Gauging effect

Implications of the Union Budget 2012 on the Oil & Gas Industry

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Contents

India Union Budget 2012 perspective 04

Economic Survey 2011-12 06

Analysis of Union Budget 2012-2013 18

Major pre-budget expectation of oil & gas industry 32

Significant policy changes and initiatives in the oil and gas industry 42

Commodity balance of petroleum & petroleum products 46

01

India Union Budget 2012 perspective

Advance Estimates released by the Central Statistical Organisation (CSO) peg India's GDP growth rate at 6.9 per cent for the year 2011-12 . These estimates indicate a clear economic slowdown when compared to the previous two years whilst also ringing the alarm bells for the government to take concrete measures for putting the economy back on a 9 per cent higher growth trajectory. Against the backdrop of political expectation management, the government was to perform the balancing act of managing growth and price stability. Amidst the global macroeconomic developments, the immediate task at hand for the government is to boost domestic consumption, keep inflationary pressures under check and reduce fiscal deficit t0 5.1 per cent of GDP. This called for addressing the structural problems with subsidy reforms being at the forefront to bring about fiscal consolidation.

Union Budget is one of the most significant economic and financial events in India. Union Budget 2012 was no exception. It was keenly being watched for what it can cause to the economy and government, both of which are challenged on stability. The Finance Minister's proposals in the budget reflect, in every manner, those challenges. Ostensibly, Union Budget 2012 clearly steered a safe path, ensured stability and thereby possibly made opportunity available for taking tough calls in future, rather than suffering for doing that now.

For the oil & gas sector, the budget was expected to provide impetus to meet national challenge of energy security. Also, it was expected to address to some of the keenly awaited structural changes. Arguably, a beginning has been made but question remains – could more have been done.

Long term plans for boost in domestic oil & gas production, creation of oil & gas infrastructure, developing unconventional gas sector, bringing in demand side efficiency in consumption of products through pricing and developing regulatory regime and such other steps by the government were expected to have been directly addressed. First look at the provisions in Union Budget 2012 do not seem to be addressing these.

A ray of hope, though, is that serious attention to fiscal deficit challenge led the budget to commit that the government will endeavour to keep the subsidy from central budget below 2 per cent in the very next year. Albeit many doubt its achievement, this is a major positive of the budget. Combined with a provision of only Rs. 43,717 Crore for oil & gas sector, this commitment leads analysts to believe that the government would take steps to pass on the cost to consumers assuming the oil marketing companies will have no capacity to take added burden. On the other front, selling LPG at market price and reimbursement of subsidy directly into the beneficiary's bank account can become reality given the success of the pilot project. If not in a short term, if executed expeditiously the confidence that "substantial economies in subsidy outgo can be achieved by the use of Aadhaar platform", and Finance Minister's announcement that, "It will be our endeavour to scale up and roll out these Aadhaar enabled payments for various government schemes in at least 50 selected districts within the next six months", will transform the subsidy disbursement and assist in reducing subsidy quantum in midterm.

Government's outlook to tax income in oil & gas sector is directionally becoming clearer. The last year, government withdrew tax holiday withdrawn earlier for gas, on oil production also from blocks awarded after April 2011. That indicated – tax breaks to the sector will be a matter of past. The direct tax amendments in Union Budget 2012 relating to lower tax rate on interest on ECB, as also relating to the accelerated weighted deduction for certain sectors dodging the oil & gas sector appear to reinforce the stance. While these decisions are harsh reality for the sector, removal of ambiguity for investors on taxability is the bright side.

Many had opined that GST is the next big reform India would need. The budget is very vocal about the government's intent to make GST happen. Not only does the Finance Minister announce introduction of the Constitutional Amendment bill, he articulates how the duties and taxes restructuring attempted in this budget is for convergence to GST. The proposed negative list would, as such, help broad base the taxes and is a definite step towards GST. The upstream industry has sticking service tax costs, which go up by 2 per cent in this budget. This is certainly worrisome for the sector, specially under circumstances of oil sector not being favoured for benefit of GST.

The oil & gas industry ought to proceed with confidence to 2012-13 with agenda for capacity growth. Afterall after presenting the Union Budget the Finance Minister also mentioned – budget is not the only window to change!

02

Economic Survey 2011-12

Economic Division of Ministry of Finance, Government of India released Economic Survey 2011-12 on March 15, 2012. The following excerpts of the Survey present the macroeconomic context to the developments in oil and gas sector for the year 2011-12.

Source: Economic Survey 2011-2012

State of Economy

In the financial year 2011-12, the Indian economy witnessed a slowdown in economic growth primarily attributed to weakening industrial growth. As per the Advance Estimates (AE) released by the Central Statistical Organisation (CSO) on February 7, 2012, the economy is expected to register a growth rate of 6.9 per cent in 2011-12, after having grown at a rate of 8.4 per cent in each of the two preceding years. The growth in real GDP in 2011-12 has been the lowest in nine years with the only exception being the year 2008-09, when the growth rate was 6.7 per cent.

At a sectoral level, growth is estimated to be 2.5 per cent for 2011-12 for agriculture and allied sectors, a little lower than expected. Growth in the services sector is likely to be 9.4 per cent in 2011-12 as against 9.3 per cent in 2010-11. Thus, even though, agriculture and services continued to perform well, it is mainly the growth in industry dipping to 3.9 per cent in 2011-12 that has led to the slowdown in real Gross Domestic Product (GDP) growth.

Indian economy has not been insulated from the global macroeconomic developments in 2011-12. The crisis in the eurozone area, near-recessionary conditions prevailing in Europe, sluggish growth in many other industrialized countries like USA, stagnation in Japan and hardening international prices of crude oil have affected the Indian economy. Domestic factors such as the tightening of monetary policy with the intent to control inflation resulted in some slowing down of investment and growth particularly in the industrial sector.

There were also the pressures of democratic politics, which slowed reforms. Keeping these factors in view, it seems reasonable to endorse the CSO's AE of 6.9 per cent growth for this year.

Although confronted with the mammoth challenge of striking a balance between the twin conflicting objectives of managing growth and price stability, the outlook for growth for the Indian economy looks promising with visible signs of gradual upswing in economic activity. Calculations based on tracking several statistical indicators and projections of incremental capital-output ratios lead to a forecast of the growth rate of real GDP for 2012-13 to be 7.6 (+/-0.25) per cent.

Prices

Headline year-on-year Wholesale Price Index (WPI) inflation, after remaining persistently high over the past two years, has started to show signs of moderation lately. Financial year 2011-12 started with a headline inflation of 9.7 per cent, which briefly touched double digits in September 2011 before coming down to 6.6 per cent in January 2012. Consumer price inflation (CPI) for the major indices declined to below 7 per cent in December 2011, and fell further in January 2012.

One of the major contributory factors to headline inflation during the financial year 2011-12 was the persistently high international (Brent) crude petroleum prices in the last two years averaging around US$111 per barrel (/bbl) in 2011 (January- December) as compared to US$80/bbl in 2010 (January-December). Thus, inflation in fuel has continued to remain high during the last two years. High crude oil prices coupled with the limited pass through of fuel prices resulting in higher levels of subsidies leading to increased fiscal deficit.

The sharp rise and volatility of prices of oil and petroleum products in international markets has become a matter of global concern. Crude oil prices remained volatile during financial year 2011-12 due to political upheaval in the major oil-exporting countries coupled with increasing uncertainly in the global economic environment. Crude oil prices have steadily been increasing since December 2008. International crude oil (Brent) prices have moved up very sharply from US$ 75 per barrel to over US$ 114 per barrel in June 2011, a 52 per cent year-on-year increase. Simultaneously, the average price of the Indian basket of crude oil which was US$ 69.76 per barrel in 2009-10 has gone up to US$ 85.09 per barrel in 2010-11 and further to US$ 109.97 per barrel in 2011-12 (up to December 2011). The pass through of higher international crude oil prices on the domestic front was clearly evident as inflation in non-administered mineral oil, which consists of aviation turbine fuel, bitumen, furnace oil, and naphtha, recorded an increase of 41 per cent between September 2010 and January 2011. In comparison, inflation in administered mineral oil prices (liquefied petroleum gas [LPG], kerosene, and diesel) recorded an increase of only 11 per cent in the same period.

Global prices of crude oil and petroleum products play a decisive role in the domestic pricing of petroleum products since more than 75 per cent of the country's crude oil requirement is met through imports. Therefore, the price of crude oil and petroleum products in the international oil markets has considerable impact on domestic prices of petroleum products. With the dismantling of administered petrol prices (with effect from 26 June 2010), prices of petrol have risen by 12.46 per cent during 2011-12 (April- December) from Rs. 58.37 per litre (April 2011) to Rs. 65.64 per litre (December 2011). Despite the increase in international oil prices, Indian consumers have been partially insulated from the adverse impact of price rise, as the prices of three important petroleum products, namely public distribution system (PDS) kerosene, LPG, and diesel continued to be administered by the government and the price rise has been passed on only partially. During April-December 2011-12 with the increasing subsidy burden and mounting under recoveries of Oil Marketing Companies (OMCs), the prices of PDS kerosene were moderately revised upwards from Rs.12.73 per litre to Rs.14.83 per litre , i.e. an increase of 16.50 per cent, and diesel from Rs. 37.71 per litre (April 2011) to Rs. 40.91 per litre, i.e. 8.49 per cent increase. The prices of domestic LPG cylinders have also been increased by 15.53 per cent from Rs. 345.35 per cylinder to Rs. 399 per cylinder. As a result, domestic fuel inflation was 14.21 per cent in January 2012.

But even after these increases, the products remain heavily subsidized, with prices lower than in most countries, including among regional neighbours such as Sri Lanka and Bangladesh. The OMCs are incurring huge under-recoveries owing to non-revision of selling prices of diesel, domestic LPG, and PDS kerosene in line with their prevailing international prices. During the current financial year (April- September), the OMCs have incurred under recoveries of Rs. 64,900 crore against total under recoveries of Rs. 78,190 crore during 2010-11 and Rs. 46,051 crore in 2009-10. To reduce the adverse impact of rising crude oil prices on the consumer, the government also removed the 5 per cent custom duty on crude oil, brought down import duty on petrol and diesel from 7.5 per cent to 2.5 per cent, and reduced excise duty on diesel by Rs. 2.60 per litre (with effect from 25 June 2011). Further, in view of the importance of the household fuels, namely PDS kerosene and domestic LPG, the Government decided that the subsidies on these products will be continued. The PDS Kerosene and Domestic LPG Subsidy Scheme 2002 as well as the Freight Subsidy (for far-flung areas) Scheme 2002 have also been extended till March 31, 2014.

External trade

During the first half of 2011-12, India's exports witnessed a high growth of 40.6 per cent. However, since October 2011 there has been a deceleration in export growth as a result of the crisis originating in the periphery of the euro zone area and spreading to the core economies resulting in a now evident mild recession in the euro area. Exports registered a high growth of 61.1 per cent in July 2011. After that growth decelerated to 41.5 per cent, 25.2 per cent, and 18.1 per cent in August, September, and October 2011 respectively.

In November 2011, export growth was negative at - 0.5 per cent but in December 2011 and January 2012, it was positive but low at 6.7 per cent and 10.1 per cent respectively.

Cumulative exports were at US$ 242.8 billion, registering a growth of 23.5 per cent during 2011-12 (April- January). During April-December 2011, petroleum and oil products as emerged as one of the export sectors that have done well registering a growth of 55 per cent.

India's merchandise imports which fell to US$288.4 billion with a negative growth of - 5.0 per cent in 2009-10 due to the global recession recovered sharply to US$ 369.8 billion in 2010-11 with a growth of 28.2 per cent. This was due to the increase in growth of petroleum, oil and lubricant (POL) imports by 21.6 per cent and non-POL imports by 31.1 per cent. POL import growth was high mainly due to increase in import price of the Indian crude oil import basket by 22 per cent in 2010-11 as against - 16.5 per cent in 2009-10. POL import volume growth decelerated from 15 per cent in 2009-10 to 4 per cent in 2010-11.

Imports in 2011-12 (April-January) at US$ 391.5 billion registered a growth of 29.4 per cent with estimated growth in 2011-12 (April-December) of the important sectors at 40.4 per cent for POL. During 2011-12 (April-January) POL imports at US$ 118 billion, grew by 38.8 per cent.

Trade deficit (on customs basis) increased by 8.2 per cent to US$ 118.6 billion in 2010-11 from US$ 109.6 billion in 2009-10. However, trade deficit for 2011-12 (April-January) at US$ 148.7 billion was 40.4 per cent higher than the US $ 105.9 billion in 2010-11 (April- January). Low export growth and moderate import growth which have led to the high trade deficit in 2011-12 (April-January) have raised the alarm of a possible unmanageable current account deficit.

