

**Exhibit I : Tax Assumptions Underlying SEAP's Tariff Offers**

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Mr. K. B. Gopalakrishnan  
Senior Vice President  
SBI Capital Markets Ltd  
202 Maker Tower 'E',  
Cuffe Parade, Mumbai  
Camp: New Delhi

Dear Mr. Gopalakrishnan,

**Re: Hirma Mega Project – Customs Duty assumptions**

We refer to our letter dated Aug 02, 2000 and our subsequent discussions.

During our discussions on Aug 16, 2000 you had mentioned that PTC would like us to review our customs duty assumptions with respect to the operations phase of the project. We would like to mention that the list of assumptions backing our tariff has been available with PTC since March 2000 i.e. much before the petition was filed. Therefore, while PTC were aware of the assumptions which accompanied our tariff offer and no objections were raised either with SEAP or in the Petition. We therefore believe that it is not appropriate for them to raise this issue at this late stage, as we have been in agreement not to re-open agreed issues.

However, keeping in mind the time schedule available to all parties to resolve tariff issues and arrive at a tariff order, we are accepting SBI Caps suggestion that we amend the Memorandum to PTC on Tax Assumptions (Annexure 1 to attachment A of our letter dated Aug 02, to SBI Caps) to limit customs duty exemptions to construction period only. The marked up version of the amended memorandum is attached for your ready reference.

With kind regards

Yours sincerely,

Sanjay Kapoor  
Country Manager

## ANNEXURE 1 TO ATTACHMENT A

### HIRMA MEGA POWER PROJECT

#### Memorandum to PTC on Tax Assumptions

The HIRMA tariff proposal has been developed on the basis of a detailed set of assumptions concerning the effect on the Project's costs and distributable profits of taxes and duties levied by the Central and State Government in India. CEPA believes that it is consistent with the Indian government's policy of seeking the most economic sources of electricity that, each of the parties having had the opportunity to review and approve these assumptions, CEPA, the PTC and the off-taking SEBs agree that the tariff will not be subject to any changes in respect of taxes so long as these assumptions prove to be correct.

#### 1 Taxes on Imports

In accordance with the relevant GOI Notifications and the relevant customs regulations as amended thereby, CEPA has assumed that there will be no customs duty whatsoever payable on goods imported for, or in connection with the Project.

For the avoidance of doubt, our assumption as to the effect of this exemption is that:

- (a) goods may be imported free of duty provided that the importer is able to demonstrate to the reasonable satisfaction of the Customs authorities that the goods are for use in connection with the Project, and in respect of whether the importer is the Project Company, the EPC contractor, the plant operator or any of their respective subcontractors or suppliers of whatever tier. As set out in Customs Notification No. 63/99, the certification of the Chief Executive Officer of the Project Company in respect of any items of import shall be sufficient to ensure the availability of the exemption;
- (b) it shall not be necessary, in order to obtain the benefit of the exemption, for the relevant importer to provide copies of any CEA techno-economic approval or other regulatory approval of the Cost of the Project or its breakdown;
- (c) where a shipment of goods is imported of which only a portion is intended for use in the Project, a *pro rata* exemption from customs duty shall be applicable;
- (d) the exemption shall apply to goods of all kinds, including without limitation design drawings, computer software, and consumables such as fuel, lubricants, catalysts and other chemicals required for the ~~construction operation or maintenance~~ of the Power Station
- (e) ~~the exemption shall apply for the entire duration of the Term, as defined in the Power Purchase Agreement with PTC (PPA);~~
- (f) where goods have been imported in bulk by a wholesale importer who has paid duty on the goods, but the goods are then purchased subsequently for use in connection with the Project, the importer will be entitled to claim a refund of duty the benefit of which will be passed on to the Project Company;
- (g) where construction machinery or other equipment is imported for use in the construction, commissioning or testing of the Project, but not for incorporation into the Project the EPC contractor will be able to import such equipment free of duty, subject only to the provision of appropriate bonding which would be released upon evidence of re-export.

It is also assumed that there will be no levy of Research and Development Cess in connection with the setting up, operation or maintenance of the Power Station.

## **2 Income Tax**

The proposed form of tariff is based on the following major assumptions as to income tax;

