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Going forward
Implications of the Union Budget 2013 on the Oil and gas Industry

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Chapter 1

India Union Budget 2013-2014 perspective

Months before the budget day, the oil and gas sector had started to receive signals that the exchequer was looking to the sector for addressing the fiscal deficit situation. Diesel prices were raised. Oil companies also announced their plan to continue to raise the diesel price in small amounts and to cap the number of subsidised cylinders to be issued per household. The desire to pass on the cost burden of petroleum fuels to consumers was evident. The need of PSU oil marketing companies for reducing under-recoveries was addressed, albeit not to the full extent.

The budget speech dealt with an altogether different but critical subject of energy security. The acknowledgement by the government of the need to reduce import dependency by enhancing domestic oil and gas production was evident in the budget speech. Stops in hydrocarbon sector for energy securitisation appear to be getting challenged by the government. Resolving policy ambiguities, allowing economic value of gas to reflect in its price, tapping unconventional hydrocarbon and importing more LNG also appear to be high on the government's agenda.

The finance minister reconfirmed the progress of the government on many fronts. Promise of reviewing the gas pricing policy to remove ambiguities meant a lot to the exploration and production sector. If the ongoing consultation amongst the stakeholders is any indication, the government appears to be in a mood to accept the principles of gas pricing recently suggested by Dr Rangarajan Committee. Thus, the producers are proposed to be getting price that producers in gas exporting countries get. Early indications are that the prices will rise. Investors will be very happy with the development, albeit at the cost of some discomfort to the power and fertiliser sectors and to the consumers in turn.

The budget speech announced that in the E&P industry, revenue share will replace the current profit share mechanism. This is a double-edged weapon. This provision will help investors to not be subjected to cost scrutiny, even though CAG audits are not entirely avoidable in a democratic country like India. However, the withdrawal of cost recovery mechanism exposes investors to more risks of investments, and that may dissuade large oil companies from investing in India. Nonetheless, the attractiveness of such a change will be proven in next round of awards incorporating this change. Benefits of this regime will be seen years later when oil and gas under future contracts will start to get produced.

Another clear acknowledgement of need of domestic oil production was in the intent of the government to clear the stalled NELP blocks. Typically, such clearances will be subject to conditions, to deal with ambiguities or circumstances which held clearances back. The obvious demand of the investors would be that the conditions need to be pragmatic and facilitating. The government would understand that long-term gains of energy securitisation are immense as compared to short-term revenue benefits.

Regarding the shale gas policy introduction, investors are of mixed opinion. If a new policy is taking so much time to be introduced, can the existing policy not start unlocking the shale benefits? Could any issues in shale oil and gas development experiences not be dealt with a specific policy at a later date? Apprehensions are also being raised about new policy's ability to deal with all issues comprehensively to make the shale development successful.

The Indian economy continued to face challenging environment during FY 2012-13 due to uncertain global economic environment, rising energy prices and status quo on domestic policy front.

According to latest estimates released by the CSO, the Indian economy is likely to grow at 5% in FY 2012-13, the slowest in the last decade. Indian economy is, thus, facing a twin challenge of controlling its current and fiscal account deficit while spurring the growth to bring the economy back on the growth path. The government has been able to contain fiscal deficit to 5.2% of GDP against the budget estimate of 5.3%. The continued Euro Zone crisis and gloomy economic trends in major economies contributed negatively, impacting India's exports negatively. This, along with high crude prices and increased gold imports led to a widening trade gap; hence, the current account deficit has reached to 3.9% of GDP.

In order to achieve the dual objective of creating positive business environment spurring economic growth and achieving fiscal consolidation to ensure long-term macroeconomic stability, the union budget has proposed expenditure management and moderately increasing government's revenue. Based on fiscal consolidation measures proposed in the budget, fiscal deficit for FY 2013-2014 is projected to come down to 4.8% from 5.2%. At the same time, the government is hopeful that Indian economy will grow at 6.5% in FY 2013-2014 as against 5% in FY 2012-13. However, rising oil prices may pose a significant challenge in achieving the targeted fiscal deficit and growth target, considering that the government has budgeted for petroleum subsidy of 65,000 crore INR based on the crude oil price of 110 USD per barrel at the current exchange rate.

Our recent publication 'It's our turn now – E&P partnership for energy security' had stated that the hydrocarbon sector can make or mar the economy. It's good news that the government has decided to take actions to strengthen the domestic production and to reduce the weakening of financial health of oil marketing companies.

Going forward, the oil and gas sector will increasingly be at the centre of action for the economy.

Chapter 2

The Economic Survey 2012-13

The Economic Division of the Ministry of Finance, government of India released the Economic Survey 2012-13 on 27 February 2013. The following excerpts of the Survey present the macroeconomic context to the developments in the oil and gas sector for the year 2012-13.

State of economy

In the financial year 2012-13, the Indian economy witnessed a slowdown in economic growth primarily attributed to weakness in industrial growth. High rates as well as policy constraints adversely impacted investment resulting in slowing down the GDP growth rate to 5% for 2012-13.

At a sectoral level, growth in agriculture has also been weak in 2012-13, following lower than-normal rainfall, especially in the initial phases (months of June and July) of the south-west monsoon. The industrial sector (comprising the mining and quarrying, manufacturing, electricity, gas and water supply and construction sectors) registered a growth rate of 3.1% in 2012-13 with the rate of growth of the manufacturing sector being even lower at 1.9%.

After achieving double-digit growth for five years and narrowly missing double digits in the sixth year (between 2005-06 and 2010-11), the growth rate of the services sector also declined to 8.2% in 2011-12 and 6.6% in 2012-13. In 2011-12, the sectors that particularly slowed within the services sector was trade, hotels and restaurants as well as transport and communications, with their growth further declining in 2012-13. Activities in this sector, being forms of derived demand, tend to grow at a slower rate with the slackening of economic activity in the industry and agriculture sectors.

A number of factors are responsible for the economy to slow down so rapidly despite recovering strongly from the global financial crisis. First, the boost to demand given by monetary and fiscal stimulus following the crisis was large. Final consumption grew at an average of over 8% annually between 2009-10 and 2011-12. The result was strong inflation and a powerful monetary response that also slowed consumption demand.

Second, starting in 2011-12, corporate and infrastructure investment started slowing, both as a result of investment bottlenecks as well as the tighter monetary policy. Thirdly, even as the economy slowed, it was hit by two additional shocks: a slowing global economy, weighed down by the crisis in the Euro area and uncertainties about fiscal policy in the US, and a weak monsoon, at least in its initial phase.