Net POL import growth (Table), which has been positive since 2002-03 and became negative at -8.9 per cent in 2009-10, turned positive again in 2010-11 with a growth of 9.8 per cent. In the first half of 2011-12 the growth was 34 per cent reflecting the higher international crude oil price affecting the dominant import side more than the export side.

Growth in POL trade (US$ terms)

	Total imports	POL imports	POL exports	Net POL imports
2001-02	1.7	-10.5	12	-13.6
2002-03	19.4	26	21.6	26.8
2003-04	27.3	16.6	38.5	12.9
2004-05	42.7	45.1	95.9	34.4
2005-06	33.8	47.3	66.5	41.4
2006-07	24.5	30	60.5	19
2007-08	35.5	39.4	51.8	33.3
2008-09	20.7	14.7	-5.2	25.7
2009-10	-5	-5	4.6	-8.9
2010-11	28.2	22	46.5	9.8
2011-12 (Apr.-Sept.)	32.7	47.7	72.7	34.0

Source: Computed from DGCI&S data

With the share of POL in total imports remaining steady at around 31 percent both in 2000-01 and 2011-12 (April-September) and share of POL exports to total exports increasing from 4.3 percent to 20.9 per cent, the share of net POL imports in total imports has fallen from 27.2 per cent to 18.4 per cent during this period.

With respect to the export composition, while the share of petroleum crude and products increased by 11.8 percentage points during the 10-year period from 2000-1 to 2009-10, it further increased by 4.8 percentage points from 2009-10 to the first half of 2011-12. A point to be noted is that most of the petroleum exports of India are refined exports and qualify for the category of manufactures. Export growth of petroleum, crude, and products was also very high due to the high prices of crude oil and also due to increase in refining capacity. The compositional change from 2000-01 to the first half of 2011-12 can also be seen in the destination-wise exports of major items. While the gain in share of petroleum, crude and products in India's export to the EU has been higher than to US with an increase of around 17 percentage points, the decrease in share of manufactured goods in India's exports to the EU is also high at around 13.7 percentage points. However, there has been a dramatic rise in the share of petroleum, crude and products in India's exports to China.

As far as import composition is concerned, the share of POL imports, which fell from 31.3 per cent in 2000-01 to 28.6 per cent in 2010-11 rose again to 31.4 per cent in the first half of 2011-12 due to high prices of crude oil.

Subsidies

Of the major items in non-plan revenue expenditure, it is the subsidies that are policy driven and amenable to reforms. Given the rising trend in some of the subsidies, recent budgets have focused on comprehensive reforms without compromising on entitlements to the poor.

Petroleum products' subsidies have gone up in the recent years on account of high global prices of crude petroleum. Given the high headline inflation levels, the pass through of global prices to the domestic market was limited. Major subsidies grew appreciably in 2010-11 and were at Rs. 1, 31,212 crore. While Budget Estimates (BE) 2011-12 placed them at Rs. 1, 34, 411 crore, given the build-up so far in crude prices, they are likely to be much higher this year. As a proportion of GDP major subsidies exceeded the 2 per cent mark in 2008-09 and 2009-10. In BE 2011-12, they were placed at 1.5 per cent of GDP.

The distortions that arise from price controls are manifold. Firstly, to lower the price of a good by government diktat means subsidizing both the rich and the poor. Thus by lowering the price of diesel, large car owners also get the subsidy. However, preventing this by creating a dual price promotes bureaucratization and incentives for cheating and corruption.

Another problem that arises from price controls are that firms producing these goods end up making a loss. So, the government has to subsidize these firms or pay for their 'under recoveries' to make sure that these goods are manufactured. This in turn means a larger fiscal deficit with all its attendant costs with no incentives for the firms to be efficient and cut costs, as they know that in the end they will be given a subsidy by the government to cover their costs.

There is a third problem with price controls. Prices are signals to consumers and sellers and to all those who deal in these products of shortages and abundance. Prices rise when there is a shortage and decline when there is a glut. Once prices are controlled, these signals are cut off. For instance, in case of diesel, when the international crude price rises, for India, which has to import the bulk of this product, there is, effectively, a shortage. If prices were left to the market, diesel price would rise in response to this, ordinary people would economize on their use of diesel and demand would decline, as indeed needs to happen during a shortage. In India, this rarely happens, because the signal of shortages and rising cost of inputs in the area of many fuels and energy resources is not permitted to be transmitted to the consumers.

All these costs add up massively, creating inefficiencies, large deficits and extra inflationary pressures (for goods and services that are not controlled). Hence, steps in India have to be taken to move away from price controls. This does not mean leaving the poor open to the vulnerabilities of the market. It means that poor should be subsidized, wherever possible, directly, that is by shoring up their income by making transfers to their bank accounts or giving them cash.

With India's growing sophistication in information technology and ability to identify individuals by bio-markers, this is now entirely within the realm of the possible. Of course, change always means some transactions costs.

Towards this end the recommendations of the Report of the Task Force on an IT Strategy for the PDS (public distribution system) and an implementable solution for direct transfer of subsidies on food and kerosene are important.

Report of the Task Force on an IT Strategy for PDS and an implementable solution for the direct transfer of subsidy for Food and Kerosene

The Task Force on 'An IT strategy for PDS and an implementable solution for the direct transfer of subsidy for food and kerosene' was constituted by the Planning Commission under the Chairmanship of Nandan Nilekani, Chairman, UIDAI. The Task Force was mandated to recommend an IT strategy for PDS reform and suggest a solution for direct transfer of subsidies on kerosene, LPG, and fertilizer to the intended beneficiaries. The Terms of Reference of the Task Force were to identify and suggest required changes in the existing systems, processes and procedures; suggest IT frameworks and supply chain management; recommend institutional mechanisms to implement IT strategy for the PDS; and examine and suggest an implementable solution for direct transfer of subsidies on food and kerosene to intended beneficiaries with the use of Aadhaar (Unique Identification Numbers), Aadhaar enabled transactions, and Aadhaar authentication infrastructure. The Task Force submitted its report in October 2011 and the main recommendations are as follows:

- Set up a strong, robust IT infrastructure backbone to reform the functioning of PDS which would be an incentive based system for all stakeholders.
- End-to end computerization of PDS across the country and provision of a token-agnostic technology solution that can accept physical coupons, smartcards, electronic coupons, and facilitate direct cash transfers.
- PDS Network (PDSN), as the National Information Utility (NIU) to be the common software platform for all States, to implement and operate the IT infrastructure for PDS. PDSN as the technology back office would manage all IT operations related to PDS with focus on supply chain management to address leakages, real time fraud analytics, entitlement portability and transparent grievance redressal channel.
- Aadhaar (UIN) to be used in PDS to simplify ration card registration, cleaning up the beneficiary database; State Governments can use Aadhaar Payments Bridge and Aadhaar Enabled Payments Systems to channel subsidy funds for approved commodities to Aadhaar-enabled Bank Accounts.
- Provision of maximum choice to the beneficiaries in terms of location, mix of commodities, convenient quantities and in any number of installments; and choice to purchase commodities or receive a direct transfer of subsidy.
- The organizational structure to operationalise the PDS to consist of a Governing Board appointed by the shareholders of PDSN which includes Government of India and other stakeholders with the Chairman of the Board appointed by Government of India. The CEO of PDSN would be selected through an open selection process by the Board.
- Set up a Core Subsidy Management System (CSMS) for direct transfer of subsidies on kerosene, LPG, and fertilizer through Aadhaar Enabled Bank Account (AEBA) to facilitate robust identification of the beneficiary. The CSMS would support all forms of direct transfers of subsidies such as non-cash transfers, conditional cash transfers, direct cash transfers etc. CSMS would be responsive to the needs of beneficiaries, provide increased transparency, grievance redressal and real time transfer of funds.

Implementation of the Unique Identification (UID) project has progressed and about 13 crore Aadhaar numbers (UID numbers) have already been generated. The Aadhaar number has been recognized as valid proof of identification /proof of address for obtaining new LPG connections. This will considerably simplify the process of disbursement of welfare funds by government departments

India has lived with controlled prices of a variety of petroleum products for a long time and it is not easy to move away from this. Petrol was decontrolled on 25 June 2010; on the same day it was announced that diesel would also be decontrolled but that has not yet happened. The basic problem arises from the fact that petrol and diesel marketing has been a controlled sector for so long (with a system of paying public sector companies subsidies to cover their costs) that virtually all private players have exited this market.

In a market, where all dominant players are public-sector companies, 'market price' is not a very meaningful concept. So as a first step, there is a need for a transparent formula on petrol pricing—if the price of crude is x and the exchange rate y, then every month or fortnight, government announces a maximum price of petrol, which anybody can work out from the x and the y. The rule has to be worked out to make sure that the Oil Marketing Companies can, in general, cover their costs. This will mean that if one company can innovate and cut costs, it will make greater profits. Hence, firms will be more prone to innovate and be efficient under this system. Once the rule is announced, there should be no interference by government. If this is done for a while, private companies will re-enter this market. And once a sufficient number of them are in the fray, the rule-based pricing can be removed and let to the market (subject to, of course, the usual regulations of antitrust and other competition laws).

For diesel, a possible intermediate step is to fix a per litre subsidy from the government. In other words, for every litre of diesel sold by an Oil Marketing Company, the government will give a fixed subsidy of a certain number of rupees. This is not ideal but as an interim measure has several advantages. Since this subsidy is fixed per litre, the government's fiscal burden will not have to take on the full share of the burden created by a rise in the price of crude. The only change in burden will be caused by changes in the aggregate consumption of crude, which is a fairly predictable number. Second, the signalling role of price will now be largely intact. If the price of crude rises, with the subsidy per litre fixed, the consumer's price will rise and so the signal to save on the use of diesel will be transmitted. In the order to cushion the consumer, the per-litre subsidy will be raised if the price rises too high. What is important is that the subsidy should be pre-specified so that, thereafter, government stays fully out of the picture. Whether or not, a per litre subsidy is given, till such time when more private firms enter this business, there may be a formula-based upper bound on the consumer price. Being formula based, this will move up and down with the international price of crude and the exchange rates and the upper bound will be set so as to ensure that the firms can cover their costs. It is possible to have an upper bound even after private players enter the market, but the purpose of the upper limit will, in that case, be like an antitrust measure to rule out collusive price hikes.

Overview of Performance of Oil and Gas Sector

During the current financial year (2011-12), production of crude oil is estimated at 38.19 million metric tonnes (MMT), which is about 1.33 per cent higher than the 37.70 MMT produced during 2010-11. Domestic crude oil production during April-December 2011-12 was 28.70 MMT showing a growth of 1.9 per cent over the same period of the previous year. Crude oil production by Rajasthan Cairn Energy India Pvt. Ltd. had started with effect from 29 August 2009. The crude oil production from Rajasthan block during April-December 2011 was 4.80 MMT against total production of 5.148 MMT during 2010-11.

Natural Gas production during April-December 2011-12 was 36.19 billion cubic metre (BCM) as compared to 39.68 BCM during the same period of the previous year. The projected production for natural gas, including coal bed methane (CBM) for 2011-12 is 51.67 (BCM), which is 1.05 per cent lower than the actual production of 52.22 BCM in 2010-11. The current gas production during April-December 2011-12 from KGD6 field is about 12.36 BCM against the actual production of 15.82 BCM during the same period in 2010-11. The gas production has reportedly decreased due to drop in pressure in the wells and increased water ingress leading to lower output of gas per well.

Exploration of Domestic Oil and Gas

As on April 1, 2011, investments made by Indian and foreign companies was of the order of US$ 15.88 billion, out of which, US$ 8.51 billion was on hydrocarbon exploration and US$7.37 billion on development of discoveries. At present, after conclusion of eight rounds of New Exploration Licensing Policy (NELP), 235 production-sharing contracts have been signed. With a view to further accelerating the pace of exploration, in the ninth round of NELP (NELP-IX), 34 exploration blocks were offered. These 34 exploration blocks include 8 deepwater blocks, 7 shallow water blocks, 11 on-land blocks, and 8 Type-S on-land blocks. On-land blocks are spread over six states, namely Assam (2), Gujarat (11), Madhya Pradesh (2), Rajasthan (2), Tripura (1) and Uttar Pradesh (1). Bids for 33 blocks are under evaluation and blocks are likely to be awarded during 2011-12.

