



# Indian Power Sector: The Future Fuel

January 2023

# India inching towards becoming a super power: An uphill journey

## Sector overviews

India is the third-largest producer and third-largest consumer of electricity worldwide, with an installed power capacity of 409.16 GW as of 30 November 2022. It has one of the most diversified portfolios ranging from conventional sources, such as coal, lignite, natural gas, oil, hydro and nuclear power, to viable non-conventional sources, such as wind, solar, agricultural, and domestic waste with surplus installed capacity. Electricity demand in the country has increased rapidly at a CAGR of 4 percent and is expected to rise further in the coming years. The country has achieved 100 percent electricity access by 2018 and has achieved 100 percent household electrification. The energy deficit has significantly improved in the past decade from -8.5 percent in 2012 to -0.4 percent in 2022. With evolving policies and a robust regulatory framework, the country has evolved and is on the right track towards sustainability.

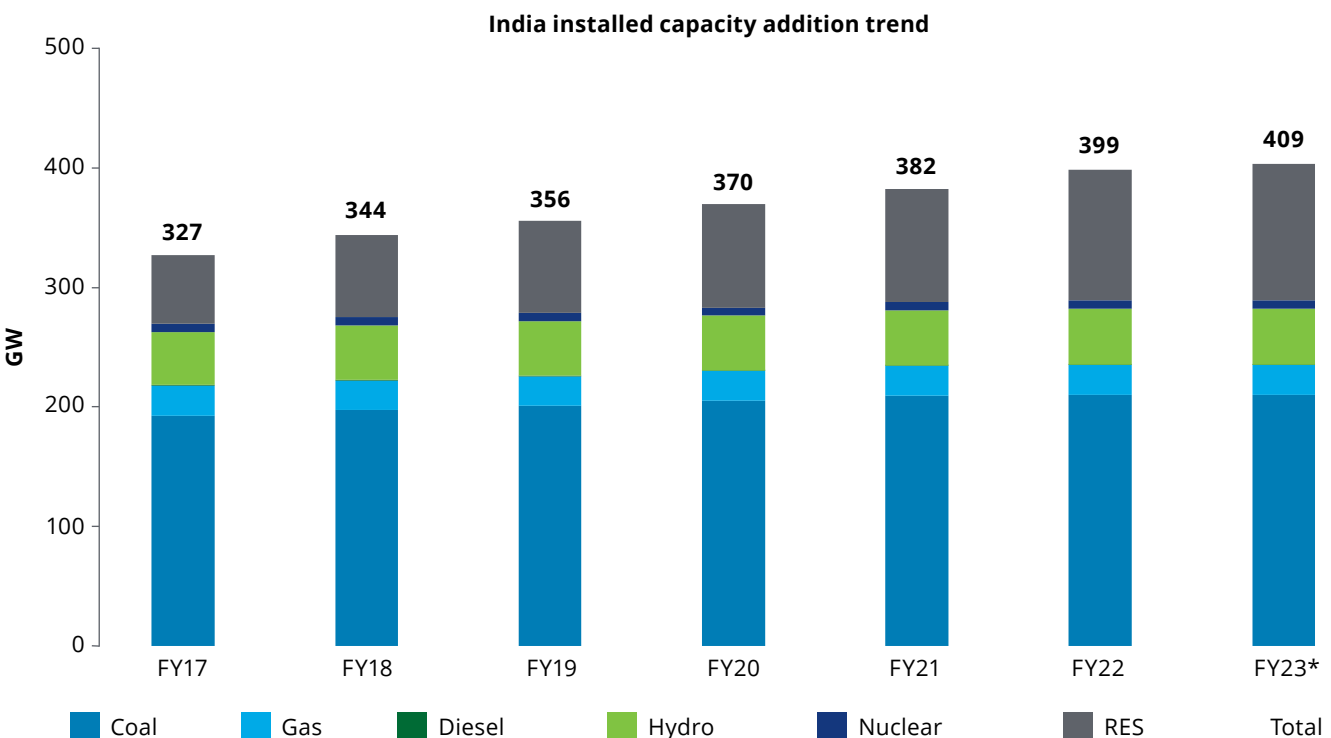
At the Conference of Parties (COP)-26 summit in November 2021, India pledged to achieve net-zero carbon emissions by

2070 and meet 50 percent of its energy requirements, i.e., 500 GW through renewables. The transition from fossil fuel based to non-fossil-fuel-based energy is also being observed in capacity addition trends between FY17 and FY22, where Renewable Energy (RE) dominated capacity additions at a CAGR of 15 percent compared with thermal additions at a CAGR of 1.2 percent. Tenders for 1 GWh battery energy storage systems and 37 GW offshore wind are opening new avenues for the latest technologies resulting in this transition.