As growth slowed and government revenues did not keep pace with spending, the fiscal deficit threatened to breach the target. With government savings falling, and private savings also shrinking, the current account deficit (CAD) also widened. As a result of weak growth in trading partner countries, Indian exports also declined. In the first half of FY 2012-13 (April-September 2012), there was a steep decline in exports. Imports did not decline as much in percentage point terms. Inelastic oil imports were the primary reason for the relatively smaller decline of imports. All these in conjunction contributed to widening the CAD.

India cannot take the external environment for granted and has to move quickly to restore domestic balance. The government is committed to fiscal consolidation. This along with demand compression and augmented agricultural production should lead to lower inflation, giving the RBI the requisite flexibility to reduce policy rates. Lower interest rates could provide an additional fillip to investment activity for the industry and services sectors, especially if some of the regulatory, bureaucratic and financial impediments to investment are eased.

Given such a scenario, where all three major sectors of the economy perform better in 2013-14 as compared to 2012-13, the overall economy is expected to grow in the range of 6.1 to 6.7% in 2013-14. Of course, these projections assume a normal monsoon, further moderation in inflation as expected (to induce further relaxation of the tight monetary stance), and mild recovery of global growth as anticipated.

Prices

Headline wholesale price index (WPI) inflation which averaged 9.56% in 2010-11 and 8.94% in 2011-2012 decelerated to 7.55% in the first nine months of 2012-13 (April-December). Although in December 2012, inflation was at a three-year low of 7.18%, it has been in the range of 7 to 8% in the last 13 months.

Relative importance of different commodity groups contributing to this persistent inflation, however, changed over time. The persistently elevated prices for animal products (eggs, meat and fish), the rise in the prices of cereals and vegetables, along with the increase in international prices of fertilisers (non-urea) and the increase in administered prices of diesel have contributed to inflation in differing degrees over time. The build-up in price pressures seems to have tapered off in recent months, as headline WPI has remained steady. Month-over-month price changes in most commodity groups have been small, indicating that the pressure on generalised inflation has fallen.

The level of inflation and its movement across three major commodity groups varied significantly. Inflation of primary articles with the weight of 20.12% in the WPI, after declining to 6.7% in Q4 of 2011-12, increased in the first three quarters of the current year and was 10.6% in December 2012. Inflation for commodities in the 'fuel and power' group, with a weight of 14.91% in the WPI witnessed some moderation in the current year.

Apart from the base effect, deceleration in the inflation of non-administered petroleum products contributed to the moderation. This helped contain the effects of the increase in administered prices of diesel effected in September 2012. Finally, the deceleration in the inflation of manufactured products with a weight of 64.97% in WPI, was relatively sharp.

The prices of non-administered petroleum products tracked international prices and witnessed moderation in inflation from its peak in Q3 of 2011-12. The increase in inflation of administered petroleum products in Q3 of 2012-13 was due to an increase in the prices of diesel. Diesel prices have been revised again in January and the inflationary impact of this revision would be reflected in the WPI for January 2013. While this will add to inflation, it will also reduce suppressed inflation, and through its contribution to fiscal consolidation, have a moderating effect in the long run.

An inter-ministerial group (IMG) on inflation was set up on 2 February 2011, on the recommendation of the Prime Minister, under the chairmanship of the Chief Economic Advisor, Ministry of Finance to review the overall inflation situation, with particular reference to primary food articles. The IMG has so far had eight meetings between 15 February 2011 and 31 January 2012 covering various aspects, including information system on all aspects of price monitoring, foreign direct investment (FDI) in multi-brand retail, reform in the APMC Act, policy options for diesel pricing and inflation in protein-rich products, among others.

In the sixth and seventh meetings of the IMG held on 28 May 2012 and 14 September 2012, it had discussed policy options to reduce price distortions between diesel and other petroleum products. It was suggested that subsidy on diesel may be gradually shifted to fixed per litre basis and price adjustment could be more frequent at regular intervals, maybe even monthly. It was also mentioned that any revision in diesel prices would have direct as well as indirect impact on inflation, which continues to be at elevated levels.

External trade

Bolstered by the measures taken by the government to help exports in the aftermath of the world recession of 2008 and also the low base effect, India's export growth in 2010-11 reached an all-time high of 40.5%, since Independence. Though it decelerated in 2011-12 to 21.3%, it was still above 20% and higher than the compound annual growth rate (CAGR) of 20.3% for the period 2004-5 to 2011-12.

After registering high growth of 56.5% in July 2011, export growth started decelerating with a sudden fall to single digits in November 2011 as a result of the emerging global situation and then to negative figures from March 2012. Monthly export growth rates in 2012-13 (April-December) were negative except for a marginal positive growth in April 2012. For three months in 2012-13, exports declined YOY by double digits with the largest decline recorded in July 2012 at -15.1%. In January, 2013, there is a marginal positive growth of 0.8%.

Export growth in dollar terms was negative at -4.9% in 2012-13 (April-January), compared to 21.3% growth in 2011-12 (full year). In rupee terms, it was positive at 9.1%, though here too, there was a deceleration from the 28.3% in 2011-12 (full year).

There are at least two reasons for the decline in export growth: external factors or partner country incomes changes in exchange rate. GDP growth of partner countries has also slowed down significantly. This would exert a negative effect on India's export growth. On the other hand, the real effective exchange rate for India has depreciated, suggesting a positive effect on exports.

After recovering in 2010-11 from the previous year's fall, India's merchandise imports increased further to 489.2 billion USD with a growth of 32.3% in 2011-12. This was due to the increase of 46.2% in the growth of petroleum, oil, and lubricant (POL) imports and non-POL imports by 26.7%. POL imports (with a share of 31.7% in India's total imports) registered high growth mainly due to an increase in the import price of the Indian crude oil import basket by 31.5% in 2011-12 as against 22% in 2010-11.

POL import volume growth decelerated from 14.9% in 2009-10 to 3.7% in 2010-11 and 3.5% in 2011-12. International oil prices (Brent) which reached a high of 132.47 USD per bbl in July 2008 declined sharply to 40.35USD per bbl in December 2008, following the global recession. From 2009 onwards, oil price has been increasing with intermittent volatility, reaching 125.33 USD per bbl in March 2012 and falling marginally with volatility in the following months. Currently Brent oil price is hovering around 110 USD per bbl.

