

# Direct Tax Alert

December 15, 2023



## Supreme Court decides on meaning of the term 'market value' for section 80-IA.

Supreme Court in recent ruling<sup>1</sup> while dealing with the issue of what shall be reckoned as market value of power captively consumed held that market value shall be price that power would fetch in an open market i.e., the rate at which power is supplied by State Electricity Board ('SEB') and not price paid by SEB for purchasing the power from the taxpayer.

### Background

- Taxpayer, a company, was engaged in the business of generation of electricity, manufacture of sponge iron, M.S. Ingots etc.
- Since electricity supplied by SEB was inadequate to meet the requirements of its manufacturing units, the taxpayer set up captive power generating units to supply electricity to its manufacturing units (Power Undertaking). Surplus power was supplied by the taxpayer to the SEB.
- SEB supplied power at the rate of Rs.3.72 per unit to its industrial units i.e., manufacturing units. As per agreement between SEB and taxpayer, surplus power from the Power Undertaking was supplied to SEB at Rs.2.32 per unit.
- During the AY 2001-02, in respect of profit of Power Undertaking the taxpayer claimed deduction under section 80-IA(1)

<sup>1</sup> C/T v. M/s. Jindal Steel and Power Limited [Civil Appeal No. 13771 of 2015]



- read with section 80-IA(4)(iv)(a) of the Income-tax Act, 1961 ('Act').
- For the units supplied to its manufacturing units i.e., for captive consumption, the taxpayer adopted the rate of Rs.3.72 per unit.
  - During assessment the Assessing Officer ('AO') observed that the profit calculated at rate of Rs.3.72 per unit was not the real profit and that the profit of Power Undertaking was inflated to claim higher deduction.
  - The AO held that rate of Rs.3.72 per unit at which power was supplied to manufacturing was not the true market value of the power.
  - Thus, AO holding it as colourable device reduced the deduction under section 80-IA by considering the rate of Rs.2.32 per unit as was agreed between taxpayer and SEB for the surplus power generated by the Power Undertaking.
  - This action of AO was upheld by CIT(Appeals). Tribunal however, allowed the deduction to taxpayer, holding that price at which electricity was supplied by taxpayer to SEB cannot be equated with market value for section 80-IA(8). It was held by Tribunal that rate of Rs.3.72 per unit was the market value for the purpose of section 80-IA(8).
  - On further appeal, the High Court answering the question in favour of taxpayer disposed of the appeal of tax department by following its own order in the case of the taxpayer itself<sup>2</sup>.
- The question before the Supreme Court was whether for purposes of computing deduction under section 80-IA the market value of the power was to be considered as (i) Rs.2.32 per unit i.e., rate at which power was purchased by SEB from taxpayer or (ii) Rs.3.72 per unit being the rate at which power was supplied by SEB to manufacturing units of taxpayer.

### Contention of the Taxpayer

- Taxpayer contended that as per section 80-IA(8) of the Act transfer of power between two undertakings should be at arm's length price corresponding to market value of such goods.
- Taxpayer stated that 'market value' would mean price that goods would ordinarily fetch in an 'open market'.
- Taxpayer contended that the stand of the AO to treat the price at which power was supplied to SEB by the Power Undertaking was not the market value as there was no open market in such case.
- Taxpayer stated that power not captively consumed by its manufacturing unit could not have been sold in an open market to any third party without prior permission of SEB.
- The restrictions imposed by SEB made it economically not viable for any third party to purchase power from taxpayer. Taxpayer submitted that there was no open market condition, and it had no option but to sell the power to SEB.
- Taxpayer contended that as SEB was the only buyer and it had virtual monopoly

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<sup>2</sup> ITA No.544 of 2006



therein, thus the rate so decided in agreement cannot be regarded as market value for section 80-IA.

- Taxpayer further contended that price at which power was supplied was not mutually decided but rather imposed by SEB upon the taxpayer under the power purchase agreement.
- Further, taxpayer stated that SEB transferred power to all industrial consumers at Rs.3.72 per unit and not at Rs.2.32 per unit. Had the manufacturing unit purchased power from SEB then it would have had to pay Rs.3.72 per unit. That price was the determinative price of the power generated by the Power Undertaking

### **Contention of the Revenue**

- Revenue contended that the surplus power was supplied by taxpayer to SEB at Rs.2.32 per unit, whereas for captive consumption power supply was done at Rs.3.72 per unit.
- Revenue argued that rate charged by SEB cannot be adopted as market value as said rate was determined after considering factors such as distribution losses, infrastructure cost for supply of power, subsidy allowed to farmers, expenses for collection of bills, etc.
- Revenue submitted that said rate was decided pursuant to an agreement between taxpayer and SEB. It was submitted that agreement was voluntarily entered by taxpayer and there was no compulsion to agree to price fixed by SEB.

- Revenue also drew attention to provisions of the Electricity (Supply) Act, 1948, highlighting that power generator is given liberty to enter into agreement with SEB for supply of power.
- Furthermore, Revenue referred to section 80A(6) of Act to submit that market value is defined inter alia to mean such price as is subject to statutory or regulatory restrictions. Basis this the Revenue submitted that restrictions agreed in agreement by taxpayer should be considered while determining the market value of the power for section 80-IA.

### **Ruling of the Supreme Court**

- Hon'ble Supreme Court agreed with the claim of the taxpayer and held that the market value in the present case was the price at which power was supplied by SEB i.e., Rs.3.72 per unit.
- Supreme Court observed that under prevailing electricity regime the power could not have been freely supplied to any consumer, also that the tariff for power was subject to statutory restrictions.
- It noted that explanation to section 80-IA(8) defines market value as price that goods or services would ordinarily fetch in open market.
- It referred to Black's Law Dictionary, 10<sup>th</sup> Edition, where 'open market' was defined to mean a place where buyer and seller can trade and where prices are determined by free competition.
- Basis above Supreme Court observed that 'market value' would mean price determined in an environment of free



trade or competition based on demands and supply, unfettered by any control or regulations.

- Considering above, Supreme Court noted that in present case the taxpayer had no room or elbow space for negotiating the price. It observed that taxpayer was compulsorily required to supply the power to SEB.
- Supreme Court therefore held that such tariff was not determined in a competitive or free environment but under a compulsive legislative mandate. Accordingly, Supreme Court held that such tariff cannot be reckoned as price determined in an open market.
- Supreme Court also held that if instead of captive power supply had the manufacturing unit purchased power from SEB, then price that the manufacturing unit would have paid was Rs.3.72 per unit.
- Supreme Court thereby concluded that market value of power should be the price at which SEB supplied power to the consumers in an open market i.e, Rs.3.72 per unit in present case.
- Reference of Revenue to provisions of section 80A(6) was dismissed by the Supreme Court by holding that section 80A(6) was effective from April 01, 2009 and was not applicable for AY 2001-02.

#### Dhruva Comments

- After a slew of Supreme Court rulings favoring Revenue, this is a welcome ruling from the Supreme Court supporting claim of the taxpayer.
- The Supreme Court has categorically accepted all contentions of taxpayer and to great extent put to rest controversy regarding interpretation of term 'market value' for section 80-IA.
- However, as regards Revenue's reliance on provisions of section 80A(6), Supreme Court has dismissed the contention holding section 80A(6) was introduced from AY 2009-10 and did not apply to assessment year under question. Accordingly, the Supreme Court has not discussed / decided on the merits of this contention of the Revenue
- The taxpayers will need to be mindful that the Supreme Court has left the field open with regard to the interpretation of section 80A(6) and to what extent it may dilute the principles laid down in this ruling.

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