## Key trends

During this transition, the major trends observed in the sector can be broadly classified under three heads: Decarbonisation, decentralisation, and digitalisation. These drivers are redefining the power sector landscape by cutting down emissions and enabling the ease of living. Some key initiatives being observed are:

**Decarbonisation:** There has been a gradual transition from conventional fossil fuel sources to greener sources. Much



Source: CEA

emphasis is being given to decarbonisation, both at the institutional and individual level. High-level penetration of renewable energy, utilisation of energy storage technologies, and promotion of electric vehicles and green hydrogen are some key initiatives that are driving the country towards decarbonisation.

**Decentralisation:** Moving from a centralised to a decentralised system helps in the optimal use of resources and security. Decentralised Renewable Energy (DRE) is picking up adoption in India. Increase in the share of roof top solar units, scaling up of mini/micro grids, green buildings, separation of carriage and content, increased cross-border energy trade through renewable energy, etc., are some initiatives towards decentralised systems.

**Digitalisation:** Technology is a major disruptor across industries, and the power sector is no exception. Utilities are using technology to ease operations and increase efficiencies. Digital technologies such as energy efficiency solutions, smart homes, smart meters, IT/ OT systems, AI, and IoT are being implemented to drive digitalisation in the country.

## Challenges

While there has been significant progress in the sector, some challenges continue to prevail during the transition. The existing transmission infrastructure is unable to support additional renewable capacity additions. The imbalances are forcing system operators to curtail renewable power. Due to poor financial condition of most of the electricity distribution companies, the investments are limited towards performance improvisation or modernisation. Further, the distress of Discoms results in long payment cycles to the developers, thereby increasing their financial obligations. Further, the cancellation or renegotiation of renewable Power Purchase Agreements (PPAs), uncertainty or frequent policy changes in terms, open access charges and approvals, banking charges, etc., are some key bottlenecks faced by developers, which in turn, is increasing investment risks.

## Recent government initiatives

The government has taken several initiatives to resolve the challenges faced by the industry. The recent Electricity (Amendment) Bill, 2022 has a provision for operating multiple distribution licensees in the same area of supply, enabling the privatisation of the power distribution segment. This enables competition in the distribution segment, enhancing the efficiency of utilities, and ensuring the sustainability of the power sector. Payment security provisions proposed in the bill provide assurance to power generators including Independent Power Producers (IPPs) who face delays in payment from distribution companies. The prompt payment of Discoms to power producers will encourage new market players in the power generation segment. The bill also mandates State Electricity Regulatory Commissions (SERCs) to specify

renewable purchase obligations (RPO) for Discoms; however, Discoms will be penalised for not complying with the RPO.

For the promotion of green power through open access, the government has framed Electricity (Promoting Renewable Energy Through Green Energy Open Access) Rules, 2022, which reduces the limit of Open Access Transaction from 1 MW to 100 kW for green energy, enabling small consumers to purchase renewable power through open access. The approval for Green Open Access will be granted in 15 days, or else, it is deemed to have been granted. These rules further provide certainty on open access charges to be levied on Green Energy Open Access Consumers.

For the expansion of large-scale grid-connected solar and wind projects in the upcoming years, the waiver of inter-state transmission system charges for solar and wind projects has been extended for projects scheduled for installation until 30 June 2025, and a phased waiver has been proposed up to 2030. The Green-Energy Corridor scheme has also been implemented to expand the existing infrastructure and cater to the transmission requirements of new renewable energy installations.

The Energy Conservation (Amendment) Bill, 2022, promotes renewable energy and the National Green Hydrogen Mission by introducing carbon trading, and mandating the use of non-fossil sources to ensure faster decarbonisation. Carbon trading opens a new carbon market in India, where entities can sell or purchase carbon credit certificates. This promotes the increased reduction of fossil fuel-based energy consumption, and the resultant carbon emissions into the atmosphere.

National Green Hydrogen Mission 2023, guidelines and standards for charging infrastructure and offshore wind block bids are some key initiatives in promoting upcoming technologies. Easy open-access approvals, Inter State Transmission System (ISTS) waiver, land lease, etc., are some incentives provided to developers for scaling such projects.

## The way forward

Per 20<sup>th</sup> Electric Power Survey Report (EPS) the demand is projected to grow at a CAGR of 5.2 percent in the coming decade. With the national development plans, indigenisation, and end-use electrification, demand from cleaner sources are expected to rise exponentially. Technologies such as energy storage and green hydrogen have a huge untapped potential, which can drive transition at a faster pace. With policy support and assured demand, the future of the sector is bright. In the coming years, larger cleaner capacity additions are envisaged, which could make India a preferred investment destination.

