT *v* . Maersk Global Service Centre (I) Pvt. Ltd. [2011] 133 ITD 543; and CIT *v* . Vegetable Products Pvt. Ltd. [1973] 88 ITR 192 [SC].

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