Domestic Exploration of Other Gaseous Fuels

Coal Bed Methane (CBM)

India has the fourth largest proven coal reserves in the world and holds significant prospects for exploration and exploitation of CBM. Under the CBM policy, 33 exploration blocks have been awarded in the states of Andhra Pradesh, Assam, Chhattisgarh, Gujarat, Jharkhand, Madhya Pradesh, Maharashtra, Orissa, Rajasthan, Tamil Nadu and West Bengal. Out of the total available coal-bearing area of 26,000 sq. km for CBM exploration in the country, exploration has been initiated in about 17,000 sq. km. The prognosticated CBM resources in the country are about 92 trillion cubic feet (TCF), out of which only 8.92 TCF has so far been established. Commercial production of CBM in India has now become a reality with current CBM gas production of about 0.23 million metric standard cubic metre per day (MMSCMD). The CBM gas produced in the country is being utilized by the nearby industries in and around Raniganj block in West Bengal. Efforts are also being made in Sohagpur block in Madhya Pradesh, Raniganj (south) in West Bengal and Jharia in Jharkhand for commencement of commercial production at the earliest.

Shale Gas

Shale gas can emerge as an important new source of energy in the country. India has several shale formations which seem to hold shale gas. These formations are spread over several sedimentary basins such as Cambay, Gondwana, Krishna-Godawari and Cauvery. The Directorate General of Hydrocarbons (DGH) has initiated steps to identify prospective areas for shale gas exploration. A multi-organizational team (MOT) of DGH, Oil and Natural Gas Corporation (ONGC), Oil India Limited (OIL) and Gas Authority of India Limited (GAIL) has been formed by the government for analysing the existing data set and suggesting the methodology for shale gas development in India. Further, the Ministry of Petroleum and Natural Gas has signed a memorandum of understanding (MoU) with the USA on October 6, 2010 for assessment of shale gas resources in India, imparting training to Indian geo-scientists and engineers, and providing assistance in formulation of regulatory frameworks.

Equity Oil and Gas from abroad

In view of an unfavourable demand-supply balance of hydrocarbons in India, acquiring equity oil and gas assets overseas is one of the important components of enhancing energy security. The government is encouraging national oil companies to aggressively pursue equity oil and gas opportunities overseas.

Total availability of oil and gas through these overseas contracts is equivalent to around 10.5 per cent of domestic production. The acquisition of overseas oil and gas has been primarily spearheaded by ONGC Videsh Limited (OVL), the wholly owned subsidiary of the ONGC. Apart from OVL (40 Projects in 15 Countries), the other oil public-sector units (PSUs), namely Indian Oil Corporation Limited (IOCL) (9 Projects in 6 Countries), Oil India Limited (OIL) (12 Projects in 8 Countries), Bharat Petroleum Corporation Limited (BPCL) (12 Projects in 7 Countries), GAIL India Limited (4 Projects in 2 Countries) and Hindustan Petroleum Corporation Limited (HPCL) (2 Projects in 2 Countries), have acquired overseas exploration acreages. Among other government companies, the Gujarat State Petroleum Corporation (GSPC), a Government of Gujarat enterprise, has also acquired overseas hydrocarbon-bearing assets. The total investment by oil PSUs (OVL, OIL, GAIL, IOCL, BPCL and HPCL) overseas is more than Rs. 64,832 crore, which includes two pipeline projects in Sudan and Myanmar. OVL's total oil and gas production from its overseas assets in Sudan, Vietnam, Venezuela, Russia, Syria, Colombia, and Brazil during 2010-11 was about 9.45 million metric tonnes of oil equivalent (MMTOE). In 2011, the consortium of OVL (OVL-25per cent) and KazMunaiGas (KMG- 75 per cent) has acquired stake in Satpayev block, Kazakhstan. The production from the OVL assets abroad in Sudan, Sudan south, Vietnam, Venezuela, Russia, Syria, Colombia, and Brazil was about 6.76 MMTOE during April-December 2011 as against 7.06 MMTOE in the corresponding period of the previous year. The reason for the shortfall is mainly geopolitical upheavals in Sudan and Syria.

Import of Liquefied Natural Gas (LNG)

To cater to the country's growing gas demand, Petronet LNG Limited (PLL) is constantly engaged with various LNG producers/suppliers as well as upcoming conventional and nonconventional LNG projects especially in Western Australia. During 2010-11, PLL imported 8.64 million metric tonnes (MMT) of LNG at its Dahej Terminal. Total LNG imports during April-December 2011 were to the tune of 8.17 MMT against the total import of 8.95 MMT during 2010-11.

In 2011, PLL has also entered into an MoU with Gazprom Marketing and Trading Singapore Pte. Ltd. (affiliate of OAO Gazprom, Russia) for sourcing up to 2.5 million metric tonnes per annum (MMTPA) of LNG on long-term basis and pursuing discussions on a sale and purchase agreement.

Possibilities are also being explored for availability of any diversion of gas available in the US market on account of shale gas finds. PLL is developing another greenfield project of 5.0 MMTPA capacity at Kochi in the State of Kerala. The construction is going on full swing and the terminal is scheduled to be commissioned by the last quarter of 2012. PLL is planning to expand its Dahej terminal capacity from 10 MMTPA to 15 MMTPA. In addition to this, it is exploring the possibility of setting up an LNG terminal on the east coast of India and has shortlisted certain ports. A preliminary market demand assessment study has been carried out and preparation of a Detailed Feasibility Report has been initiated.

Refining Capacity

The total refining capacity in the country as on 1 January 2012 is 193.39 MMTPA, of which 116.89 MMT is in the public sector, 6.00 MMT in joint ventures, and the balance 70.50 MMTPA in the private sector. Out of the 21 refineries operating in the country, 17 are in public sector, 3 in private sector, and 1 is a joint venture of BPCL and Oman Oil Company. The refinery capacity is further expected to increase to 214.07 MMTPA by the end of 2011-12. Refinery production (crude throughput) during 2010-11 had reached 206.15 MMT (including Jamnagar Refinery under a special economic zone [SEZ] by Reliance Industry Ltd.), showing an increase of 6.9 per cent compared to 192.77 MMT in 2009-10. During the current financial year (April-December 2011-12), refinery production was 158.26 MMT. The country is not only self-sufficient in refining capacity for its domestic consumption but also substantially exports petroleum products. During 2010-11, the country exported 59.13 MMT of petroleum products worth Rs. 1, 96,112 crore.

Pipeline Network and City Gas Distribution (CGD) Network

There has been substantial increase in the pipelines network in the country with 31 product pipelines of a length of 11,274 km and capacity of 69.19 MMT at present.

With increased availability of gas in the country, the network of city gas distribution (CGD) has been enlarged to cover various cities supplying gas for domestic consumers, public transport, and commercial/ industrial entities. At present, there are a total of 588 CNG stations spread across the country. The current consumption of gas in the CGD network, operating in 43 geographic areas (GAs), is around 14 MMSCMD of which 6.63 MMSCMD is from regasified liquefied natural gas (RLNG). In Vision 2015, it is envisaged to provide piped natural gas (PNG) to more than 200 cities across the country. The Petroleum and Natural Gas Regulatory Board (PNGRB) has recently invited bids for authorization of CGD in these cities. The PNGRB has envisaged a roll-out plan of CGD network development through competitive bidding in more than 300 possible GAs on the basis of expressions of interest (EOI) submitted to the Board and on suo moto basis. During the Twelfth and Thirteenth Plans, the PNGRB has targeted a roll-out of CGD projects in 121 and 150 cities respectively.

Rajiv Gandhi Gramin LPG Vitaran Yojana (RGGLVY)

Vision 2015 adopted for the LPG sector inter alia focuses on raising the population coverage of LPG in rural areas and areas where LPG coverage is low. The RGGLVY for small size LPG distribution agencies has been launched on October 16, 2009. Under this scheme 5.5 crore new LPG connections are to be released to cover 75 per cent population as LPG users by 2015. Public-sector oil marketing companies (OMCs) are assessing/ identifying locations in a phased manner under the RGGLVY. Advertisements inviting applications for distributorships under the scheme have been released by OMCs in 26 states. Letters of intent (LOI) has been issued for 1,377 locations out of which 782 distributors have already been commissioned. Selection for the rest of the locations is in progress.

Free LPG Connections to BPL Rural Households

A proposal for release of one-time grant of Rs. 1400 to each BPL household for a new LPG connection up to a limit of 35 lakh families per year has been formulated by the Ministry of Petroleum and Natural Gas. One-half of this expenditure is to be borne out of gross budgetary support (GBS) and the remaining 50 per cent is to be borne partly from the corporate social responsibility (CSR) funds of the six major oil companies, i.e. ONGC, IOCL, BPCL, HPCL, OIL, and GAIL, and partly by the three oil marketing companies IOCL, BPCL, and HPCL in the ratio of LPG connections released to BPL families by each company. During 2011-12, a total of 8 lakh connections will be released. The financial implication for these 8 lakh connections is estimated at Rs.112 crore.

One of the foremost challenges in the coming years is to meet the energy requirement. The Twelfth Plan projections made by the Planning Commission indicate that for a GDP growth rate of 9 per cent per year, energy supply has to grow at around 6.5 per cent per year. The ability to meet the energy requirement would depend upon the ability to expand domestic production in the critical sub-sectors such as petroleum, natural gas, and coal, and meeting the balance requirement through imports.

Energy requirements and import dependency in critical components are expected to be as given in table below.

Projected Primary Commercial Energy Requirement (MMToE)

	2010-11[a]	2016-17[b]
Oil	164.32	204.8
Of which imports	125.5	164.8
	(76.4%)	(80.5%)
Natural Gas & LNG	57.99	87.22
Of which imports	10.99	24.8
	(19%)	(28.4%)
Coal	272.86	406.78
Of which imports	54	90
	(19.8%)	(22.1%)
Lignite	9.52	14
Hydro	10.31	14.85
Nuclear	6.86	9.14
Renewables	0.95	1.29
Total Energy	522.81	738.07
Total Imports	190.97	280.12
	(36.53%)	(37.95%)

Source : Approach to the Twelfth Five Year Plan, Planning Commission
Note:
[a]Provisional data;
[b]On the assumption that annual demand /growth would be 6.5 per cent up to 2016 17. The figures include use of oil and gas feed stock for fertilizer and other non-energy use. MMToE is million metric tonnes of oil equivalent.

Reforms are necessary in the energy-pricing policy. While the overall energy prices, as reflected by the wholesale price index (2004-05=100), seem to have increased faster than the prices for all commodities, relative prices within the energy components indicate a varying trend. Prices, particularly of electricity and petroleum products under the administered price mechanism have recorded much lower relative growth as can be seen in table that follows.

The Ministry of Statistics and Programme Implementation (MOSPI) has been monitoring the progress of all central-sector projects costing Rs. 150 crore and above. The flash report for the month of October 2011 tracks the progress of 583 projects in different sectors. There has been a delay in 29 petroleum projects. Likewise cost overruns of 17 projects in the petroleum sector are expected to be 32 per cent. While the project delays are due to exogenous factors beyond the control of the implementing agencies, in the majority of cases the delays are mainly due to a dismal record of project implementation starting from project identification and designing to undue delays in procurement (both tendering and contracting) and ineffective project monitoring. Such delays increase project risks and costs and could be minimized.

Wholesale Price Index for Fuel Group of Commodities (2004-05=100)

	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12[b] Apr.-Dec.(P)
Financial Averages							
All commodities	104.5	111.4	116.6	126	130.8	143.3	154.9
Crude petroleum	109.8	127	136.6	149.7	181.4	202.8	284.3
	117.6	117.7	121.7	151.3	156.5	165.3	184.6
Electricity	102.6	105.3	106.2	106.4	107.4	113.2	114.4
Administered petroleum products[a]	115.2	123.5	119.7	128.9	125.1	144.8	161.1
Other petroleum products	122.7	142.2	151.2	191.2	176.3	205.5	258.1
Overall fuel index	113.4	121.3	121.9	135.8	134.9	151.4	173
Relative index							
Crude	96.7	104.6	112	109.8	134.3	133.9	164.3
Coal	103.9	97.1	99.8	111.8	116	109.2	106.8
Administered petroleum products	101.6	101.8	98.2	95	92.7	95.6	93.1
Other petroleum products	108.1	117.2	124	139.5	130.4	135.6	149.1
Electricity	90.6	86.9	87.2	78.6	79.7	74.8	66.1
Overall Fuel	108.5	108.9	104.5	107.7	103.1	105.6	111.7

Source : Economic Division, Department of Economic Affairs based on WPI data.
[a]Covers LPG, Kerosene, Diesel and Petrol.
[b]Data for 2011-12 are provisional.