## Contributors

Swati Kedia  
Sharath Nair

## Corporate tax

For India, 2022 marks the beginning of “Amritkaal”, as it received the G20 presidency for the first time w.e.f 1 December 2022. With the intent of promoting the universal sense of one-ness, India titled the captioned theme for India’s G20 presidency tenure. The government has taken several steps to promote the power sector in the country. A few of the key steps are listed below:

1

The **Energy Conservation (Amendment) Bill** was passed on 12 December 2022 to mandate non-fossil sources of energy and establish a domestic carbon market in India. The passage of the Energy Conservation (Amendment) Bill paves the way for enhanced use of renewable energy.

2

The **Electricity (Amendment) Bill, 2022** was also introduced in Lok Sabha on 8 August 2022. The Bill amends the Electricity Act, 2003, which regulates the electricity sector in India.

3

The Ministry of New and Renewable Energy (MNRE) also notified the **National Bioenergy Programme** on 2 November 2022 to provide financial assistance to set up bioenergy projects such as Biogas, BioCNG, power from urban, industrial, and agricultural waste/residues for reducing capital costs/interest on loan.

4

In continuation with the announcement made in the Union Budget 2022-23, the government on 9 November 2022 approved the framework for India's first green bonds to fund new solar, wind, and hydro energy projects.



With the aforementioned policy developments and the Union Budget 2023 being around the corner, detailed below are a few significant issues and recommendations as highlighted by industry bodies from a direct tax perspective:

### Burning issues:

#### Controversial carbon credits

- The taxation of income on the transfer of carbon credit has always been under the lens of tax authorities. Be it treating the income as business income v/s capital receipt or setting off business losses against the income from carbon credits. The question also arises on the taxability of renewable energy certificates (RECs), which are similar to carbon credits.
- Presently, the income from the transfer of carbon credit is taxed at special rate of 10 percent under Section 115BBG of Income Tax Act, 1961 (Income Tax Act). However, carbon credits defined under section 115BBG of the Act **only covers incentive granted for reduction of emission of GHGs, including carbon dioxide in accordance with the Kyoto Protocol of United Nations. This does not include RECs.**
- Recently, the Energy Conservation (Amendment) Bill, the empowered issue of carbon credit certificates and trading by eligible entities. However, clarity needs to be obtained on whether such certificates will be taxed at a special rate under Section 115BBG or taxed as business income.
- Therefore, clarity on tax implications on the transfer of carbon credit would be the impetus for growth of carbon credit trading.

#### Concessional tax regime

- Section 115BAB provides a concessional tax rate of 15 percent for new manufacturing/power-generating companies. To avail this benefit, the company should be set up after 1 October 2019 and power generation should commence on or before 31 March 2024.
- The provision further states that the company needs to exercise the option before **filing its first income tax return.**
- It has been observed that in a few cases, in the absence of the project commencing and no record of revenue, the company fails to opt for a concessional tax regime in first year. At the time of filing the tax return in the subsequent year with a concessional rate tax return, a warning is generated on the company not having opted for concessional regime in the first year. Therefore, tax authorities in such cases may question the eligibility for concessional tax rates.
- However, the above is against the intent of the provision. Usually any manufacturing/power-generating companies takes 2-3 years' time for commencement. Section 115BAB has a provision for incentives and should be interpreted in a liberal manner. Therefore, one could take the benefit of concessional tax rate in the subsequent year; however, this will not be free from litigation.
- That said, Section 115BAB also provides a sunset date for the commencement of activity, i.e., 31 March 2024. Therefore, companies opting for a concessional tax regime in the first year should appropriately document that it will be able to commence operations before the sunset date.

### Valuation for the issue of new shares of SPVs

- Section 56(2)(viib) of the Act provides that in case of issue of shares at premium the consideration received shall not exceed the fair market value (i.e. FMV computed as per Rule 11UA of Rules) of the shares.
- Typically, it is observed that the valuation report provides reference for various assumptions. It also states that they have not independently verified the same and relied on the projection provided by the management. Tax authorities in such cases have held that the valuation report is not reliable on the ground, the projections are not justified, and that it does not contain empirical data to be used as the basis for projected future financials.
- A practical way out to negate such contention of tax authorities is that the valuation report clarifies that projections are prepared by the management, considering power-generation data from a technical evaluation, in which prices are determined from the energy-supply agreement entered into with potential customers. If required, the copy of engineer certificate and PPA are also submitted to the valuer.