- (a) The Project Company will benefit from the income tax deduction provisions of Section 80 IA of the Income Tax Act. In respect of this tax deduction it is further assumed that:
  - (i) the deduction will apply to income from all six Units of the power station irrespective of when they begin the generation of power for the purposes of the Act. It is therefore assumed that the Government of India will grant an extension of the current 31 March 2003 time limit if necessary;
  - (ii) all income derived from payments under the PPA1 will be treated as profits derived from the business of power generation and will therefore be eligible for deduction;
  - (iii) 100% of the taxable income during first 5 years and 30% of the taxable income during next 5 years will be exempted from income tax. This 10 year block will be available on a Unit-by-Unit basis anytime during the first 15 years from Commencement of Commercial Operations of relevant Unit.
- (b) For periods when no income tax holiday is applicable, we have assumed that taxable income up to an annual amount equal to the "Return on Equity" component under the GOI Notification Tariff (i.e. 16% of all invested equity in the Project in the currency of investment plus the amount of the applicable tax gross-up thereon under the Notification) will be taxable at the rate of 35% with no surcharge. We assumed that taxable income over and above this amount will be taxed at whatever is the prevailing rate at the time. Please note that the HIRMA tariff structure does not include any component calculated by reference to a 16% Return on Equity. It will therefore be necessary to calculate this as a notional amount for tax equalisation purposes only.
- (c) The Project Company will be entitled to claim depreciation allowances in accordance with currently applicable rules and prevailing rates, on the basis that the Project Company opts to compute depreciation using the written down values prescribed under the Indian Income Tax Act 1962. However, depreciation on pollution control equipment is assumed to be allowed at 100%.
- (d) In all other respects, the rules relating to the calculation and payment of income tax are assumed, in respect of the tax payable on annual income up to the "Return on Equity" component referred to above, to be same as those in force as at 1 December 1999.

For this purpose, we will be assuming that "Equity" means the aggregate amount in each currency of all amounts, including share premiums, which have then been paid up or subscribed to (or deemed to have been contributed to) the capital of the Project Company by any shareholders and all other amounts that have been raised by the Project Company from any form of subordinated indebtedness that has been provided or guaranteed by the Project sponsors

## **3 Tax on income under the EPC Contract**

Taxes affecting the pricing of the principal contracts for the engineering, procurement and construction of the Project have a major impact on the tariff. CEPA will be seeking competitive bids for these contracts and asking the bidders to submit tenders on the basis of certain assumptions as to the rate and applicability of taxes in India. If the actual application of taxes results in taxation at a level greater than would be the case if these assumptions applied, the contractor(s) will be entitled to claim additional costs.

The relevant assumptions are as follows:

- (e) income of the contractors
  - in respect of the CIF supply of goods and equipment from outside India

will not be subject to any income tax in India and payments under such contracts may be made by the Project Company without payment of any withholding tax.

- (f) income of the contractors in respect of the performance of design, engineering and/or procurement services outside India shall be eligible for taxation under the applicable concessional treaty for the avoidance of double taxation at a rate not exceeding 15% (on a gross income basis);
- (g) income of the contractors arising from the supply of goods and technical/engineering services and/or the performance of construction work in India by an Indian company (whether or not a subsidiary of a foreign company) will constitute business income taxable in the hands of the Indian supplier at the rate of 35%;

#### **4 Indirect Taxes**

- (h) Works Contract Tax will apply at the rate of 8% plus a 15% surcharge (giving an effective rate of 9.2%) on the gross value less the amount of labour and services charges of any sub-contracts entered into by the EPC Contractors which qualify as works contracts under the Orissa Sales Tax Act 1947. It is assumed that none of the principal contracts entered into by the Project Company:

- for the supply of goods or machinery, whether from overseas or within India;
- for the performance of civil engineering, construction, mechanical & electrical engineering or commissioning; or
- for the supply of any other goods or services,

will qualify as works contracts for these purposes.

- (i) Central Sales Tax Central Sales Tax on inter-state sales will be applicable at the concessional rate of 4% in respect of the purchase of all goods to be used in connection with the construction, commissioning, testing, operation or maintenance of the Power Station, whether such purchases are made by the Company, the Operator or their respective contractors and suppliers.
- (j) It is assumed that no State level taxes (such as octroi, entry tax, sales tax and other local taxes, including water tax) will be levied on the Project Company, its contractors and suppliers and their respective sub-contractors and sub-suppliers of any tier in respect of transactions relating to the construction, commissioning and testing of the Project. This is on the basis that the Government of Orissa (and, if required, the governments of each of the off-taking States), will grant appropriate exemptions from such taxes.
- (k) It is assumed that no excise duty will be payable on the domestic supply of any goods or any process/activity required for the Power Station. It is also assumed that there is no excise duty on generation/sale of electricity.

#### **5 Taxes affecting the Financing Cost**

Taxes which the Project Company may have to bear in regard of financing the Project will also have a major impact on the tariff. All Lenders to the project will insist in their loan documentation on indemnifications from the Project Company in respect of any taxes payable by the Lenders in or outside of India for loans made to the Project Company. The financing cost used in the calculation of the tariff is based on the following assumptions:

- (l) There will be no withholding tax on any interest payments due in respect of the financing of the Project, irrespective of the identity or nationality of the lending institution.
- (m) There will be no ad valorem Stamp Duty payable on any of the financing or security documents
- (n) No Interest Tax will be payable in India in respect of any debt funding raised by the Project Company.

- (o) All domestic lending is “qualified” for the purposes of Section 10(23)(g) of the Indian Income Tax Act 1962.

## **6 Other Taxes**

In respect of all other taxes and duties, (including taxes or duties, if any, applicable to the raising of equity financing for the project) it is simply assumed that such taxes will continue to be levied at the rates and in the manner prescribed under the relevant legislation and in accordance with any relevant court decisions or executive rulings applicable as at 1 December 1999.