03

Analysis of Union Budget 2012-2013

Direct Taxes Code

The Government intends to introduce DTC at the earliest

Corporate Tax Rates

- Corporate tax rates are proposed to remain unchanged at 30% (plus applicable surcharge and education cess) for domestic companies and 40% (plus applicable surcharge and education cess) for foreign companies
- The MAT rate remains unchanged at 18.5% (plus applicable surcharge and education cess)
- The DDT rate also remains unchanged at 15% (plus applicable surcharge and education cess)

Personal Tax Rates

- The tax slabs for individuals (other than resident senior citizens and resident very senior citizens)/ HUFs/AOPs/BOIs are proposed to be revised as under:

Existing Slab Rates		Proposed Slab Rates	
Income Slab (INR)	Tax Rate	Income Slab (INR)	Tax Rate
0 - 1,80,000[a]	Nil	0 – 200,000	Nil
1,80,001* – 5,00,000	10%	200,001 – 500,000	10%
5,00,001 – 8,00,000	20%	5,00,001 – 10,00,000	20%
Above 8,00,000	30%	Above 10,00,000	30%

([a]INR 190,000 in case of resident woman)

- Correspondingly the slab for maximum marginal tax rate for resident senior citizens and resident very senior citizens will also be changed.

Taxability of computer software

- The Bill seeks to increase the scope of 'royalty' by amending the definition with retrospective effect from June 01, 1976 to include transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which it is transferred.
- The above proposal however may not affect non-resident software suppliers who are entitled to the tax treaty benefits where the definition of royalty is narrower. The proposal would, however, certainly affect the domestic software suppliers, where the withholding tax provisions would be attracted in the hands of the purchaser if the payment exceeds the specified limit.

Taxability of foreign companies providing transmission services

- It is proposed to extend the definition of royalty with retrospective effect from June 01, 1976 as to specifically cover therein transmission by satellite (including up-linking, amplification, conversion of down-linking of any signal), cable, optic fibre or by any other similar technology.

General Anti Avoidance Rule (GAAR)

- General anti-avoidance provisions are proposed to be incorporated in law, which will take effect from FY 2012-13. It is provided that the preferential status of treaty shall not apply if GAAR provisions are invoked.
- Arrangement declared as impermissible avoidance arrangement (IAA), if one of the main purposes is to obtain a tax benefit and it:
  - creates rights and obligations, normally not created between parties dealing at arm's length;
  - results, directly or indirectly, in the misuse, or abuse of provisions of the Act;
  - lacks/ deemed to lack commercial substance; and
  - is entered into/ or carried out in a manner normally not employed for bonafide purpose.
- If arrangement results in any tax benefit, it shall be presumed that the arrangement is entered into for the main purpose of obtaining tax benefit. The onus is on the taxpayer to rebut.
- An arrangement will be deemed to lack commercial substance irrespective of tenure of arrangement, the amount of taxes paid under the arrangement, if:
  - the substance, or effect, of the arrangement as a whole is inconsistent with its individual steps or a part; or
  - it involves (i) round trip financing; (ii) elements that have the effect of offsetting or cancelling each other; or (iii) a transaction that disguises the value, nature, location, source, ownership, or control, of the fund; or
  - the location of an asset or of a transaction or of the place of residence of any party lacks substantial commercial purpose.

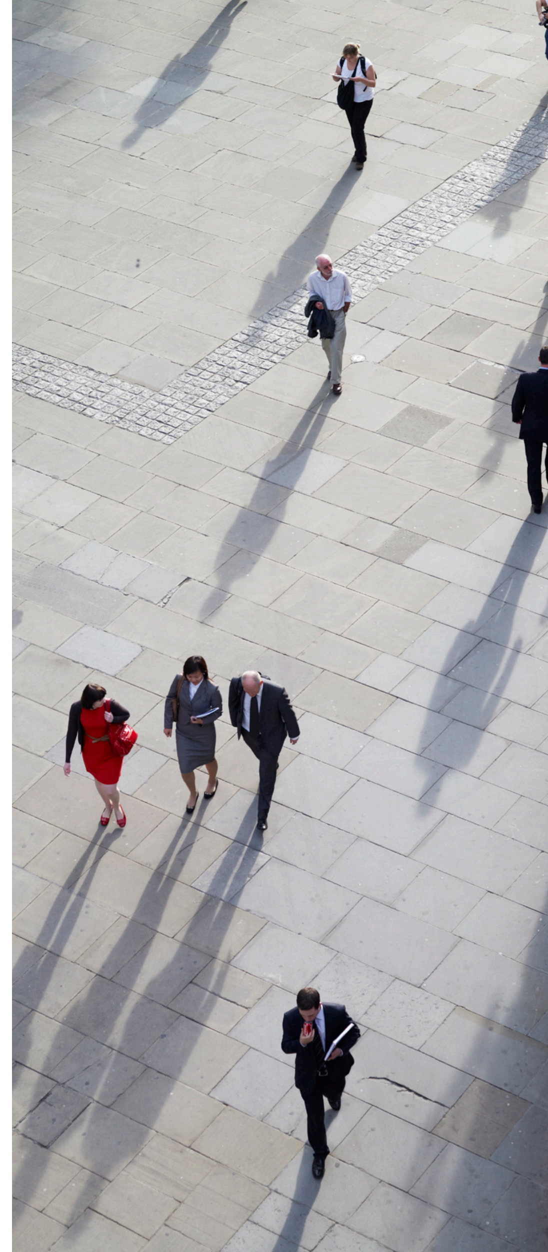
- If the arrangement is declared to be an IAA, then the consequences, depending on the circumstances of the case, may include:
  - disregarding, combining or recharacterizing the IAA or any step/ part thereof;
  - disregarding the accommodating party;
  - deeming connected persons to be one and same;
  - reallocating expenses and income amongst the parties;
  - deeming the place of residence of a party, or location of a transaction or situs of an asset other than as provided; and
  - disregarding any corporate structure.
- "Tax benefit" for the purpose of GAAR has been defined to mean—
  - a reduction or avoidance or deferral of tax; or
  - an increase in a refund of tax; or
  - a reduction in total income including increase in loss.
  - To invoke GAAR, tax officer shall require making a reference to CIT. On receipt of the reference, the CIT shall hear taxpayer and if not satisfied shall refer the matter to an Approving Panel (Panel).
- A Panel comprising of minimum of 3 members shall be set up by the CBDT of the rank of CIT and above. The Panel would be required to dispose the reference declaring whether an arrangement is impermissible or not after examining material and making any further inquiry, if required.
- The final order shall be passed by tax officer only after approval by CIT. The first appeal against such Order would lie with the Tribunal. The period taken by the proceedings before CIT and the Panel would be excluded from limitation period for completion of assessment. It is also proposed that the CBDT shall prescribe a scheme for regulating the condition and manner of application of the GAAR provisions.

Taxing indirect transfer of capital assets

- Vodafone judgement is sought to be overruled by way of retrospective amendment. Transaction between two non-resident companies in relation to transfer of shares of or interest in an overseas company is sought to be taxed if such shares or interest substantially derives value from assets located in India;

Exemption to foreign company selling crude oil in India

- The Bill proposes to provide an exemption for any payment made in India in Indian currency to a foreign company (not engaged in any activity in India) on account of import of crude oil subject to fulfilment of prescribed conditions
- Presently, receipt of money in India by a non-resident is taxable in India under the Act. Thus, this proposal appears to give relaxation to foreign companies selling crude oil in India and receiving payments in Indian currency in India.



Tax incentives – Power Projects

- It is proposed that the companies engaged in the following businesses shall be eligible to claim profit linked incentive for a further period of one year i.e. the sunset date has been extended to March 31, 2013 (from the present March 31, 2012):
  - Generation or generation and distribution of power;
  - Transmission or distribution by laying a network of new transmission/ distribution lines;
  - Undertakes substantial renovation and modernisation of the existing networks of transmission/ distribution lines.
  - The Bill proposes to allow the additional depreciation @ 20% on new plant & machinery to companies engaged in generation or generation and distribution of power.

Extension of weighted deduction for in-house Research & Development

- Presently, a weighted deduction of 200% for in-house research and development carried out by companies engaged in manufacture or production of any article or thing (other than article or things specified in Eleventh schedule) is available till March 31, 2012.
- It is proposed to extend the above weighted deduction till March 31, 2017.

Infrastructure - Investment based incentives

- The Bill seeks to provide the following incentives to infrastructure businesses which commence operations on or after April 01, 2012:

Deduction	Businesses
Weighted deduction of 150% of capital expenditure	• Cold chain facility; • Warehousing facility for storage of agricultural produce; • Hospital having minimum 100 beds; • Developing and building specified affordable housing project; • Production of fertilizer
100% of capital expenditure	• Inland container depot or container freight station; • Bee keeping and production of honey and beeswax; and • Warehousing for sugar
150% weighted deduction of any expenditure	• Specified agricultural extension project
150% weighted deduction of any expenditure (other than land or building)	• Specified skill development projects

- The benefit of weighted deduction @ 150% eludes the business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network
- It is also proposed that the hotel owner having a two star hotel or above category shall be deemed to be eligible to enjoy the 100% deduction towards the capital expenditure even if it transfers the operations of the hotel to any other person. This proposal shall have retrospective effect from April 01, 2011.

Capital Gains

- In case of transfer of capital asset due to succession of sole proprietorship or firm by a company (not regarded as transfer for capital gains purposes), the cost of acquisition of asset in the hands of the successor company would be the same as that in the hands of the sole proprietary concern or the firm. Amended retrospectively with effect from April 01, 1999.
- For the purposes of computation of capital gains in connection with assets acquired on or before April 01, 1981, the Tax Officer can make reference to valuation officer, where he is of view that the value taken by assessee is higher than the fair market value of the asset as on April 01, 1981.
- The Bill provides that the conditions of issue of shares not applicable to amalgamation or demerger between holding - subsidiary companies.
- Fair market value of asset shall be deemed to be the full value of consideration if actual consideration is not attributable or determinable.

Dividend Distribution Tax

- Cascading effect of DDT in multi-tier corporate structure removed. The amendment would be effective from July 01, 2012.

Alternate Minimum Tax

- The law currently provides for Alternate Minimum Tax for Limited Liability Partnerships. These provisions have been introduced for balance category of tax payers availing profit linked tax holiday at a tax rate of 18.5% (plus applicable surcharge and cess) with credit available up to 10 years. For some categories threshold limit of INR 2 million of adjusted total income has been provided.

Tax Return Filing Obligations

- The Bill proposes that every resident person, who is not required to furnish a return of income under the provisions of the Act and who has any asset (including financial interest in any entity) located outside India or signing authority in any account located outside India, during the financial year, is required to furnish a return of income mandatorily. This amendment is proposed to be effective retrospectively from Assessment Year 2012-13.

Tax withholding

- A new section is proposed to be introduced which requires deduction of tax at source at 1% by the transferee while making payment in a transaction for transfer of immovable property (other than in case of a compulsory acquisition). However, the transferee is not required to obtain a tax deduction account number for the purposes of this section. In case the sale consideration is less than the value adopted by a government authority for the purpose of payment of stamp duty, then it shall be deemed to be the value so adopted. The registering officer shall not register any document relating to the transfer unless proof of TDS on such payments is produced before him. This amendment shall take effect from October 01, 2012.

- Any compensation, whether by way of fee, commission or by whatever name called, other than by way of salary, to a director of a company shall now be subjected to deduction of tax at source at 10%. This amendment shall take effect from July 01, 2012.
- Clarified that withholding tax provisions would apply to non residents, whether or not the non-resident has a residence, place of business, business connection, or any other presence in India
- Tax rate on interest payments for foreign currency loans reduced from 20% to 5% for funding certain infrastructure sectors. Consequently, a new section has been introduced providing tax withholding at the rate of 5% for loan agreement approved by the Central Government between July 1, 2012 and June 30, 2015
- An explanation has been inserted to clarify that the obligation to deduct TDS under this section applies to non-residents as well; irrespective of whether the non-resident has a presence in India or not. This explanation has been inserted with retrospective effect from April 01, 1962.
- Also, the Board has been empowered to specify class of persons or transactions (whether chargeable to tax or not), wherein person responsible for making payments to non-residents shall have to mandatorily make an application to the tax officer for determining the appropriate proportion of the sum chargeable to tax.
- Where any person, including the principal officer of a company fails to deduct whole or part of taxes from payment to a resident payee, he shall not be deemed to be an assessee in default, if
  - the payee files a tax return of income,
  - takes into account such sum for computing the income in its return of income,
  - pays taxes due on his income; and
  - the person furnishes a certificate from an accountant to this effect.
  - Time limit for passing order to treat defaulter in withholding tax as "assessee in default" where no withholding tax return is filed, increased from 4 years to 6 years.

Advance Tax

- Presently, while computing the advance tax payable, income tax on estimated income is reduced by the tax which should have been deductible/ collectible on the estimated income even if the said tax has not been deducted/ collected. It has been proposed that in computing the advance tax payable, credit would be allowed only in respect of tax actually deducted/ collected instead of deductible/ collectible.