### Ready-to-use asset – year-end CODs

- A power company starts recording its revenue from the date from which its power plant commences. Therefore, its activity is akin to a manufacturing company. A common issue faced by such companies is the date from which it will be eligible to claim expenses. As the major expenditure for a power company is its depreciation costs, the question that also arises is the date from which it shall be eligible to claim depreciation i.e., the date from which the plant is ready to be used or the date of the commissioning certificate.
- In the case of **Orient Green Power Co. Ltd. 138 taxmann.com 383 [2022]**, the Hon'ble Chennai tribunal held that where assessee-company, engaged in the business of investing, owning, and operating renewable energy sources had already acquired land to carry out business activities, obtained various approvals, deployed technical personnel, placed purchase orders, and also signed long-term power purchase agreement with clients. It could be said that business had been set up and was ready to commence, and hence, business expenditure claimed towards employees cost, depreciation, etc., was to be allowed as deduction.
- Further, in case of **Lakshmi General Finance Ltd 129 taxmann.com 256 [2021]**, wherein windmills were said to be connected with Grid at 2100 hours, on 31 March 1999, the meter reading practically showed 0.01 unit of power. The Assessing Officer disallowed 50 percent depreciation on the grounds that even though the windmills were connected there was negligible production of power. In this case, the Hon'ble Madras High Court held that even trial production machineries kept ready for use are considered to be used for the purpose of business and would qualify for depreciation, thus, the assessee would be entitled to claim depreciation on windmills, which were connected with the grid, even though it had not generated electricity during the relevant year.
- Both the above rulings are relevant for power companies for evaluating the deductibility of the expense and claiming depreciation in the first year of operations.

## Power funding

- Usually, power projects are capital-intensive and have a long-gestation with risky ventures. Therefore, the question arises on what the sources of funds will be. Or to what extent a project should have owned funds or debt funds.
- As a step one, while selecting a funding option or an appropriate group structure one needs to consider the following key factors:
  - Investor perspective (i.e., whether investors need flexibility in funds in terms of repatriation or timelines)
  - Income stream (to see if the holding company categorises as NBFC due to passive income)
  - Exit option (i.e., whether the project would be monetised by outright sale or slump sale or through formation of InvIT)
  - Blockage of funds on account of withholding, therefore the option with lower withholding rate should be considered. (For example, if sourced from outside India in a foreign currency, the withholding rate is 5.46 percent, a lower withholding certificate at the Hold Co level)
  - Tax deductibility (thin capitalisation)
  - Lender perspective
- There are also certain issues that companies faces at the operational level. Typically, companies undergo losses for the first few years, therefore interest expense in excess of 30 percent of EBIDTA gets disallowed. Similarly, if the company has a Hold Co structure that is under loss, the withholding tax made by the SPVs creates a blockage of funds on an overall basis.
- Per the Companies Act, interest-free loans are permissible for a company involved in infrastructural facilities, which includes power projects. However, companies availing a concessional tax rate under Section 115BAB are required to have transactions at an arm's-length price. Therefore, any interest-free loan to such company may not be permissible. Such interest-free loan also needs to be evaluated from a withholding obligation under Section 194R of the Income Tax Act.
- In view of the above, financing still counts to be one of the crucial issue for a power project.

## Contingent consideration

- Usually at the time of acquiring SPVs, it has been observed that there are certain contingencies in the receipt of certain considerations.
- Therefore, it has been observed that a combination of clauses in the shareholder agreement are included, including the consideration payable in a contingent manner on achieving certain milestones.
 

There is no clarity on whether such contingent consideration is to be taxed in the year of transfer or in the year of receipt once the consideration crystallises. Therefore, it is recommended to have clarification on such issues under Section 45 and 48 of the Act to avoid controversies.

## Recommendations for the Union Budget FY2023:

### Tax incentive for green bonds

- In continuation with the announcement made in the Finance Act 2022, the Hon'ble Finance Minister on 9 November 2022 approved the final Sovereign Green Bonds framework of India. Additionally, there are green bonds being issued by Indian issuers.
- Therefore, to attract investments in Green Bonds issued by Indian issuers, including Sovereign Green Bonds, from Indian resident investors as well as non-resident investors, industry bodies have made recommendations such as the exemption from interest income or profit earned on transfer of bonds.

### Consolidated group taxation regime

- A longstanding request by the industry is the introduction of a consolidated group taxation regime.
- Currently, in the power sector, the players are required to have multiple Special Purpose Vehicles (SPVs) due to regulatory compulsions.
- This results in increased compliance burdens. Further, tax loss of one entity cannot be offset against the profits of another, thereby leading to tax leakage at the group level. Introducing a group taxation regime will allow such tax losses to be set off, thereby improving the cash flow of the group.

## Conclusion

The aforementioned are a few of the key issues for the power sector from a direct tax perspective. The power sector plays a vital role in the economic growth of the nation. There are various other initiatives that can be taken for long-term policy stability and promote investments in the power sector, such as the extension of the sunset clause for the concessional tax regime and tax incentives for sufficient storage facilities.

## Contributors

Jimit Devani  
Jash Davda  
Trishala Shah



## Transfer Pricing

India has witnessed significant growth in the captive power market as large-scale industries explore alternative sources to meet their need for uninterrupted power supply. By setting up a Captive Power Plant (CPP), industries reduce their dependability on state electricity, given the high tariffs for industrial use and erratic power supply. The business models for CPP are also changing to adapt to industry requirements and the increasing focus on renewable energy. For example, the group captive model enables smaller players to meet their electricity needs without significant capital spend, as compared with the setting-up of their in-house power plant. Also, the share of solar-based CPPs has remarkably increased in recent years due to the decline in capital costs of solar infrastructure. CPP is likely to remain a viable alternative in meeting industry needs for quality and reliable power supply, including the use of renewable energy.