At 406.9 billion USD imports in 2012-13 (April-January) registered a growth of 0.01%. During 2012-13 (April-December), POL imports at 125.2 billion USD grew by 12.8%.

Trade deficit (on customs basis) reached a peak of 184.6 billion USD in 2011-12 from 118.6 billion USD in 2010-11 with the highest growth of 55.6% since 1950-1. Moderate export growth and high import growth, particularly in POL imports due to high prices and high gold and silver imports, led to the highest-ever trade deficit in India since 1950-1, contributing to a high current account deficit (CAD) of 4.2% of GDP.

POL imports grew by 46.2% in 2011-12. POL export growth was relatively lower at 34% due to lower growth in the quantum of POL exports by 3.8%, resulting in net POL imports increasing to 99.3 billion USD in 2011-12. In 2012-13 (April-November), though POL import growth moderated to 11.7%, POL export growth was negative at -7.3% which was also due to the decline in the volume of POL exports by -0.9%. As a result, the share of net POL imports in total imports increased to 23.5% in 2012-13 (April-November) compared to 20.3% in 2011-12 (whole year).

Compositional changes in India's export basket have been taking place over the years. Share of petroleum, crude and products exports, which also include refined items, increased from 4.3% in 2000-1 to 18.3% in 2011-12 and 18.6% in 2012-13 (April-November).

There have been some significant compositional changes in India's import basket in recent years. The share of POL imports increased from 28.7% in 2010-11 to 31.7% in 2011-12 (with a very high growth rate) and 34.6% in 2012-13 (April-November).

Subsidies

The Budget for 2011-12 had estimated total expenditure to be contained at 14.0% of GDP. There was an overshooting on account of the high global oil prices and the insufficient pass-through to domestic oil and fertiliser prices. The overshooting of expenditure on subsidies was also because of the accounting changes which placed all subsidies ‘above the line’.

The Budget for 2012-13 estimated growth in total expenditure at 13.1% over 2011-12 (RE) and sought to restrict expenditure on subsidies to 2% of GDP. As against a provision of 3,640 crore INR in 2011-12 for oil subsidies, the Budget for 2012-13 provisioned an amount of 3,580 crore INR assuming a certain level of global crude oil price. It must be noted that oil subsidies are paid to oil marketing companies (OMC) on a calendar-year basis because only after quarterly results are declared is the subsidy released.

In the event, the Indian basket crude oil was 107.52 USD per bbl (April-December) in 2012 and even with the pass-through effected in the course of the year, under-recoveries of OMCs surged and were estimated at 1,24,854 crore INR during April-December 2012-13. As the bulk of the under-recoveries is accounted for by two subsidised products, viz. diesel and LPG, the government raised diesel prices by 5 INR per litre and capped the subsidised cylinders at six per connection per year in September 2012. With continued rise in prices, on 17 January 2013 the government further permitted OMCs to raise diesel prices in small measures periodically. However, in order to protect household budgets, it simultaneously raised the annual LPG cap from six to nine cylinders per connection.

The high level of global crude oil prices also has a significant bearing on the level of fertiliser subsidies because it is not only a key input as feedstock, but also because there is inadequate pass-through in urea (the major domestic fertiliser) prices. Subsidy on fertilisers had increased substantially from 32,490 crore INR in 2007-8 to reach 67,199 crore INR in 2011-12 (RE). It is budgeted at 60,974 crore INR in 2012-13.

Oil and gas sector

During FY 2011-12, crude oil production was 38.09 million metric tonnes (MMT) with the share of national oil companies at 72.4%. The projected crude oil production in 2012-13 is 42.31 MMT which is about 11.1% higher than that in 2011-12. The increase in production is expected mainly on account of higher crude oil production from Barmer Fields, Rajasthan. Crude oil production by Cairn Energy India Pvt Ltd in Rajasthan started with effect from 29 August 2009 and reached 5.77 MMT during April-November 2012 against 4.26 MMT during the same period of 2011-12. Overall crude oil production during April-November 2012-13 at 25.39 MMT, however, shows a negative growth of 0.54% over the same period of the previous year.

The average natural gas production in the year 2011-12 was 130 million metric standard cubic metre per day (MMSCMD) which was about 9% lower than the previous year mainly due to lower production from the KG D6 deep-water block. The projected natural gas production in 2012-13 is about 117.8 MMSCMD, which is about 9% lower than production in the previous year. Natural gas production during April- November 2012-13 was 28.05 billion cubic metre (BCM) as compared to 32.28 BCM during the same period of the previous year.

Exploration of domestic oil and gas

As on April 2012, about 737 MMT of oil equivalent hydrocarbon reserves have been added under the NELP. The investment made by Indian and foreign companies until April 2012 was of the order of 20.2 billion USD, of which 12.1 billion USD was on hydrocarbon exploration and 8.1 billion USD was on the development of discoveries. With a view to further accelerating the pace of exploration, in the ninth round of the NELP (NELP-IX), 34 exploration blocks were offered. These include eight deep-water blocks, seven shallow-water blocks, 11 on-land blocks, and eight Type-S on-land blocks. Nineteen production-sharing contracts have already been signed with the awardees. A total of 254 production-sharing contracts have been signed under the NELP so far.

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 have so far been established. Commercial production of CBM in India has now become a reality with current CBM gas production of about 0.28 MMSCMD.

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. The shale gas formations are spread over several sedimentary basins such as Cambay, Gondwana, Krishna-Godawari on-land and the Cauvery. The Directorate General of Hydrocarbans (DGH) has initiated steps to identify prospective areas for shale gas exploration.

A multi-organisational team (MOT) of the DGH, Oil and Natural Gas Corporation (ONGC), Oil India Limited (OIL) and Gas Authority of India Limited (GAIL) has been formed by the government to examine the existing data set and suggest a methodology for shale gas development in India. Further, a memorandum of understanding (MoU) between the Department of State, USA and the Ministry of Petroleum and Natural Gas has been signed for the assessment of shale gas resources in India, imparting training to Indian geo-scientists and engineers and assistance in the formulation of regulatory frameworks. A draft shale oil / gas policy was placed in the public domain by the government for inviting comments. The views and comments received from various stakeholders and agencies are under examination.

Equity oil and gas from abroad

In view of an unfavourable demand-supply ratio of hydrocarbons in the country, acquiring equity oil and gas assets overseas is an important strategy for enhancing energy security. The government is encouraging national oil companies to aggressively pursue equity oil and gas opportunities overseas. ONGC Videsh Limited (OVL) has produced about 8.753 MMT of oil and equivalent gas during 2011-12 from its assets in Sudan, Vietnam, Venezuela, Russia, Syria, Brazil, South Sudan and Colombia.