Fee/ penalty for non-furnishing of TDS/ TCS statement

- Fee of INR 200 per day would be levied for the late furnishing of TDS/ TCS statement from the due date of furnishing such statement till the date of furnishing. Additionally, penalty may be levied ranging from INR 10,000 to INR 100,000 on not furnishing TDS/ TCS statement after expiry of 1 year from the prescribed time or on furnishing incorrect information. This amendment would be effective for statements furnished on or after July 01, 2012.

Prosecution Proceedings

- With effect from July 01, 2012, prosecution mechanism strengthened by providing for constitution of Special Courts for trial of offences; simplification of procedures in summons trial; and appointment of public prosecutors.
- Additionally, threshold for imposition of imprisonment enhanced to tax evasion of INR 2.5 million and the maximum term of imprisonment reduced to 2 years.

Widening the tax net

- It is also proposed to widen the royalty definition with retrospective effect from June 01, 1976 in order to nullify some judicial precedence where use or right to use of right, property or information was held not to be royalty in the absence of active use by the payer of such right, property or information.
- The above proposal seeks to do away with the condition of active use by the payer, and intends to cover the payments within the purview of royalty even if the right, property or information is not in the possession of or directly used by the payer, and its location is outside India.

Treaty benefits

- The Bill proposes to restrict the treaty benefit to the non-resident unless the non-resident obtains a tax residency certificate from the home country containing the specified particulars.
- It is also provided that where any term is used in the tax treaty but is not defined in the tax treaty or in the Act, the CBDT may assign a meaning to the term by way of notification, and such meaning shall take effect from the date when such tax treaty came into force.

Removing the rigor of non deduction of tax on domestic payments

- The TDS provisions under the Act provide that the payer shall not be treated in default where the payee has deposited the tax directly. That direct payment of tax by the payee dissolves the payer from the tax deduction obligation.
- Besides, under the Act specified payments made by any person to a resident attracts disallowances in the hands of the payer if the tax has not been deducted thereon or after deduction, the tax has not been paid before the due date of filing the tax return by the payer. If the taxes are deposited beyond this due date, the deduction is available to the payer in the year in which taxes are deposited.
- In the above situation, the difficulties are faced by the payers for claiming the expense deduction where taxes are deposited by the payee directly. The Bill seeks to rationalise the provisions and proposes to allow the deduction to the payer in the year in which payment is made to the payee, if the payee files its tax return on or before the due date. However, if the payee files its tax return after the due date, the deduction to payee shall be available in the next year.
- The above rationalisation has not been extended to payers making payment to non-resident payee even if such non-resident payee deposits the tax directly or files its tax return in India.

Transfer Pricing

- Keeping in view the large scale litigation in Transfer Pricing in India, the Government has introduced APA with a view to significantly bring down TP litigation and provide tax certainty to foreign investors. APA is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future.
- Definition of international transactions proposed to be broadened to specifically include business restructuring, intra-group financing arrangements, etc. Further, 'intangible property' has been explained to include marketing intangible, customer related intangible, human capital intangible, location related intangible etc. The explanation has been inserted retrospectively and shall have effect from 1 April 2002;
- Transfer pricing provisions (reporting/ documentation/penalty) are proposed to apply to specified domestic transactions;
- Arm's length range is proposed to restricted to upper limit of 3% with effect from 1 April 2013;
- Penalty for non-filing of Form 3CEB is proposed to be increased from INR 100,000 to 2% of the total value of international transactions;

- Retrospective amendment proposed to be introduced to empower Transfer Pricing Officer to examine international transactions not reported in Form 3CEB.

Transfer pricing regulations on domestic parties

- The Bill seeks to apply transfer pricing regulations on the following transactions with related domestic parties:
    - Any expenditure in respect of which deduction is claimed while computing profits and gains of business or profession;
    - Any transaction related to businesses eligible for profit linked tax incentives i.e. infrastructure facilities (section 80-IA) and SEZ units (section 10AA); and
    - Any other transactions as may be specified.
- The transfer pricing regulations shall not apply where the aggregate transactions do not exceed INR 50 million.

Wealth Tax

- The limit of gross salary in respect of a residential house allotted by a company to an employee/ officer/ director, who is in the whole time employment, for excluding it from the definition of 'assets' has now been proposed to be increased to INR 10,00,000 from an earlier limit INR 5,00,000. This amendment is proposed to be effective from Assessment Year 2013-14.

Score Card (DT)	
Removal / extension of sunset clause for tax holiday on income from production of mineral oil	No
Availability of tax holiday under Section 80IB (9) on the gas produced from all the blocks awarded under NELP / CBM or in any other manner by Central or State Government	No
Tax holiday should be given to each well treating as a separate 'undertaking'	No
Tax Holiday to E&P Companies to be Enhanced to Ten Years from Seven Years and Flexibility to Choose Period of Ten Years of Tax Holiday out of 15 Years	No
Extension of the sunset clause beyond 31 March 2012 for tax holiday under section 80-IA(4) for undertakings set up for generation or generation and distribution of power	Yes
Exemption from MAT to the companies eligible u/s 80IB(9)	No
Weighted deduction be extended to expenditure in respect of drilling and exploration activities u/s 42 in line with R&D expenses	No
Expenditure incurred on drilling and exploration activities by an Indian company on overseas production block be allowed u/s 37	No
Deduction for infructuous or abortive exploration expenses u/s 42 be delinked with the surrender of block	No
Grant of profit linked tax holiday to business of laying and operating Cross Country Pipelines for natural gas, crude and petroleum oil	No
Benefit u/s 35AD to be extended to intra-city and inter-state distribution network	No
Infrastructure status to LNG projects for the purpose of tax holiday	No
Extension of depreciation benefit to capital investments made by refineries for producing fuels in accordance with stringent emission norms similar to pollution control equipment	No
Extension of the sunset clause beyond 31 March 2012 for tax holiday under Section 80IB(9) for undertakings engaged in refining of mineral oil	No
Clarification that the income of O&G Service Providers shall not be chargeable to income tax @ 10% on gross basis and will be eligible for presumptive tax regime	No

Indirect tax

Goods and Services Tax – Update Status

In the Budget speech, while the Finance Minister ('FM') did not touch upon the likely date for introduction of Goods and Services Tax (GST), he informed the floor of the progress made towards introduction of GST. Furthermore, as a precursor to introduction of GST, FM proposed to introduce the negative list of services along with place of supply rules. Once passed by the parliament, Government will comprehensively tax the service providers barring few exceptions as contemplated under the negative list of services. Following are the major highlights flowing from the Budget speech in this regard:

- The Constitution Amendment Bill, which is a preparatory step in the implementation of Goods and Services Tax (GST), was introduced in Parliament in March 2011 and is before the Parliamentary Standing Committee;
- The drafting of model legislation for Centre and State GST is under progress; and
- GST Network (GSTN), an IT platform to be used under GST regime, has been approved by the Empowered Committee of State Finance Ministers. GSTN would adopt common PAN based model for registration, payment of taxes and filing of returns and will be operational by August 2012.

CUSTOMS

Tariff

- The median rate of basic customs duty ('BCD') has been maintained at 10%.
- Basic customs duty has been exempted on import of natural gas/ liquefied natural gas by power generation companies for power generation. This will have positive impact on midstream sector.
- Mode of computing custom duty has been simplified to provide for non applicability of Education cess and Secondary & Higher Education cess on the CVD component.
- There has been no change in custom duty rates of other petroleum products.

Non Tariff

- New Section 28AAA has been inserted to provide for recovery of duty from the person who has obtained duty scrips through collusion/willful misrepresentation or suppression of facts without prejudice to any action that may be taken against such importer.

CENVAT

Tariff

- The standard rate of Excise duty for non-petroleum goods has been increased from 10% to 12%.
- The merit rate of excise duty has been increased from 5% to 6% and from 1% to 2% except for coal, fertilizers, jewellery, mobile handsets
- The duty of excise levied under Oil Industries Development Act on crude petroleum has been increased from Rs. 2,500/- per metric tonne to Rs. 4,500/- per metric tonne. This will negatively impact the upstream sector.
- Tariff rate for HSD reduced from 16% + Rs 5 /ltr to 14% + Rs 5/ ltr. However, effective rate of duty continues to remain NIL for branded diesel and Rs 3.75/ltr for branded diesel. Hence, no impact.

Non Tariff

- New Section 28AAA has been inserted to provide for recovery of duty from the person who has obtained duty scrips through collusion/willful misrepresentation or suppression of facts without prejudice to any action that may be taken against such importer.

Following significant amendments have been made in the Cenvat Credit Rules, 2004 ('CCR')

Effective from 17th March 2012

- The provisions relating to reversal/ payment of CCR on used capital goods have been amended. The duty shall be higher of the amount calculated as per the prescribed formula or the duty on transaction value.

Effective from 1st April 2012

- The prescribed percentage of CENVAT credit reversal in terms of Rule 6(3) on exempted goods and exempted services has been increased from 5% to 6%. This will negatively impact the downstream sector.
- No interest would be payable on CENVAT credit wrongly availed if reversed before utilization.
- Provision relating to distribution of CENVAT credit by input service distributor has been amended. In terms of the amended provisions, the transfer of CENVAT credit to any of the units of the manufacturer shall be done as under:
    - Credit attributable to service used in a unit exclusively engaged in manufacture of exempt goods or exempt services shall not be distributed
    - Credit attributable to service used wholly in a unit shall be distributed to that unit only; and
    - Credit attributable to service used in more than one unit shall be distributed prorata on the basis of the turnover of the concerned unit to the sum total of the turnover of all the units to which the service relates.
- CENVAT credit in respect of inputs and capital goods shall be available even if the goods are not received in the premises of the service provider.

SERVICE TAX

Effective from 1st April 2012

- The rate of service tax has been increased from 10% to 12%.
- The rate of service tax rate on work contract services has been increased from 4% to 4.80%. This will increase the input tax cost to upstream and downstream sector.
- Time limit for issuance of invoice has been increased from 14 days to 30 days.
- The definition of 'Continuous service' under Point Of Taxation Rules has been amended to include only those services which are provided continuously over a period of 3 months and for which payments are received on a recurring basis.
- Service Tax Rules, 1994 has been amended by removing the erstwhile limit of Rs. 2 lakhs for self adjustment of service tax.

Effective from a date to be notified

- The definition of "service" has been introduced and all services would be taxable except for the negative list of services which comprises of 17 heads. The negative list specifically includes transportation of petroleum products falling under2710 & 2711 through rail or a vessel from one port in India to another. The proposal to introduce negative list of service taxation once implemented will have a negative impact to all upstream, midstream and downstream sectors as it will increase the sticking cost to the companies.
- In addition to the negative list, it is proposed to provide specific exemption as well to limited number of services.
- New valuation rules to substitute works contract (composition scheme for payment of service tax) Rules, 2007.
- Liability to pay service tax under reverse charge has been shifted partly on service providers for select services to be notified.

- New classification rules have been introduced for determination of service category in case of bundled services wherein, an element of provision of one service is combined with one or more elements of another service. The classification shall be done as under:
- If various elements are naturally bundled in the ordinary course of business - The classification shall be done as per the essential characteristic of the service.
- If various elements are not naturally bundled in the ordinary course of business – The classification shall be done based on the applicable rate of service tax. The highest rate of service tax shall be the determining factor.
- Periodicity of service tax return proposed to be changed from half yearly to monthly Further, return forms to be simplified and integrated for excise and service tax.
- Place of provision of service rules, 2012 ('POPS') to be released for public debate. These rules will replace present Export of Service Rules, 2005 and Taxation of Services (Provided from Outside India and Received in India) Rules, 2006.

Effective from the date of enactment of finance bill

- Limitation period under service tax for the purpose of issuance of show cause notice increased from 12 months to 18 months.
- Provisions pertaining to Settlement Commission and Revision Mechanism introduced.
- Special audit provisions made applicable to service tax.
- Time period for filing appeal has been reduced to two months.

Score Card (IDT)	
Removal of National Calamity Contingent Duty on crude oil levied at 50 INR per MT	No
Removal of basic custom duty of 5% on the import of natural gas	Yes, (If imported by Power Generating Companies for power generation)
No liability of interest where CENVAT credit has been wrongly availed but reversed before utilization	Yes
Admissibility of Cenvat credit on goods meant for construction of buildings and structures	No
Requirement to pay service tax in cash under reverse charge mechanism	No
Admissibility of Cenvat credit on services used for setting up a factory or refinery	No
Exemption from service tax on services consumed by E&P companies in relation to exploration and production activities	No
Goods required to lay natural gas pipeline network to be included in the category of goods eligible for concessional CST against form C	No
Declared Goods status to natural gas and naphtha under the Central Sales Tax Act, 1956	No
Inclusion of petroleum products in GST regime	No

04

Major pre-budget expectation of oil & gas industry

These are the industry expectations from the Union Budget 2012-2013.