To promote and incentivise the setting-up of CPPs by business houses, the government provided income tax benefits by exempting the profits generated from CPP. CPPs generate power and transfer it to other business units of the taxpayer. The resultant profit arising out of such a transfer is allowed as deduction under the income-tax law. Given that the profit earned by CPP is eligible for deduction, Indian tax authorities typically dispute, inter-alia, the amount of eligible profits by challenging the notional price at which electricity is transferred by CPP to other business units for captive consumption.

Income tax regulations provide that the transfer of power from CPP to other business units should be at a "market price", i.e., a price that the product or service would ordinarily fetch in the open market<sup>1</sup>. Further, if such transfer qualifies as a Specified Domestic Transactions (SDT), market value of the transfer of power from CPP to other business units would be the "arm's-length price" determined per the transfer pricing regulations.<sup>1</sup>

Generally, taxpayers have been considering tariff rates at which the State Electricity Board (SEB) supplies electricity to industrial or commercial consumers as market price or arm's-length price for determining the transfer of power from CPP to other business units of taxpayers. Unless the taxpayer supplies the excess power generated by CPP to SEB, the taxpayer adopts the rate agreed with SEB as the market or arm's-length price. If the

CPP is likely to remain a viable alternative in meeting industry needs for quality and reliable power supply, including the use of renewable energy.

Given that the profit earned by CPP could be eligible for deduction under the income-tax law, the notional rate at which electricity is transferred by CPP to other business units for captive consumption is under the lens of and is often disputed by tax authorities.

taxpayer generates electricity through windmill and gets credit for the units generated and transferred to the SEB grid, the transfer of electricity unit is recognised at a rate at which SEB gives credit to the taxpayer.

<sup>1</sup> Explanation to Section 80-IA(8) of the Act

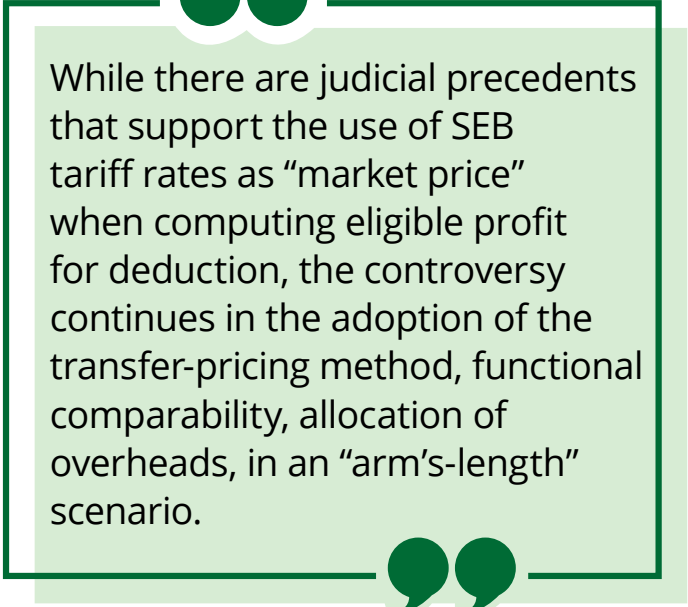
The taxpayer's approach of considering SEB's tariff rates for electricity supply as market price or arm's-length price is often challenged by Indian tax authorities. Indian tax authorities have been alleging that the rate to be adopted can be ascertained on the basis of regulated rates, fixed by the State Electricity Regulatory Commission for the sale of electricity by power-generating companies to electricity distribution companies. This approach was upheld by the Hon'ble Calcutta High Court in the case of ITC Limited<sup>2</sup>. The ruling was rendered in light of the Indian income-tax law, Indian Electricity Act, 1910, and Electricity (Supply) Act, 1948. Until 2003, the electricity regulations specifically prohibited the sale of electricity by any individual in the open market. Electricity generated by an individual was allowed to be sold only to licensed persons at regulated rates fixed by the State Electricity Regulatory Commission. Accordingly, the Hon'ble High Court was of the view that as electricity was not allowed to be sold by CPP to consumers, the price at which SEB supplies electricity to consumers should not be considered as market price in the open market. Hence, only the regulated rates fixed by the State Electricity Regulatory Commission for sale of electricity by power-generating companies to electricity distribution companies should be adopted.