The estimated crude oil and natural gas production in 2012-13 is about 6.865 MMT. The reasons for lower overseas production are geopolitical problems in South Sudan and Syria. Oil public-sector units (PSU), viz. OVL, India Oil Corporation (IOC), OIL, Bharat Petroleum Corporation Limited (BPCL), Hindustan Petroleum Corporation Limited (HPCL), and GAIL have acquired exploration and production (E&P) assets in more than 20 countries.

Refining capacity

The total refining capacity in the country increased from 187.4 MMT (as on 1 April 2011) to 215.1 MMT (as on 1 January 2013) and is projected to reach 218.4 MMT by the end of 2012-13 and 239.6 MMT in 2013-14 with capacity augmentation of existing refineries and commissioning of the Paradip Refinery. Refinery production (crude throughput) during 2011-12 was 211.4 MMT (including the Jamnagar Refinery under the special economic zone [SEZ] by Reliance Industries Ltd) showing an increase of 2.6% compared to a production of 206.15 MMT in 2010-11.

During the current financial year (April-November 2012-13), refinery production (crude throughput) is 141.45 MMT. The country is not only self-sufficient in refining capacity for its domestic consumption but also exports petroleum products substantially. During 2011-12, the country exported 60.84 MMT of petroleum products worth 2,66,486 crore INR.

Pipeline network and city gas distribution (CGD) network

There has been substantial increase in the pipelines network in the country with 32 product pipelines with a length of 11,274 km and capacity of 70.688 MMT at present. There are also 16 crude pipelines spreading over 8,558 km with a capacity of 106.45 MMT. In addition, there are LPG pipelines of 2,313 km with 3.94 MMT capacity and gas pipelines of 13,428 km with 355 MMSCMD capacity. The gas pipeline infrastructure is being augmented with about 14,889 km of pipeline network with additional capacity to transport 264 MMSCMD of gas by 2015-16. In addition, around 4,300 km of pipeline network has been authorised by the Petroleum and Natural Gas Regulatory Board (PNGRB) which will further add capacity to transport 184 MMSCMD of gas.

With increased availability of gas in the country, the city gas distribution (CGD) network has been enlarged to cover various cities supplying gas for domestic consumers, public transport, and commercial and industrial entities. At present, there are a total of 588 compressed natural gas (CNG) stations across the country. Vision 2015 envisages providing piped natural gas (PNG) to more than 200 cities across the country. The current consumption of gas in the CGD network is around 14 MMSCMD, of which 6.63 MMSCMD is from regasified liquefied natural gas (RLNG). At present, there are several entities operating in 43 geographical areas (GAs). The PNGRB has recently invited bids for authorisation of CGD in these cities. The CGD sector comprises CNG and PNG customers. The PNGRB has envisaged a rollout 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.

Rajiv Gandhi Gramin LPG Vitaran Yojana (RGGLVY)

Vision-2015 adopted for the LPG sector inter alia focuses on raising the LPG population coverage in rural areas and areas where LPG coverage is low. The Rajiv Gandhi Gramin LPG Vitaran Yojana (RGGLVY) for small-size LPG distribution agencies has been launched in 2009.

Under this scheme 75% of the population is to be covered by 2015 by releasing 5.5 crore new LPG connections. To ensure that growth of LPG usage is evenly spread, public-sector oil marketing companies (OMCs) are assessing and identifying locations in a phased manner under the RGGLVY. OMCs have undertaken to set up 5,261 LPG distributors in 29 states. Out of this, 1,591 LPG distributors had already been commissioned as on 1 November 2012. Selection for the rest of the locations is in progress as per policy.

Free LPG connections to BPL rural households

In order to check leakages, adulteration and inefficiency resulting from the current system of delivery of subsidised products, the government of India set up a task force for evolving a suitable mechanism for the direct transfer of subsidies to individuals and families entitled to subsidised kerosene, LPG and fertilisers. A pilot project was launched in Mysore. So far, details of 35,000 customers have been collected. Of these, nearly 18,000 have authenticated Aadhaar numbers. As on 25 November 2012, OMCs had completed more than 35,000 successful biometric-authenticated deliveries. Modalities on subsidy payment as token amount (10 INR) have been finalised with a sponsor bank and participating banks using the Aadhaar payment bridge. It has now been decided to close the Mysore Pilot Project as Mysore is one of the 51 districts selected for roll-out under the wider direct benefit transfer scheme.

Energy prices

In case of petroleum products pricing, the government dismantled the administered pricing mechanism in 2002. This decision, however, was not fully implemented and domestic pass-through of global price increases remained low for petrol, diesel, kerosene and LPG. On 25 June 2010, the government announced that the price of petrol was fully deregulated and the oil companies were free to fix it periodically.

However, diesel price deregulation was deferred. In January 2013, the government announced the new roadmap providing for a gradual price increase for reducing diesel under-recoveries.

Admissibility of a subsidised number of liquefied petroleum gas (LPG) cylinders and prices of LPG have also recently been revised.

Pricing of gas is presently done under the new exploration licensing policy (NELP). The government provides the operator freedom to sell the gas produced from the NELP blocks at a market-determined price, subject to the approval of the pricing formula. The government is reviewing pricing under the price-sharing contract (PSC) to clarify the extent to which producers will have the freedom to market the gas.

Owing to a number of external and internal factors, the viability of airline operations in India has come under stress. A high operating cost environment owing to high and rising costs of aviation turbine fuel (ATF) coupled with rupee depreciation is making operations unviable for carriers in India. The expert report of Nathan Economic Consulting India Private Ltd (Nathan India) which went into the question of pricing and the tax regime governing ATF concluded that ATF prices in India are significantly higher (at least 40%) than in competing hubs in the region such as Singapore, Hong Kong and Dubai.

Therefore, there is need to rationalise the tax regime, particularly value-added tax on ATF which is in the range of 20 to 30% in most states. The Ministry of Civil Aviation is of the view that ATF should be included under the declared category of goods under the relevant provision of the Central Sales Tax Act so that a uniform levy of 5% is achieved. Equally important is the need for a transparent pricing regime for ATF in India. A high tax regime for aviation in general and ATF in particular will reduce the wider economic benefits available from aviation, resulting in negative impact on economic growth and overall government revenue bases.