Source: PetroFed, Industry interviews

Direct tax

Upstream

Income tax holiday under section 80-IB(9) of the Income Tax Act 1961 ('the Act'): Sunset clause

A tax holiday of seven years was allowed to undertakings engaged in the production of mineral oil. The Finance Act, 2011 had inserted a sunset clause stating that this tax holiday would not be available to blocks licensed under a contract awarded after 31 March 2011.

This amendment has effectively withdrawn the tax holiday incentive for production of mineral oil in respect of blocks licensed under contracts awarded after 31 March 2011.

The amendment will lead to an increase in the cost of mineral oil production, since the operator will pass on the burden to downstream companies, which may ultimately have a cascading effect on the economy.

Since blocks under the ninth round of bidding under the New Exploration Licensing Policy (NELP IX) are to be awarded after 31 March 2011, the income from mineral oil production in blocks licensed under NELP IX will not qualify for tax holiday. This amendment is not in line with the promises made by the government while inviting bids under NELP-IX, since the bid document specifically mentioned the availability of a tax holiday. Thus, such withdrawal is clearly retro-active in nature and could lead to litigations, which could have been avoided.

The government was expected to declare that the sunset clause would be applicable to contracts awarded subsequent to NELP IX, so that undertakings engaged in mineral oil production pursuant to contracts awarded under NELP IX qualify for tax holiday.

Income tax holiday under section 80-IB(9) on income from production of natural gas

The income tax department is adopting a narrow interpretation of the tax holiday provisions of section 80-IB(9) and states that tax holiday is available only if exploration results in the striking of crude oil. Further, it consequently states that profits made on the sale of gas, where gas is struck, are not eligible for income tax holiday.

The Finance Minister, during the discussion on the Finance Bill, 2008, gave assurances that the benefit of section 80-IB(9), as finally interpreted by the courts, would be applicable to all exploration and production contracts. The Finance (No.2) Act, 2009 includes new clauses to clarify

that the tax holiday would be available on gas produced from blocks licensed under the eighth round of bidding under the NELP (NELP VIII) and the fourth round of bidding for award of exploration contracts for the Coal Bed Methane (CBM IV). The insertion of these clauses may suggest that the income from gas produced from the blocks other than those awarded under NELP VIII /CBM IV is not entitled to the benefit of tax holiday.

Therefore, the Union Budget 2012-13 was expected to clarify that the benefit of tax holiday would be available on the gas produced from all the blocks awarded under NELP/CBM or in any other manner by central or state governments.

Availability of tax holiday to each gas well

As per legal pronouncements and the general provisions of the Act, each gas well can be considered as a separate undertaking for the purpose of tax holiday under section 80-IB(9). However, the Finance (No. 2) Act, 2009 has amended the provisions of the Act to clarify that all blocks licensed under a single contract, awarded under NELP or in pursuance of any law for the time being in force or awarded by the central or a state government in any other manner, will be treated as a single 'undertaking' for the purpose of claiming a tax holiday under section 80-IB(9). This amendment has virtually overturned previous cases which were ruled in favour of the assessee, by making retrospective legal amendments to rewrite the law from FY 1999-2000 and pre-judging matters pending in courts and tribunals. These changes are detrimental to the nation's energy security and also cause hardship to taxpayers who have acted upon the pre-amendment provisions of the Act.

Therefore, we expected section 80-IB(9) to be amended so that each well or cluster of wells is defined as an undertaking for the purpose of availing tax holiday. Alternatively, the section could be amended such that each distinct field development evidenced by a separate development plan is defined as an 'undertaking'.

If at all, the term 'undertaking' is to be defined to reflect a change in government policy with regard to the oil and gas sector, a clarification was expected that such change will become effective only on prospective basis, i.e. from FY 2009-10.

Tax holiday for exploration and production (E&P) companies to be enhanced to ten years from seven years and flexibility to choose period of ten years of tax holiday out of 15 years

Tax holiday under section 80-IB (9) is available to E&P companies for seven consecutive years starting from the year in which commercial production commences. The period of seven years of tax holiday is less than the tax holiday period available to companies in the infrastructure sector, such as power generation and distribution companies. Furthermore, during the initial seven years, companies have large expenditure to set off, due to which they are unable to enjoy the actual benefit of the tax holiday.

Like the infrastructure industry, the E&P industry is also highly capital-intensive and has a long gestation period. Thus, it was expected that the provisions of section 80-IB(9) would be amended to extend the tax holiday from seven to ten years and to allow flexibility to E&P companies to choose the period of the tax holiday any time during the initial 15 years from the commencement of commercial production.

Extension of the sunset clause beyond 31 March 2012 for tax holiday under section 80-IA(4) for undertakings set up for generation or generation and distribution of power

The tax holiday is available to an undertaking set up for generation or generation and distribution of power if it begins to generate power on or after 1 April 1993, but not later than 31 March 2012.

The sunset clause has been extended for one year (i.e. 31 March 2013).

Exemption from Minimum Alternate Tax (MAT) under section 115-JB

The exploration and extraction of mineral oil has been given a tax holiday under section 80-IB(9). However, this provision has been nullified to an extent by the provisions of MAT under section 115-JB. These companies normally earn higher book profits in the initial years after commercial production begins, since the tax deductions in respect of accumulated exploration and drilling expenditure are allowable in the year in which the commercial production commences. It was therefore expected that the exploration and extraction of mineral oil would be exempt from MAT under section 115-JB of the Act.

Weighted deduction in line with research and development (R&D) expenses under section 42

Section 42 of the Act allows deductions in respect of capital and revenue expenditure actually incurred by the assessee in respect of drilling and exploration activities. Allowing capital expenditure as a deduction beginning with the year of commencement of commercial production only allows an accelerated deduction of the expenditure incurred and does not grant any additional deduction or incentive to the assessee.

It is important that expenditure in respect of drilling and exploration activities be treated the same as R&D expenditure to encourage the E&P sector to invest aggressively even in areas where the probability of striking oil reserves is lower than in other areas. It was therefore expected that weighted deduction of 200% of the actual expenses incurred by the assessee in respect of drilling and exploration activities would be allowed under section 42 of the Act.

Deduction for expenditure incurred on drilling and exploration activities by an Indian company with an overseas production block under section 37 of the Act

An Indian E&P company typically does not enter into section 42 agreements with the central government in respect of its overseas exploration block. Thus, section 42 does not apply to such companies with respect to their overseas exploration blocks.

However, where the company has already started exploration activities, the deduction for the expenditure incurred on drilling and exploration activities in respect of the overseas blocks should be available under section 37 of the Act. It was therefore expected that the government, by way of an amendment to the Act, would clarify this matter.

Deduction for infructuous or abortive exploration expenses under section 42

Typically, the provisions of the production sharing contract do not require the area to be surrendered as a prerequisite for claiming the deduction of unsuccessful exploration cost. However, under section 42 of the Act, a deduction for infructuous or abortive exploration expenses is not allowed until the area is surrendered, even though the expenses are already charged off in the books of accounts as per the company's accounting practices. As a result of the requirement to surrender the area prior to the commencement of commercial production, the assessee is not able to avail the deduction of expenses on account of abortive exploration in the year when expenditure is incurred. It was expected that the requirement to surrender the area would be deleted from section 42(1)(a) and that deduction will be allowed from the year in which the area is abandoned as abortive.

Midstream

Grant of profit-linked tax holiday to cross-country pipelines for crude and petroleum products

The Finance (No.2) Act, 2009 has withdrawn the profit-linked tax holiday provided to undertakings engaged in laying and operating natural gas distribution networks, including pipelines and storage facilities and has provided 100% deduction for any capital expenditure incurred wholly and exclusively for the purpose of such business.

Such incentive does not provide any real benefit but creates only a timing difference as the capital expenditure incurred wholly and exclusively for the purpose of business is, in any case, allowed over a number of years. However, the profit-based tax holiday available to such companies under section 80-IA offered a real benefit.

Since pipelines have several distinct advantages over other modes of transport in terms of safety, eco-friendliness, lower product losses, etc., it was expected that the benefit of tax holiday under section 80-IA would be returned to the natural gas pipeline and will also be extended to crude and petroleum product pipelines.

Investment-linked incentive under section 35-AD

The benefits of investment-linked tax holiday are provided only to the cross-country natural gas, crude or petroleum pipeline network for distribution, including storage facilities being an integral part of such network.

Since pipelines have several distinct advantages over other modes of transport, it was expected that this benefit would be extended to intra-city and intra-state gas distribution networks used for transporting natural gas, and it was expected that the Government of India, by way of an amendment to the Act, would define the term 'cross country' in relation to the gas distribution network.

Infrastructure status to LNG projects for the purpose of tax holiday

At present, there is a huge requirement of natural gas to meet the requirements of city gas distribution networks, refineries and the power sector. Therefore, it was expected that in order to promote the import of LNG, LNG facilities located at port would be included in the definition of infrastructure facility for the purpose of tax holiday under section 80-IA.

Downstream

Extension of depreciation benefits available to pollution control equipment to capital investments made by refineries for producing fuels in accordance with stringent emission norms

Refineries are making substantial capital investments to produce fuels under stringent emission standards in order to reduce pollution. It was expected that such capital investment, being a pollution control measure, would be given the depreciation benefits available to other pollution control equipment.

Extension of the sunset clause beyond 31 March 2012 for tax holiday under section 80-IB(9) for undertakings engaged in refining of mineral oil

A seven-year tax holiday is available to undertakings engaged in refining of mineral oil, which begin such refining on or after 1 October 1998 but not later than 31 March 2012. Thus, refineries which will begin the refining of mineral oil after March 31, 2012 are not eligible for tax holiday.

Several refineries are expanding rapidly and are planning new capacities during the 12th Five Year Plan (2012–2017). The tax concession enables a reduction in under-recoveries and encourages further investment.

Therefore, it was expected that the sunset clause will be extended so that the refineries that will begin refining of mineral oil after 31 March 2012 will also be eligible for the tax holiday.

Service providers

Clarification that the income of oil and gas (O&G) service providers shall not be chargeable to income tax @ 10% on gross basis and will be eligible for presumptive tax regime

Section 44-BB provides for presumptive taxation of income earned by a non-resident engaged in the business of providing services or facilities in connection with, of supplying plant and machinery on hire used or to be used, in the prospecting for, or extraction or production of mineral oil. Such income is taxable at 10% of the gross sum paid or payable to such non-resident.

Section 44-DA separately provides that the fee for technical services (FTS) or royalty income earned by a non-resident having a permanent establishment (PE) in India shall be taxable on net income basis at 40%.

The definition of FTS as provided under the Act categorically excludes the consideration for any mining or like project. Instruction No. 1862 issued by the Central Board of Direct Taxes on 22 October 1990 states that the expression 'mining project' or 'like project' would cover the services rendered for exploration or exploitation of oil and natural gas. Thus, the consideration for such services will not be treated as FTS under section 9(1)(vii) and payment will be taxed under section 44-BB of the Act.

The scheme of presumptive taxation under section 44-BB has been amended by the Finance Act, 2010 to exclude the income referred to in section 44-DA (i.e. royalty or FTS) earned by a non-resident having a PE in India. A corresponding amendment has also been made in section 44-DA to provide that section 44-BB shall not apply in respect of the income referred to in section 44-DA of the Act.

Considering that the services rendered by the oil and gas service providers do not fall within the definition of FTS as provided under section 9(1)(vii) of the Act, the amendment shall result in unnecessary litigation with the tax authorities.

The intention behind the presumptive taxation scheme was to simplify the determination of income of the non-resident who is providing services or facilities to oil and gas sector. This rationale still holds good.

Therefore, it was expected that the government would issue a clarification to the effect that the instruction no. 1862 will continue to apply to all services rendered in connection with the prospecting for, or extraction or production of, mineral oil so that the benefit of presumptive taxation will continue to be available to such service providers.

Indirect Tax

Customs

Removal of National Calamity Contingent Duty on crude oil levied at 50 INR per MT

The National Calamity Contingent Duty (NCCD) of 50 INR per metric tonne was imposed on domestic and imported crude oil in the Union Budget 2003-04. This was done in order to augment the funds available with the government to support relief work in the natural calamity-affected areas. This results in stranded cost to the refining sector and so, is expected to be abolished.

Removal of basic custom duty of 5% on the import of natural gas

Presently, the import of natural gas into India is subject to a basic custom duty of 5%. Natural gas is a major source for generating power and manufacturing highly subsidized fertilizers. Accordingly, in line with the removal of the custom duty of 5% in FY 2011 on the import of crude oil, it is expected that this custom duty will be removed, to benefit the sector.