However, post 2003, the regulations relating to generation and sale of electricity underwent significant amendments with the introduction of the Electricity Act, 2003. The new regulations permit the power producer to sell electricity to end consumers at negotiated prices. The above distinction in the regulatory framework was noted and adopted by the Kolkata Tribunal in the case of Birla Corporation Limited<sup>3</sup>. In this case, the Kolkata tribunal upheld the taxpayer's approach of adopting SEB tariff rates as the market price of electricity, while computing eligible profit for deduction under the Income-tax Act. Subsequently, a similar view has been adopted by various courts<sup>4</sup> and tribunals in other cases. In an arm's-length scenario as well, this rationale is finding acceptance amongst appellate authorities<sup>5</sup>.

Notably, the above judicial precedents provide significant relief to taxpayers as the courts have considered the changes in the electricity regulatory environment.

While the above judicial precedents provide support to business houses with CPPs and in availing tax incentives, the controversy around the arm's-length scenario continues

with issues, such as correct application of transfer pricing methods, functional comparability while adopting a particular rate per unit, and allocation of overheads and finance costs. Given the continued controversy, it is important to articulate and substantiate how the SEB tariff rate meets the arm's length principle, and how adopting such a rate for computing exempt profit does not result in undue tax advantage.



While there are judicial precedents that support the use of SEB tariff rates as “market price” when computing eligible profit for deduction, the controversy continues in the adoption of the transfer-pricing method, functional comparability, allocation of overheads, in an “arm's-length” scenario.

It is pertinent to note that while the government is discontinuing profit-linked deductions to rationalise income-tax rates; the aforementioned controversy could be relevant for open years and in on-going litigations of taxpayers with CPP.

#### Contributors

Setu Mankad  
Nisha Karkera  
Ashutosh Soni

<sup>2</sup> CIT v. ITC Limited (64 taxmann.com 214) (Calcutta High Court)

<sup>3</sup> Birla Corporation Limited v. DCIT (IT Appeal Nos. 686 and 1106 of 2014) (Kolkata Tribunal)

<sup>4</sup> CIT vs. Gujarat Alkalies & Chemicals Ltd. (88 taxmann.com 722) (Gujarat High Court)

CIT vs. Godawari Power & Ispat Ltd. (223 Taxman 234) (Chhattisgarh High Court)

CIT vs. Reliance Industries Ltd. (102 taxmann.com 372) (Bombay High Court)

<sup>5</sup> DCIT vs. Balarampur Chini Mills Ltd. (TS-200-ITAT-2021(Kol)-TP) (Kolkata Tribunal)

Reliance Industries Ltd vs. ACIT (TS-606-ITAT-2020(Mum)-TP) (Mumbai Tribunal)

Deputy Commissioner of Income-tax v. Vishal Fabrics Ltd. (139 taxmann.com 30) (Ahmedabad Tribunal)

DCM Shriram Ltd. v. Addl. CIT, Special Range - 3, New Delhi (TS-554-ITAT-2021(DEL)-TP) (Delhi Tribunal)

## Indirect tax

India ranks third in the world as a consumer of power, generated from coal, oil, and solid biomass. Owing to the high demand of power and shortage of existing resources, India plans to curtail its reliance on non-renewable energy sources and become the largest renewable power-producing nation in the world.

With the world's largest expansion plan in the renewable energy sector, the country has set an ambitious target to achieve a capacity of 175 GW of renewable energy by the end of 2022 (as of May 2022, is the capacity stood at 160 GW), which is slated to be expanded to 500 GW by 2030.<sup>6</sup> To achieve this target, the government has announced Production Linked Incentive (PLI) schemes worth ~INR 24,000 crore for solar power equipment, to boost the domestic manufacturing industry, as part of the government's commitment to ensure one solar city in each state.

While the solar power sector has historically been import-intensive with a concessional import duty regime, the recent

entry of domestic players, a huge demand-supply gap for locally manufactured modules, coupled with increased duty structure on imports, have significantly increased capital investment for developers, leading to costly clean-energy tariff structures across the country.

While relying on the domestic manufacturing industry for future renewable energy requirements is the need of the hour, it also entails an adequate gestation period before domestic players get into formulating and delivering state-of-the-art technology-driven solutions and quality products. Some attributes that lead to a significant increase in capital investment for the solar industry are as under:

- Basic Customs Duty applicable on import of solar cells and modules was exempted until March 2022, but has now been significantly increased to 25 percent and 40 percent, respectively, from April 2022.
- Increased GST rate for setting up solar and wind power projects from 5 percent to 12 percent, with effect from October 2021.

<sup>6</sup> Source: <https://www.investindia.gov.in/sector/renewable-energy>



- Few key components such as transformers and control systems have been brought under the tax rate bracket of 18 percent.
- Taxability of corporate/bank guarantees given by parent entities for project companies, tax on other inter-company support activities, from parent entities to group companies, treating supply of solar/wind power projects to be works contract with service taxable at 18 percent, adds up to the total cost of the project. *For power companies, input credit is not available, hence, it is adverse for working capital for project developers.*
- The introduction of “Approved List of Modules and Manufacturers (ALMM)” wherein solar modules from listed manufacturers only can be used in government/ government-assisted projects/projects under government schemes and programmes.
- Withdrawal of benefits of duty exemptions for a non-conventional power plant set-up in an SEZ area, which is otherwise available for any other SEZ unit.