VGF for PPP projects

Under the scheme for financial support to PPPs in infrastructure (Viability Gap Funding Scheme) [VGF], 145 projects have been granted approval with a total project cost (TPC) of 80,203.28 crore INR and a VGF support of 1,56,72.68 crore INR and 902.96 crore INR has been disbursed. Thirteen new sub-sectors have been included in the list of sectors eligible for VGF support under the scheme. These include the following:

- Oil, gas and liquefied natural gas (LNG) storage facility [includes city gas distribution (CGD) network; oil and gas pipelines (includes CGD network); irrigation (dams, channels, embankments, etc); telecommunication (fixed network) (includes optic fibre, wire, cable networks which provide broadband and internet); telecommunication towers; terminal markets; common infrastructure in agriculture markets; and soil-testing laboratories
- Capital investment in the creation of modern storage capacity including cold chains and post-harvest storage
- Education, health and skill development
- Internal infrastructure in national investment and manufacturing zones

Chapter 3

Analysis of Union Budget 2013-2014

Personal tax rates

- The tax slabs for individuals, HUFs, AOPs and BOIs remain unchanged
- Surcharge of 10% applicable for individuals having total income more than 1 crore INR.
- Tax credit of 2,000 INR is available to individuals having total income more than 2 lakh INR but less than or equal to 5 lakh INR.
- One-time interest deduction of 1 lakh INR is available on housing loan taken by first home buyer.

Corporate tax rates

- Corporate income tax rate is proposed to remain unchanged at 30%.
- The MAT rate remains unchanged at 18.5%.
- The DDT rate also remains unchanged at 15%.
- Surcharge rate remains unchanged for the companies having income up to 10 crore INR. For companies having income or book profits more than 10 crore INR, the rate is proposed to increase as follows:
  - Domestic companies: From 5% to 10%
  - Foreign companies: 2% to 5%

- Effective rate as follows:

Category of tax payer	Existing effective rate	Proposed effective rate
On domestic companies		
• Income less than 1 crore INR	30.90%	30.90%
• Income more than 1 crore INR but less than 10 crore INR	32.44%	32.44%
• Income more than 10 crore INR	32.44%	33.99%
On foreign company		
• Income less than 1 crore INR	41.20%	41.20%
• Income more than 1 crore INR but less than 10 crore INR	42.02%	42.02%
• Income more than 10 crore INR	42.02%	43.26%

- The higher surcharge rate of 10% is also applicable for dividend distribution tax.
- The concessional rate of 5% of withholding tax on interest paid by an Indian company further extended to investment in long-term infrastructure bonds through Indian rupee denominated designated accounts by foreign companies.

Tax holiday: 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 31 March 2014 (from the present 31 March 2013):
  - 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.

International taxation

Tax rate for royalty and fees for technical services (FTS)

- At present, the tax rate applicable on royalty and fees for technical services (FTS), on a gross basis, varies from 10% to 30% depending upon the date on which the agreement was entered into. However, the tax treaties with different countries provide for taxability of gross amount of royalty/ FTS at the tax rate ranging from 10% to 25%.
- The Finance Bill, 2013 proposes to streamline the tax rate of royalty or FTS at 25% under the Indian tax law subject to benefit under tax treaties.
- This amendment will take effect from 1 April 2014 and will, accordingly, apply in relation to the tax year 2013-14 and subsequent years.

Tax residency certificate

- The Finance Bill, 2013 seeks to amend sections 90 and 90A in order to provide that submission of a tax residency certificate is a necessary but not a sufficient condition for claiming treaty benefits.

- This amendment will take effect retrospectively from 1 April 2013 and will, accordingly, apply in relation to the tax year 2012-13 and subsequent years.

General Anti-Avoidance Rules (GAAR)

- It is proposed that GAAR will come into effect from tax year 2015-16.
- It will apply to impermissible avoidance arrangements, whose main purpose is to obtain a tax benefit (in addition to the other conditions). The onus is on the taxpayer to prove the genuineness of the transaction. All arrangements will be presumed to have been entered into with the main purpose of obtaining a tax benefit, unless the contrary is proved by the tax payer. An arrangement will be deemed to be lacking commercial substance, if inter alia, the arrangement does not have a significant effect upon the business risks or net cash flows of any party to the arrangement (apart from the tax benefit).
- In the last year's budget, the following factors were specifically excluded for determining whether an arrangement lacks commercial substance: (i) period of time of existence of arrangement; (ii) payment of taxes under the arrangement; (iii) exit route is provided under the arrangement. The new law provides that the aforesaid factors may be relevant but shall not be sufficient for determining whether an arrangement lacks or does not lack commercial substance.
- The directions of the Approving Panel are binding on the revenue department as well as the tax payer. The assessment orders passed with the directions of the Panel continue to be appealable by the taxpayer to the ITAT. The approval panel will comprise of Chairperson (who is/ has been judge of a High Court), one member from IRS (not below rank of CCIT) and another member will be an academic/ scholar having special knowledge of direct taxes, business accounts and international trade practices.
- The GAAR provisions are silent on the following recommendations of the Shome Committee which the Government had specifically accepted:
  - Grandfathering of the investments made before 30 August 2010
  - Monetary threshold of 3 crore INR of tax benefit in the arrangement. The draft guidelines had recommended that a monetary threshold be prescribed for the application of GAAR
  - Where a part of the arrangement is an impermissible avoidance arrangement, GAAR will be restricted to the tax consequence of the impermissible part and not to the whole arrangement
  - Corresponding adjustment to the tax payer's requirement to issue show cause notice by tax officer

Investment allowance

- On the acquisition of new plant and machinery worth more than 100 crore INR, the companies engaged in manufacturing or production of any article or thing shall be eligible to claim an investment allowance maximum of 15% during financial year 2013-14 and 2014-15.
- The benefit of this allowance shall only be available for financial year up to 2014-15.
- Benefit of investment allowance shall not be available to following:
  - Used plant or machinery
  - Office equipments or plant & machinery installed at residential accommodation
  - any office appliances including computers or computer software
  - any vehicle
  - ship or aircraft
  - any plant or machinery, the whole of the actual cost of which is allowed as deduction.
- In case of transfer of new asset before 5 years of installation, the amount of deduction allowed shall be treated as income.
- The above incentive would be in addition to the normal and additional depreciation on the same plant & machinery.