CENVAT

CENVAT credit on goods meant for construction of buildings and structures

In the Union Budget 2011-12, the definition of 'inputs' as contained under the CENVAT Credit Rules, 2004 ('CCR') was amended by specifically excluding the goods used for the construction of buildings or for supporting capital goods. The CENVAT scheme has to give credit of input tax to remove the cascading effect of taxes. This is more pertinent, given that we are now moving towards the GST regime. In this scenario, restricting input tax credit on such items defeats the purpose and goes against the grain and principle of the CENVAT Credit Scheme.

Accordingly, keeping in view the huge capacity ramp-up by this sector and substantial investment in buildings and civil structures, it is expected that the CENVAT credit benefit will be extended on these items as well.

Liability of interest where CENVAT credit has been wrongly availed but reversed by the assessee before utilization

The apex court, in the recent judgment of Ind Swift, upheld the liability to pay interest on the wrongful availment of CENVAT credit even though an assessee has already reversed such CENVAT credit before its utilisation. The Supreme Court concluded this after analysing the underlying statutory provisions under CENVAT Credit Rules, 2004 ('CCR').

Wrong availment of CENVAT credit by itself is only an accounting entry. It does not mean that an assessee has undertaken undue benefit of CENVAT credit not due to it at the first instance. Such incorrect availment of CENVAT credit does not create any liability for the payment of excise duty. Hence, the interest must be leviable only when the wrongly availed CENVAT credit has been utilised for the payment of duty. Consequently, Rule 14 of the CENVAT Credit Rules, 2004 must be amended to clearly distinguish that interest must be payable on wrongful availment and utilisation of CENVAT credit and not only on wrong availment of CENVAT credit.

Service tax

Exemption from service tax on services consumed by E&P companies in relation to exploration and production activities

Elimination of service tax on services consumed by E&P companies has been a recurring demand of the oil and gas sector. However, service tax has been gradually made applicable to more and more services used in the upstream sector, leading to increased costs of carrying out E&P activities. It started in 2004 when survey and exploration of mineral, oil and gas service was introduced. Then, in 2005, the taxable category of site formation and clearance, excavation and earthmoving and demolition services was brought within the ambit of service tax. Later, effective 1 June 2007, the government brought 'mining services' i.e., services provided in relation to the mining of mineral, oil or gas, under the service tax net. This worsened in 2009 when the provisions of service tax were extended to the installations, structures and vessels in the Indian continental shelf as well as the exclusive economic zones.

As a result, service tax now comprehensively covers the upstream sector. Most of these E&P services are outsourced by E&P companies to third-party service providers. Further, there is no output CENVAT or service tax liability regarding the crude oil and natural gas production activities of the upstream sector. This has resulted in a break in the credit chain which increases the operating costs for exploration companies. Hence, the service tax paid on the procurement of taxable services by E&P companies ends up as a sticking cost.

So, it is expected that the central government, in line with the other concessions, will exempt services consumed by the E&P sector. Alternatively, the possibility of refund of the service tax paid on input services consumed by the E&P sector must also be considered. However, it is recognized that the refund mechanism is not a convenient procedure.

Requirement to pay service tax in cash under reverse charge mechanism

Presently, a person importing the services from outside India is liable to discharge service tax (popularly known as reverse charge mechanism). As per Import of Services Rules, this service tax needs to be discharged in cash.

Since this stipulation unduly strains the cash flows of the assessee, it is expected that a suitable amendment is brought in for payment of such tax by using the available CENVAT credit as well.

Rule 6 (3A) of the CCR: Applicability only in case of common services used for manufacturing exempted and taxable goods

In run-up to Budget 2011, the government has amended Rule 6 (3A) of CCR governing the reversal of CENVAT credit by a manufacturer of both taxable and exempted goods. The refineries manufacture both taxable and exempted goods by using input services. Some of the input services are meant solely for taxable and exempted goods, and some are commonly used for manufacturing the taxable and exempted goods.

In terms of the existing statutory provisions, no Cenvat credit is available on input services used in manufacture of exempt goods. A manufacturer, engaged in manufacture of both dutiable and exempt goods, who opts for reversal of Cenvat credit as per Rule 6(3A) of the CCR is required to reverse proportionate Cenvat credit on common input services (used in manufacture of both dutiable and exempt goods) and input services directly attributable to dutiable goods. This interpretation will further increase the sticking tax cost in this sector.

Accordingly, it is expected that a suitable clarification about the reversal under Rule 6(3A) is required for the common services used for manufacturing taxable and exempted goods.

CENVAT credit on services used for setting up a factory or refinery

Effective 1 April 2011, the definition of 'input services' has been amended to exclude the services used for setting up a factory and the specified services (such as architect services, construction services, etc.) used for construction of building or civil structure. To set up a new refinery, there is huge requirement of erection, commissioning and installation agency's services, architect services, etc. Service tax charged by such service providers will now be a cost at the hands of such refineries.

Accordingly, it is expected that the definition will be amended to allow the CENVAT credit on input services used for setting up a new factory.

Sales tax and value added tax (VAT)

Inclusion of goods required to lay the natural gas pipeline network in the category of goods eligible for concessional CST against form C

Presently, public sector undertakings (PSUs) are investing heavily on the development of National Gas Grid to transport natural gas. However, unlike the telecom sector, products required for laying down natural gas pipeline network products have not been specified under the CST law for issuing C forms. Therefore, it is expected that goods required for the natural gas pipeline network will be included in eligible category of goods under the CST law.

'Declared Goods' status to natural gas and naphtha under the Central Sales Tax Act, 1956

After the introduction of VAT in India, natural gas and naphtha are classified at the revenue neutral rate of 12.5% under most state VAT laws. Some states have also kept natural gas out of the VAT regime and are levying VAT at a high rate of 20%.

Both natural gas and naphtha are important sources of energy for fertiliser, petrochemicals, power and several other industries. The importance of natural gas is likely to increase in future with its rising domestic use. However, the high and multiple point sales tax structure on natural gas and naphtha, without input credits, is adversely affecting consumers, the trade in natural gas and the Indian economy on the whole. Therefore, a suitable relief in sales tax is urgently required to help develop associated infrastructure.

Natural gas and naphtha are primary energy sources. As of now, other primary energy sources such as coal and crude oil are declared as 'goods of special importance' in Inter-State trade or commence u/s 14 of the Central Sales Tax Act, 1956. Over the years, natural gas and naphtha become costlier and non-competitive with such other fuels. To provide a level playing field amongst different primary energy sources, natural gas (including R- LNG) and naphtha must be accorded the 'Declared Goods' status under the Central Sales Tax Act, 1956.

VAT on petroleum products

Petroleum products are being subject to single point levy of tax on sale at a very high rate (20% to 35%) even post the implementation of VAT in India. Tax is being levied at first point in most states and no VAT credit is available on the sale and purchase of petroleum products leading to distortion in the tax credit chain.

To implement goods and services tax (GST) in 2013-14, it is important that the government, as a step towards GST, brings all items under the ambit of the VAT regime. Therefore, it is expected that petrol and petroleum products are brought under the VAT regime and taxed at multipoint, with credits available for the tax paid on purchase thereof. Since these are items of mass consumption, the government may consider levying VAT on them at the revenue neutral rate of 12.5%. However, if this is not feasible due to revenue constraints, the Finance Ministry must request to the Empowered Committee to ensure that the variation in revenue neutral rate (i.e., 12.5%) and the VAT rates in case of diesel and petrol must not exceed 3% to 4%.

Goods and service tax (GST)

Inclusion of petroleum products in GST regime

The draft proposal circulated by the Ministry of Finance to the state government proposes to keep petroleum products such as crude oil, MS, HSD, ATF and natural gas permanently outside GST through a constitutional amendment. It is proposed that the taxation of these goods will continue as provided under the existing scheme of taxation. This will lead to inefficiencies and tax cascading.

Countries such as Australia, Canada, Sri Lanka, Singapore and Brazil have included petroleum products in GST. The 13th Finance Commission has recommended including petroleum products under GST.

Petroleum products must not be kept out of GST in the proposed constitutional amendment since any change in future, to bring the same under GST, will need the amendment of the constitution again. Further, the partial implementation of GST for some petroleum products will push up costs for the sector as states will levy service tax under the new regime and the input credit will not be available to the sector.

Thus, to continue the tax chain and the overall growth of the oil and gas sector, it is suggested that all the petroleum products must be brought into GST regime. If they have to be excluded from the GST at this stage, it may be done through an appropriate provision in the GST legislation instead of excluding them through the constitutional amendment bill.

05

Significant policy changes and initiatives in the oil and gas industry

The government of India introduced the following significant changes relating to the oil and gas industry in the financial year 2011-12.

Upstream

The bidding process for exploration blocks under the Ninth Round of New exploration Licensing Policy (NELP-IX) was completed by MoPNG[1] on 28 March 2011. A number of Indian and foreign oil companies participated in the bidding. Evaluation of bids is in progress and decision on award of blocks is expected soon. This exercise is expected to provide impetus to domestic exploration and production (E&P) efforts.

Apart from this, the government also approved the induction of BP as the partner of Reliance Industries Limited (RIL) in the latter's fields in India. The government also approved the strategic sale by Cairn Energy Plc, UK, of its stakes in Cairn India Ltd. to the Vedanta group. These changes in holdings and the induction of experienced global partners are expected to accelerate E&P activities in the respective blocks. Such developments in the sector are expected to boost investor confidence.

Shale gas

The United States Geological Survey carried out the assessment of shale gas resources in three Indian basins (KG, Cauvery and Cambay) in January 2012, after signing a memorandum of understanding (MoU) with government of India. Further, the Directorate General of Hydrocarbons (DGH) has entrusted Central Mine Planning and Design Institute Limited with the task of identifying and assessing the areas with shale gas potential in the Damodar and Sohagpur sedimentary basins.

Domestic gas from small or isolated fields

In February 2012, the government of India issued guidelines for the selection of customers for gas sourced from small or isolated fields. These guidelines define such small fields and prescribe the process to be followed for allocation of gas to customers. This policy will cover existing or new fields from nominated blocks satisfying one of the following two conditions:

- Fields whose peak production is less than 0.1 million metric standard cubic metres per day (mmscmd) and are situated at a distance of more than 10 km from the gas grid
- Fields whose peak production is less than 0.1 mmscmd and whose gas pressure is less than the grid pressure

The guidelines[2] state that in order to ensure that national oil companies (NOCs) are able to quickly monetise the output of their small discoveries where production is small and fields are isolated, such discoveries can be allocated to customers expeditiously without referring each case to the Ministry of Petroleum and Natural Gas (MoPNG). However, this gas will be priced according to the guidelines for pricing and commercial utilisation of Non-APM (Administered Pricing Mechanism) gas produced by NOCs from their nominated blocks issued by the MoPNG vide its order dated 28 June 2010 and any further orders issued in this regard.

[1]Ministry of Petroleum & Natural Gas, Government of India
[2]MoPNG notification dated 16th February, 2012

Inter-ministerial committee report on policy for pooling of natural gas prices and pool operating guidelines

In order to ensure efficient allocation of domestic gas and efficient sourcing and pricing of R-LNG for domestic consumers, particularly in priority sectors like power and fertilisers, the government constituted a committee headed by Saumitra Chaudhuri of the Planning Commission to formulate policy. In its report dated August 2011, the committee recommended against pooling or averaging out of prices of domestic gas with imported LNG to have a uniform fuel price. However, it recommended pooling in cases where it is 'found to be the best workable option'.

This report projects that of the total consumption in the fertiliser sector, R–LNG will amount for 21 to 22%, while for the power sector the share of R-LNG will be around 25 to 27 % based on the existing capacity and new plants already under construction. The consumption of R-LNG by the power sector may change depending on the level of domestic gas production.

The committee recommends that 6 mmscmd of domestic gas be set aside for city gas distribution (CGD) networks, and 1 mmscmd for other court-mandated customers. Presently, the former group is drawing 5.3 mmscmd, and the latter 0.9 mmscmd. Thus, the committee does not reduce the amount of domestic gas current allocated to the above user groups. It instead requires that the additional needs be met through imports.

Non-priority sectors presently consume about 18.4 mmscmd of domestic gas, and 5 mmscmd of gas is being set aside for these users. Their additional needs for both current and future consumption have to be met by imported R-LNG. The users should be able to either source their own LNG or buy it from their present suppliers at domestic blended gas and R–LNG prices.

Aggressive Oil diplomacy

A tripartite agreement was signed between Kazmunaigaz, the NOC of Kazakhstan, ONGC Videsh Limited (OVL) and the Ministry of Oil and Gas of Kazakhstan for 25% participating interest in Satpavev Block which is marked as one of the major success in oil diplomacy. It is estimated that the Satpayev block in the oil-rich north Caspian Sea possesses a potential output of around 1.8 billion barrels of Oil which is expected to flow by 2020.