So, before power producers unlock themselves from offshore dependencies, there is a need to evaluate the overall tax framework for developers to survive the competitive tariff edge, until domestic manufacturers enter the renewable equipment space and are able to cater to high demands of the renewable industry at large.

## Contributors

Gulzar Didwania

Punita Bhuchar Rana

Ankit Garg

**Therefore, some interim tax relief measures that will rebuild and revamp the energy footprint in the country are as follows:**

- 01 State-level subsidies under customised package scheme to continue for power developers and quick disposal of state-specific incentive applications for GST claims.
- 02 Lower GST rate on domestic supply of goods used in setting up projects, including battery energy storage system and extending this benefit to sub-contractors.
- 03 Non-levy of GST on corporate guarantee, cross-charges for intercompany support, etc., which is more of an outcome of the multiple-entity structure needed to be adhered to by renewable entities due to the regulatory framework.

While the above are a few alternatives that can support developers in the interim period, inclusion of electricity under GST may go a long way in reducing the overall cost for developers and at the same time, provide impetus to domestic manufacturing of solar modules and other items.

## India-UAE CEPA

India and UAE have recently entered into a Comprehensive Economic Partnership Agreement (CEPA) to foster economic, trade, and cultural ties between the two countries. The pact was signed on 18 February 2022 and went into effect on 1 May 2022.<sup>7</sup> This agreement is a trendsetter because of the short duration (88 days<sup>8</sup>) in which it was negotiated and concluded.

CEPA is expected to increase the total value of bilateral trade in goods to over US\$100 billion<sup>9</sup> and trade in services to over US\$15 billion<sup>10</sup> within five years. The CEPA covers almost all

tariff lines dealt in by India (11,908 tariff lines) and the UAE (7581 tariff lines), respectively<sup>11</sup>. As for trade-in services, Indian service providers will have enhanced access to around 111 sub-sectors from 11 broad service sectors<sup>12</sup>.

### Key benefits of the agreement

As CEPA is foreseen to further accelerate cross-border trade and investment flows between the two countries, the key benefits of the agreement for India and the UAE (individually as "contracting party") shall include:



#### Lower tariffs for trade in goods

- i) Preferential tariff rates
  - Tariff Elimination Immediate (TEI) - A majority of tariff lines will be subject to 0 percent customs duties
  - Tariff Elimination Phased (TEP) - Other tariff lines will benefit from the elimination of customs duties in a phased manner, i.e., over the period of five, seven, and 10 years
  - Tariff Reduction (TR) - Tariffs will be reduced as compared with existing customs duty rates
- ii) For a product to be eligible for duty benefit as discussed above, it will have to meet one of the following origin criteria specified in the Rules of Origin (RoO):
  - Wholly obtained or produced in the territory of the contracting party (for example, live animals, plant-based products grown and harvested in the respective country, and mineral products extracted from the respective country's soil or seabed).
  - Product having undergone sufficient work or production in the territory of the contracting party.
- iii) Conditions have been laid down in the agreement as the Product Specific Rules (PSR), along with specified value addition (3 percent, 3.5 percent, 6 percent, 7 percent, 40 percent, or 45 percent) for extending the tariff rate benefits. Mostly, the mandate has been laid down for 40 percent value addition on export items and a certificate of origin from local government authorities.



#### Boost to trade in services

CEPA is intended to enhance the mutual provision of services between the two economies, by providing an open environment and market access for the cross-border trade of services.