Dividend Distribution Tax (DDT)

- Dividend received by Indian company from its foreign subsidiary not to attract dividend distribution on further distribution by Indian company to its share holders
- Concessional tax rate of 15% on dividends received by domestic company from its overseas subsidiary allowed for one more year
- DDT of 20% to be levied on share buyback by an unlisted company. No taxation in the hands of shareholder

Transfer of immovable property

- At present, in case of a transfer of an immovable property for a consideration less than the value adopted by any authority of a State Government for the purpose of payment of stamp duty, the full value of consideration for the purpose of capital gains is taken to be the stamp duty value.
- These provisions do not apply to transfer of immovable property, held by the transferor as stock-in-trade.
- It is proposed that stamp duty value be adopted for sale of land and building held as stock in trade, if transferred for a value less than the stamp duty value.
- Under the existing provisions, transfer of immovable property for inadequate consideration is taxed in the hands of the transferee, if it is a company. It is proposed by the Bill to extend it to the transferees, who are individuals or HUF.

Tax deduction on transfer of certain immovable properties

- Under the present law, buyer is not required to deducted tax at source on transfer of immovable property by a resident (except in the case of compulsory acquisition of certain immovable properties).
- It is proposed to introduce a new section in the Act for withholding tax at1% of consideration on transfer of immovable property (other than agricultural land).
- These provisions shall not apply if the total consideration is less than 50 lakh INR.

Liability of director in case of private companies

- The current provisions provide for the recovery of dues from the directors of the private company. But such dues were limited to 'tax' payable under the Act. Judiciary interpreted that these provisions do not apply for recovery of penalty, interest and any other sum payable under the Act.
- The Finance Bill, 2013 proposes to clarify that the term "tax due" includes penalty, interest or any other sum payable under the Act.

Commodity Transaction Tax (CTT)

- CTT of 0.01% has been introduced on transaction of sale of commodity derivative in respect of commodities other than agricultural commodities. The same would be treated as non-speculative and would be allowed as deduction.

Transfer pricing provisions

- Rules on safe harbour will be issued after examining the reports of the Rangachary Committee, which is expected by 31 March 2013.

Wealth Tax

- Wealth Tax returns to be filed electronically
- Rules pertaining to electronic filing of wealth tax return to be notified

Policy

- It is proposed that the oil and gas exploration policy will be reviewed to move from profit sharing to revenue sharing contracts.
- A policy to encourage exploration and production of shale gas will be announced.
- The natural gas pricing policy will be reviewed and uncertainties regarding pricing will be removed.
- NELP blocks that were awarded but are stalled will be cleared.

Direct Taxes Code

- The government's endeavour is to bring DTC to the Parliament before the end of the Budget session.

Tax Administration Reform Commission

- It is proposed to set up a Tax Administration Reform Commission:
  - to review the application of tax policies and tax laws; and
  - submit periodic reports that can be implemented for strengthening the capacity of tax system.

Scorecard (DT)

Removal or extension of sunset clause for tax holiday on income from production of mineral oil to blocks licensed under NELP IX	No
Availability of tax holiday under section 80-IB (9) on the natural gas produced from all the blocks awarded under NELP/CBM or in any other manner by the Central or State Government	No
Tax holiday should be given to each well treating, it as a separate 'undertaking'	No
Ceiling of 20% on the deduction for investment into site restoration fund either removed or increased to 50%	No
Tax holiday to E&P companies to be enhanced to ten years from seven years and flexibility to choose period of ten tears of tax holiday out of 15 Years	No
Extension of the sunset clause beyond 31 March 2012 to 31 March 2016 for tax holiday under section 80-IA(4) for undertakings set up for generation or generation and distribution of power	Yes (Partially)
Exemption from MAT to the companies eligible under section 80-IB(9)	No
Weighted deduction be extended to expenditure in respect of drilling and exploration activities under section 42 in line with R&D expenses	No
Weighted deduction under section 35 (2AB) on R&D activities for bio-fuels	No
Condition for surrender of block to be deleted for claiming deduction for infructuous or abortive exploration expenses under section 42.	No
Benefit under section 35AD to be extended to intra-city and inter-state distribution network	No
Conditions of approval under section 35AD of Petroleum and Natural Gas Regulatory Board (PNGRB) for specified business and availability of common carrier capacity as per PNGRB regulations, may be waived for crude oil pipelines and the dedicated pipelines which are dedicated for supply of petroleum products to a specific consumer	No
Weighted deduction under section 35AD to cross-country pipeline network	No
Removal of restrictions for set off of losses for specified business of section 35AD	No
Infrastructure status to LNG projects for the purpose of tax holiday under section 80-IA	No
100% depreciation allowance on capital investments made by refineries producing fuels for up-gradation of fuel quality as per 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
Deduction Under Section 80-IB (9): Income from Government subsidy and discount on LPG/SKO from upstream companies to be treated as income from the business of the undertaking for the purpose of deduction under section 80-IB(9)	No
Interest under section 234 B and 234 C exemption to oil companies	No
Profit-based or investment-based incentive to OMCs for expansion and up-gradation of their refineries	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 taxes

Goods and Services Tax: Status update

One of the most awaited expectations from the Budget was that the Finance Minister would lay down a clear roadmap for the implementation of GST. The Budget, however, has dashed these hopes to the extent that there was neither any announcement on the likely date of introduction of GST nor a roadmap for its introduction.

Nonetheless, the finance minister has made significant comments which highlight the government's commitment to the expeditious implementation of GST. He announced that a majority of the states agree to the introduction of GST and the consequential need for amendment to the Constitution and the introduction of a draft GST law that will be jointly drafted by the State Finance Ministers and the GST Council. The finance minister was optimistic that the draft bill on constitutional amendment and draft bill on GST will be introduced in Parliament in a few months.

The seriousness of the government to implement GST has been further emphasised by the fact that a sum of 9000 crore INR has been set apart towards the first installment of the balance CST compensation to states. This has been a major stumbling block in moving to a GST regime. It now needs to be seen to what extent the states move forward and work with the government to introduce this transformation in the indirect tax regime of India.

Customs

Tariff

- The median rate of basic customs duty (BCD) has been maintained at 10%.
- There has been no change in the custom duty rates of petroleum products.

Effective 1 March 2013

- BCD and CVD on bituminous coal have been reduced from 5 and 6 to 2% respectively.
- BCD and CVD on steam coal have been increased from nil and 1 to 2% respectively.