Midstream

Progress on TAPI pipeline

In January 2012, discussions were held for implementing the proposed Turkmenistan-Afghanistan-Pakistan-India (TAPI) gas pipeline project. India and Pakistan agreed to a transit fee formula for the project. Pakistan agreed in principle to accept the fee formula eventually adopted by India and Afghanistan, subject to approval of the competent authority in Pakistan.

Augmenting LNG import capacity at Kochi terminal

In November 2011, the board of Petronet LNG Limited approved the capacity expansion of its proposed Kochi LNG terminal from 2.5 mmtpa to 5.0 mmtpa. The project is expected to be commissioned in the third quarter of 2012-13.

Access code for City or Local Natural Gas Distribution Networks Regulations, 2011

The access code[3] aims to establish industry-wide transparent and uniform principles allowing entities to gain or allow access to pipeline systems and CGD networks. According to the Chairman of the Petroleum and Natural Gas Regulatory Board (PNGRB), "The objective of this code is to promote development of a competitive gas market by establishing uniform principles for owners and users of gas pipelines to allow transparent and non-discriminatory access to the gas pipelines and CGD networks."

The regulations apply to an entity authorised to lay, build, operate or expand a city or local natural gas distribution in a geographic area under the PNGRB Act, 2006, or to an entity or shipper who wants access to entry point capacity, exit point capacity and delivery at CNG exit point capacity to domestic, commercial or industrial consumers.

The regulations touch upon capacity declaration, capacity booking, obligation of shippers and entity, gas parameters, facilities at entry and exit points, billing and metering aspects, etc.

Downstream

Maintaining surplus refining capacity

The refining capacity in the country has been augmented to about 194 million metric tonnes per annum (MMTPA), with the completion of commissioning of the 6 MMTPA refinery project at Bina, Madhya Pradesh which is well above annual demand of about 142 MMTPA.

HMEL (HPCL-Mittal Energy Ltd.) is expected to commission its 9 mmtpa refinery in Punjab by March 31, 2012. HPCL-Mittal Energy Ltd. (HMEL) is a joint venture between Hindustan Petroleum Corporation Limited and Mittal Energy

Investments Pte Limited (MEI), Singapore. Both partners hold 49 % equity stake in HMEL and balance is held by various financial institutions.

The crude distillation unit/vacuum distillation at the refinery complex has already been commissioned. The refinery began crude processing on trial in August 2011 and became fully operational in November 2011.

Meanwhile HPCL has commissioned a study on pre-project activities for a 9 MMTPA refinery at Ratnagiri in Maharashtra.

[3]Notification No. & Dated: F.No. S-Admn./II/8/2010 29/03/2011

Pricing reforms in Auto fuels

"As part of major pricing reforms, prices of petrol were reduced twice by oil marketing companies (OMCs) in the second half of the 2011. The OMCs are revising the price of petrol since it was deregulated on 26 June 2010" . The government significantly reduced central duty on diesel, crude oil and petrol products in June 2011 to keep prices of diesel, domestic LPG and Public distribution system (PDS) kerosene at affordable levels. Despite this, OMCs are expected to under-recover over Rs. 1, 30,000 crore during the current fiscal year. Thus, consumers have been greatly insulated from the impact of high global oil prices, which have been at about US$ 110 per barrel this fiscal as against US$ 84.09 per barrel in 2010-11.

To reduce the burden of the rise in international oil prices on the consumers, the government took the following decisions on 24 June 2011:

- Elimination of 5% customs duty on crude oil and reduction in customs duty on all petroleum products by 5%
- Reduction of excise duty on diesel by Rs. 2.60 per litre
- The remaining excise duty of Rs. 2.06 per litre on diesel could not be reduced as it is earmarked towards road and education cess.

General

Considering oil security, the MoPNG held various bilateral and multi-lateral talks among various oil rich countries to enhance cooperation in hydrocarbon sector. These include attending and holding international conferences like India-Africa Hydrocarbon Conference in Delhi, International Energy Forum at Riyadh, WPC at Doha, ASEAN Energy Ministers Summit at Brunei, and the 4th Asian Energy Ministerial Roundtable at Kuwait.

These initiatives help in developing a favourable environment and lead to projects and activities for mutual benefits.

06

Commodity balance of petroleum & petroleum products

(Million Tonnes)

	Item	1980-81	1990-91	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
	1	2	3	4	5	6	7	8	9	10	11	12
I.	Crude Oil											
1	Refinery Throughput	25.8	51.8	121.8	127.4	130.1	146.6	156.1	160.8	192.8	206.2	139.9
2	Domestic Production	10.5	33.0	33.4	34.0	32.2	34.0	34.1	33.5	33.7	37.7	25.5
(a)	On-shore	5.5	11.8	11.5	11.6	11.4	11.3	11.2	11.3	11.8	16.4	11.9
(b)	Off-shore	5.0	21.2	21.9	22.4	20.8	22.7	22.9	22.2	21.9	21.3	13.6
3	Imports	16.2	20.7	90.4	95.9	99.4	111.5	121.7	132.8	159.0	163.6	112.1
4	Exports	—	—	—	—	—	—	—	—	—	—	—
5	Net Imports (3-4)	16.2	20.7	90.4	95.9	99.4	111.5	121.7	132.8	159.0	163.6	112.1
II.	Petroleum Products											
1	Domestic Consumption [a]of which	30.9	55.0	107.8	111.6	113.2	120.7	128.9	133.4	138.2	141.8	96.6
(a)	Naphtha	2.3	3.4	11.9	14.0	12.2	13.9	13.3	13.9	10.2	10.7	7.7
(b)	Kerosene	4.2	8.4	10.2	9.4	9.5	9.5	9.4	9.3	9.3	8.9	5.5
(c)	High Speed Diesel Oil	10.3	21.1	37.1	39.7	40.2	42.9	47.7	51.7	56.3	60.0	42.0
(d)	Fuel Oils	7.5	9.0	12.9	13.5	12.8	12.6	12.7	12.4	11.6	10.9	6.1
2	Domestic Production [b]of which	24.1	48.6	113.5	116.6	119.8	135.3	144.9	150.5	179.8	190.4	130.2
(a)	Naphtha	2.1	4.9	11.3	14.1	14.5	16.7	16.4	14.8	17.1	17.5	13.3
(b)	Kerosene	2.4	5.5	10.2	9.3	9.1	8.5	7.8	8.2	8.5	7.7	4.9
(c)	High Speed Diesel Oil	7.4	17.2	43.3	45.9	47.6	53.5	58.4	62.9	73.3	78.1	54.0
(d)	Fuel Oils	6.1	9.4	13.4	15.0	14.3	15.7	15.8	17.7	18.3	20.1	13.3
3	Imports	7.3	8.7	8.0	8.8	13.4	17.7	22.5	18.5	14.7	12.0	10.0
4	Exports	Neg.	2.7	14.6	18.2	23.5	33.6	40.8	38.9	46.0	59.0	40.6
5	Net Imports (3-4)	7.3	6.0	–6.6	–9.4	-10.1	-15.9	-18.3	-20.4	-31.3	-47.0	-30.6

Source: Ministry of Petroleum & Natural Gas

a Excluding refinery fuel consumption, including imports by private parties

b Excludes LPG production from fractionators

Neg Negligible

Abbreviations

AEBA	Aadhaar Enabled Bank Account
AED	Additional Excise Duty
ALP	Arm's Length Price
AMT-	Alternate Minimum Tax
AOP	Association of Persons
APA	Advance Pricing Agreement
APM	Administered Pricing Mechanism
ASEAN	Association of Southeast Asian Nations
ATF	Aviation Turbine Fuel
bbl	Barrel
BCM	Billion Cubic Meters
BE	Budget Estimate
BED	Basic Excise Duty
Bill	The Finance Bill, 2012
BOI	Body of Individuals
BPCL	Bharat Petroleum Corporation Limited
BPD	barrels per day
BPL	Below Poverty Line
CBDT	Central Board of Direct Taxes
CBM	Coal Bed Methane
CCR	CENVAT Credit Rules
CENVAT	Central Value Added Tax
CGD	City Gas Distribution
CIT	The Commissioner of Income-tax
CPI	Consumer Price Inflation
CSMS	Core Subsidy Management System
CSO	Central Statistical Organisation
CSR	Corporate Social Responsibility
CST	Central Sales Tax
CNG	Compressed Natural Gas
DGH	Directorate General of Hydrocarbons
DGCI&S	Directorate General of Commercial Intelligence and Statistics
DTC	Direct Taxes Code

ECB	External Commercial Borrowing
E&P	Exploration and Production
EOI	Expression of Interest
EU	European Union
FC	Finance Commission
FCI	Fertilizer Corporation of India
FDI	Foreign direct investment
FRBM Act	Fiscal Responsibility and Budget Management Act, 2003
FY	Financial Year
GA	Geographical Area
GAAR	General Anti Avoidance Rule
GAIL	Gas Authority of India Limited
GDP	Gross Domestic Product
GoI	Government of India
GBS	Gross Budgetary Support
GSPA	Gas Sale Purchase Agreement
GSPC	Gujarat State Petroleum Corporation
GST	Goods and Service Tax
HMEL	HPCL-Mittal Energy Limited
HPCL	Hindustan Petroleum Corporation Limited
HSD	High Speed Diesel
EGoM	Empowered Group of Ministers
HSE	Health Safety and Environment
IAA	Impermissible Avoidance Arrangement
IPO	Initial public offering
INR	Indian National Rupee
IOCL	Indian Oil Corporation Limited
IOR/EOR	Improved Oil Recovery/ Enhanced Oil Recovery
IT	Information Technology
KG	Krishna Godavari
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
LSHS	Low Sulphur Heavy Stock

MAT	Minimum Alternate Tax
MMBTU	Million British Thermal Units
MMSCMD	Million Metric Standard Cubic Meter Per Day
MMTOE	Million Metric Tonnes Oil Equivalent
MMTPA	Million Metric Tonnes Per Annum
MoPNG	Ministry of Petroleum and Natural Gas
MOSPI	Ministry of Statistics and Programme Implementation
MoU	Memorandum of Understanding
MS	Motor Spirit
MSME	Micro small medium enterprises
MT/MMT	Metric Tonnes/ Million Metric Tonnes
NCCD	National Calamity Contingent Duty
NELP	New Exploration Licensing Policy
NIU	National Information Utility
NOC	National Oil Company
NR	Non resident
NTPC	National Thermal Power Corporation
OIL	Oil India Limited
OISD	Oil Industry Safety Directorate
ONGC	Oil and Natural Gas Corporation
OVL	ONGC Videsh Limited
OMC	Oil Marketing Companies
PDS	Public Distribution System
PDSN	PDS Network
PE	Permanent Establishment
PGBP	Profits and Gains of Business or Profession
PLL	Petronet LNG Limited
PNG	Piped Natural Gas
PNGRB	Petroleum and Natural Gas Regulatory Board
POL	Petroleum Oil & Lubricants
PSC	Production Sharing Contract
PSU	Public Sector Undertaking
QFI	Qualified Foreign Investors
R&D	Research and Development
RIL	Reliance Industries Limited
R-LNG	Regasified Liquid Natural Gas
SAED	Special Additional Excise Duty
SC	Supreme Court
SEZ	Special Economic Zone
SIDBI	Small Industries Development Bank of India
TAPI	Turkmenistan-Afghanistan-Pakistan-India
Tax Treaty	Double Taxation Avoidance Agreement
TCF	Trillion Cubic Feet
TCS	Tax Collected at Source
TDS	Tax Deducted at Source
The Act	Income-tax Act, 1961
TP	Transfer Pricing
TPO	Transfer Pricing Officer
Tribunal	Income Tax Appellate Tribunal
UIDAI	Unique Identification Authority of India
UIN	Unique Identification Number
VAT	Value Added Tax
WPI	Wholesale Price Index
WPC	World Petroleum Congress
w.r.e.f.	With retrospective effect from
w.e.f.	With effect from

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It is a Registered Society of Indian and International Companies/Associations
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It acts as an oil industry interface with Government, regulatory authorities, public and representatives bodies of traders. It helps in resolution of issues
and facilitates evolution of hydrocarbons related policies and regulations. It represents the industry on Government bodies, committees & task forces.

PetroFed organizes seminars, conferences, workshops, training programmes, lectures and brings out technical publications. It promotes energy conservation, health, safety & environment and helps to optimize resource utilization of members. It produces a quarterly journal.

It functions through knowledge committees from member organizations and other experts and bodies of knowledge, covering all aspects of oil and gas industry, which submit recommendations on ongoing basis.

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