#### Smooth customs procedures and trade facilitation

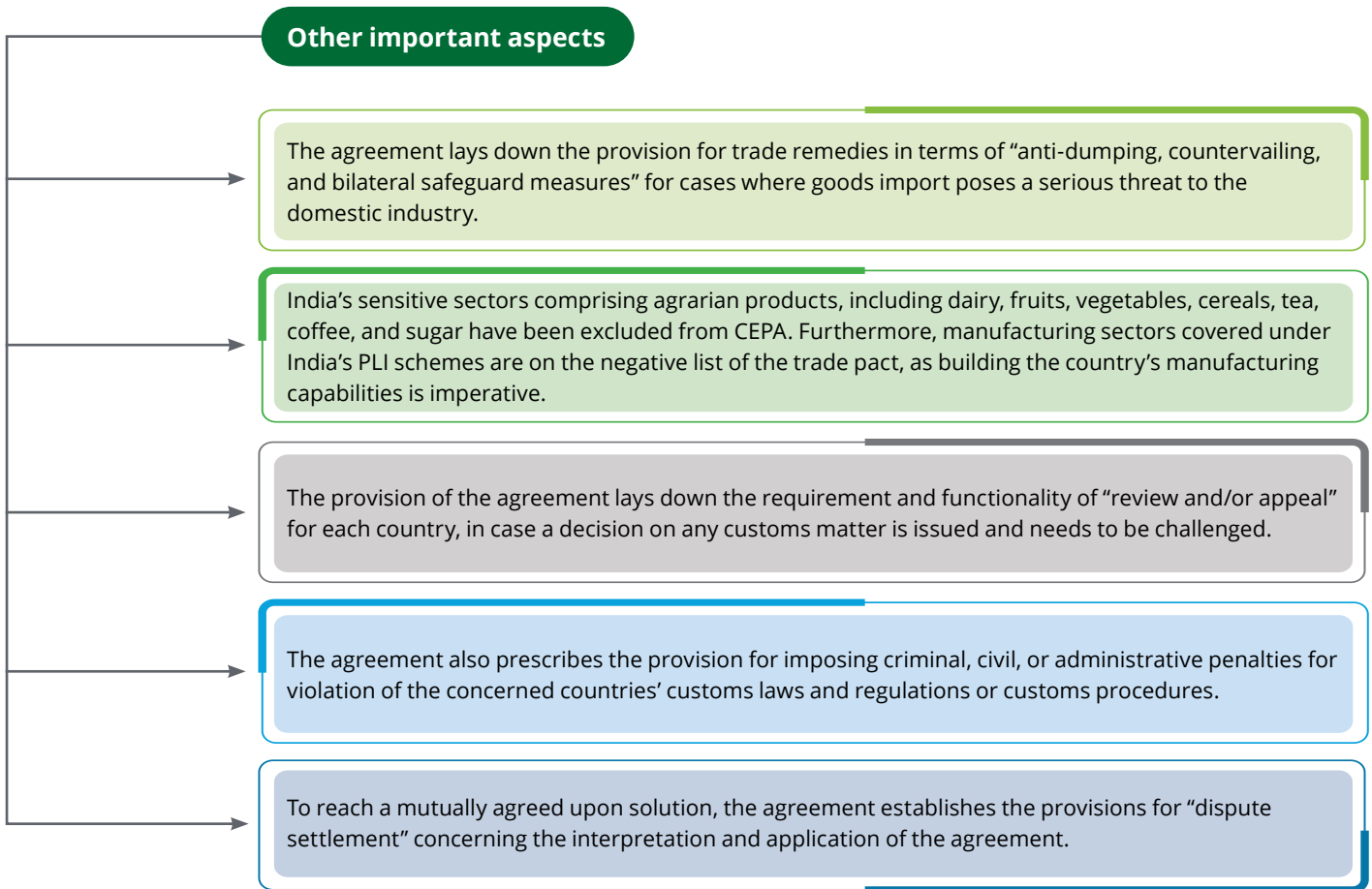
CEPA emphasises on reducing unnecessary regulatory or administrative customs procedures and adopting international best practices for customs management, such as invoice declaration of origin for approved exporters, agreement on Technical Barriers to Trade (TBT), and authorized economic operator (AEO) mutual recognition agreement.

<sup>7</sup> Press release on Secretary, Department of Commerce, flagging off the first consignment of goods under India-UAE CEPA dated 1 May 2022, <https://pib.gov.in/PressReleasePage.aspx?PRID=1821785>

<sup>8</sup> Press release on India and UAE signing the historic CEPA dated 18 February 2022, <https://pib.gov.in/PressReleasePage.aspx?PRID=1821785>

<sup>9, 10 & 10</sup> Press release on Secretary, Department of Commerce, flagging off the first consignment of goods under India-UAE CEPA dated 1 May 2022, <https://pib.gov.in/PressReleasePage.aspx?PRID=1821785>

<sup>11 & 12</sup> Press release dated 27 March 2022, <https://pib.gov.in/PressReleasePage.aspx?PRID=1810279>



### Conclusion

As the India-UAE CEPA has already taken place, businesses are analysing the benefits associated with this trade pact. The enhanced market access for Indian exporters due to the tariff reduction will be beneficial, especially for labour-intensive sectors, such as plastic, leather, furniture, gems and jewellery, and pharmaceuticals. In this regard, India will be benefit on

over 97 percent of its tariff lines, which account for 99 percent of Indian exports to the UAE in terms of value<sup>13</sup>.

Further, it is evident that CEPA will open up a host of opportunities in the form of development of new trade, investment, and innovation for both economies.

### Contributors

- Hardik Gandhi
- Manali Agarwal
- Shalini Chamaria

<sup>13</sup> Press release dated 27 March 2022, <https://pib.gov.in/PressReleasePage.aspx?PRID=1810279>



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