Non tariff

Effective the date of enactment of the Finance Bill

- The time limit for the payment of customs duty has reduced from five to two days from the date of return of the bill of entry, failing which the importer will be liable for payment of interest at prescribed rates.
- The maximum period for which the Tribunal can grant a stay of recoveries has been limited to 365 days. The stay will stand vacated if the appeal is not disposed off by the Tribunal within the specified time period of 365 days.
- The scope of activities in relation to which an advance ruling can be obtained has been expanded to cover new business of import or export proposed to be undertaken by the existing importer or exporter, as the case may be.

CENVAT

Tariff

- The standard rate of excise duty for non-petroleum goods has been maintained at 12%.

Non-tariff

Effective 1 March 2013

- The provisions relating to reversal or payment of CENVAT credit on the removal or writing-off of capital goods and inputs have been amended to provide for recovery of amount in case of failure to make the payment in terms of Rule 14 of the Cenvat Credit Rules, 2004.

Effective date of enactment of the Finance Bill

- The following amendments have been made to the Advance Ruling provisions under the Central Excise Act, 1994:
  - Public limited companies have been included in the list of applicants who may make application for advance ruling (effective 1 March 2013).
  - The scope of activities in relation to which an advance ruling can be obtained have been expanded to cover production or manufacture of goods including any new business of production or manufacture proposed to be undertaken by any existing manufacturer or producer.
  - The scope of advance rulings has been expanded to include the question relating to the admissibility of CENVAT credit of service tax paid on input services. Prior to the amendment, the advance ruling was restricted to the availability of CENVAT credit on goods used in the manufacturing process.
- The maximum period for which the Tribunal can grant a stay of recoveries has been limited to 365 days. The stay would stand vacated if the appeal is not disposed off by the Tribunal within the specified time period of 365 days.
- The scope of mode of delivery of decisions, order and summons has been expanded to cover speed-post with proof of delivery and couriers as approved by the CBEC.

Service tax

Effective 1 March 2013

- Public limited companies have been included in the list of applicants who may make an application for advance ruling under Sec 96A of the Finance Act, 1994 (Finance Act).

Effective 1 April 2013

- Exemptions from payment of service tax on the transportation of petroleum and petroleum products through rail or vessel has been withdrawn.
- The scope of service tax has been expanded to cover air-conditioned restaurants whether or not having the licence to serve liquor.

Effective date of enactment of the Finance Bill

- A negative list of services has been expanded to include processes under the Medical and Toilet Preparations (Excise Duties) Act, 1955 under the category of 'process amounting to manufacture or production'.
- Provisions have been introduced for the levy of penalty which may extend to 1 lakh INR on directors, managers, secretaries or other officers of such company who were in charge at the time of specified contraventions. Also, specific provisions have been introduced to arrest a person in case of specific contraventions.
- The maximum period for which the Tribunal can grant a stay of recoveries has been limited to 365 days. The stay will stand vacated if the appeal is not disposed off by the Tribunal within the specified time period of 365 days.
- The government has introduced a one-time scheme called the voluntary compliance encouragement scheme to give the benefit to tax defaulters. The scheme can be availed of by specified persons after making truthful declaration of all pending tax dues for the period 1 October 2007 to 31 December 2012 and subject to the conditions prescribed. The scheme is not available to assessees to whom any notice or an order of determination has been issued as on 1 March 2013.

Scorecard (IDT)	
Clarification to the effect that mere cash transactions between members and the unincorporated joint ventures and between the members inter-se shall not qualify as services; hence, will not be leviable to service tax	No
Exemption from service tax on input services consumed by E&P companies in relation to exploration and production activities	No
Exemption from payment of service tax on transportation of petroleum products by road or pipelines	No
No service tax implications on recoveries made by an employer from employee	No
Service tax adjustments for amounts written off as bad debts	No
Withdrawal of requirement to pay service tax under partial reverse mechanism	No
Expansion of the list of goods that can be imported duty-free by E& P companies to cover all goods imported in relation to petroleum operations	No
Removal of National Calamity Contingent Duty (NCCD) on crude oil	No
Exemption from payment of customs duties on the import of liquefied natural gas (LNG) (on sectors other than power)	No
Availability of CENVAT credit on crude and product pipelines located outside the refineries	No
CENVAT credit on cement and steel articles	No
Inclusion of goods required for laying down of natural gas pipeline network in the category of goods eligible for concessional CST against form C	No
Declared goods status to natural gas and naphtha under CST regulations	No

Chapter 4

Major pre-budget expectation of the oil and gas industry

Direct tax

Upstream

Income tax holiday under section 80-IB(9) of the Income Tax Act, 1961 (the Act)

A tax holiday of seven years was allowed for 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. This 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 the NELP IX will not qualify for a tax holiday. This amendment is not in line with the promises made by the government while inviting bids under the 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 a 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 or CBM IV is not entitled to a tax holiday.

Therefore, the Union Budget 2013-14 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 well

As per legal pronouncements and the general provisions of the Act, each well can be considered as a separate undertaking for the purpose of a tax holiday under section 80IB(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 80IB(9). This amendment has virtually overturned previous cases that 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 a 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, the government was expected to issue a clarification that such change will become effective only on prospective basis, i.e. from FY 2009-10.

Site restoration fund under section 33-ABA of the Act

Section 33-ABA provides for deduction of the amount deposited in the site restoration fund scheme, subject to the ceiling of 20% of the profits. Due to environmental concerns, site restoration or abandonment is increasingly attracting the attention of governments worldwide. Thus, it was expected that the ceiling of 20% would be either removed or increased to 50%.

Further, considering most of the items required for site restoration or abandonment are imported and there are many foreign companies operating in the Indian exploration and production (E&P) sector, it was expected that the contractor would be allowed to maintain the fund in US dollars, in addition to the rupee deposit allowed at present. This would help in avoiding currency fluctuation risk.

Tax holiday for E&P companies to be enhanced to 10 years from seven years and flexibility to choose the period of 10 years out of the initial 15 years

The 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 is less than the tax holiday period available to companies in the infrastructure sector. 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 10 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.

Deduction under section 80-IA for infrastructure development on solar or wind power project to be extended from 31 March 2013 to 31 March 2016

The benefit is available under section 80-IA(4) (iv) to set up in India for the generation or generation and distribution of power if it begins to generate power any time during the period beginning 1 April 1993 and ending 31 March 2013.

In order to promote the renewable energy generation, the tax benefit extended to power generation plants through section 80IA of the Act was expected to be extended further. The period for commencement of generation of power was expected to be extended to 31 March 2016.

Exemption from minimum alternate tax (MAT) under section 115-JB

The production of mineral oil and natural gas 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. Therefore it was expected that the production of mineral oil and natural gas 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 for drilling and exploration activities. Exploration and production of mineral oil is a capital-intensive and high-risk business. Therefore, weighted deduction of 150% of all capital and revenue expenditure incurred on E&P was expected to be allowed under section 42 of the Act. Presently, 100% of the expenditure incurred on E&P business is allowed as a deduction under section 42.

Weighted deduction on R&D activities for bio-fuels

To encourage R&D initiatives by the industry and to make R&D an attractive proposition, the Finance Bill, 1997, introduced a sub-section (2AB) in section 35 of the Act allowing a deduction of 200% of the expenditure. However, such expenditure needs to be approved by the prescribed authority (Secretary, DSIR).

In order to promote investment or R&D initiatives for renewable or non-conventional energy sources, it was expected that any expenditure incurred on bio-fuel activities would also qualify for a deduction of 200% under section 35(2AB) of the Act.

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 of surrendering 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 the deduction will be allowed from the year in which the area is abandoned as abortive.

Further, we also expected a clarification by inserting a proviso in section 42 that taxpayers will be eligible to claim deduction for exploration expenses (including survey expenditure) and drilling expenses in the year of incurrence against other business income irrespective of whether or not commercial production has started (as the position is not clear from section 42).

Midstream

Investment-linked incentive under section 35AD

The benefits of investment-linked tax holiday are provided only to the cross-country natural gas, crude or petroleum pipeline network for distribution, with 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 Indian government, by way of an amendment to the Act, would define the term 'cross-country' in relation to the gas distribution network

Amendment in section 35AD

Under the existing provisions of section 35AD of the Act effective 1 April 2010, investment-linked tax incentive is provided by way of allowing 100% deduction in respect of any expenditure of capital nature (other than on land, goodwill and financial instrument) incurred wholly and exclusively, for the purposes of the 'specified business'.

Such 'specified business' include the business of laying and operating a cross country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network.

Benefit under section 35AD of Act is available only to the oil and gas pipelines that are approved by the Petroleum and Natural Gas Regulatory Board (PNGRB) and notified by the central government in the official gazette and have common carrier capacity as per the PNGRB regulations.

As crude oil pipelines and the dedicated pipelines, which are dedicated for supply of petroleum products to a specific consumer, are outside the ambit of the PNGRB Act, the benefit under section 35 AD is not available to such pipelines. Therefore, inadvertently, the benefit to oil and gas pipelines made available under section 35 AD of the Act is not actually available to crude oil pipelines and the pipelines dedicated to supply of petroleum products to a specific consumer.

It was expected that conditions under sub-clause (b) and (c) of clause (iii) of sub-section (2) of section 35 AD of the Act, regarding approval of the PNGRB for specified business and availability of common carrier capacity as per PNGRB regulations may be waived for crude oil pipelines and the pipelines dedicated to the supply of petroleum products to a specific consumer.

Weighted deduction under section 35AD to cross-country pipeline network

Under section 35AD of the Act, 100% deduction in respect of capital expenditure incurred (other than land, goodwill and financial instrument) prior to commencement of operation of the specified business to the assessee engaged in laying and operating a cross-country natural gas, crude oil or petroleum pipeline network for distribution is allowed.

Section 35AD (1A) inserted by the Finance Act, 2012, provided that where the specified business is of the nature referred to in the following sub-clauses of sub-section 8(c) of section 35AD, and has commenced its operations on or after 1 April 2012, deduction of an amount equal to 150% of the expenditure under section 35AD (1) shall be allowed.

- Setting-up and operating a cold-chain facility
- Setting up and operating a warehousing facility for storage of agricultural produce
- Building and operating, anywhere in India, a hospital with at least 100 beds for patients
- Developing and building a housing project under a scheme for affordable housing framed by the central government or a state government, as the case may be, notified by the Central Board of Direct Taxes (CBDT) in this behalf in accordance with the guidelines as may be prescribed
- Production of fertiliser in India

A similar deduction of 150% was expected to be allowed under section 35AD to the specified business of laying and operating a cross-country natural gas, crude oil or petroleum pipeline network for distribution, including storage facilities, since this is an integral part of such network, covered under sub-clause (iii) of sub-section 8(c) of section 35AD of the Act and as allowed to the other specified businesses mentioned above.

Removal of restrictions for set-off of losses for specified business of section 35AD

Section 70 provides that in case of loss under any head of income (other than head of capital gain), the assessee is entitled to set off such loss from any other source of income under the same head. Therefore, the loss from one business can be set off from the profits of another business.

However, section 73A provides that loss computed under sec 35AD will be set off only against profits and gains of

specified business, which inter alia includes the business of laying and operating a cross-country natural gas (laid after 01 April 2007) or crude oil or petroleum pipeline network for distribution, including storage facilities being an integral part of such network. This restricts the claim for adjustment of loss from profits of other income, which is allowed in all other cases.

In the initial three to four years, there may be no profit in the specified business of an assessee. Therefore, section 73A appears to be restrictive and unfair to the assessee. There was an expectation of an amendment allowing the set-off of loss under section 35AD against profits of any other business carried on by the assessee.

Further, section 72A was expected to be amended suitably so that in case of amalgamation or demerger of a company accumulated loss in specified business (under section 35AD) of amalgamating company or demerged company shall:

1. where such loss of specified business (under section 35AD) is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company; and
2. where such loss of specified business (under section 35AD) is not directly relatable to the undertakings to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertaking have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

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 and the benefit may be extended for next five years.

Downstream

Full depreciation allowance for projects undertaken for upgradation of fuel quality

As per section 32 of the Act, assesses engaged in a business or profession are allowed the depreciation allowance in respect of assets used in the business or profession. Rule 5 of the Income Tax Rules along with Appendix 1 provides for the rate of deprecation on various categories of assets. As per this rule, 100% depreciation allowance is admissible in respect of air or water pollution control equipments. Also, Appendix 1 provides the list of equipment that are eligible for 100% depreciation allowance.

As per the auto fuel policy, the government has directed oil companies to provide high-speed diesel (HSD) with maximum sulphur content of 0.035% (BS-III) and 0.005% (BS-IV) effective 1 October 2010 throughout the country. In order to fulfil this criterion, oil refineries are required to make a huge capital investment to undertake necessary changes.

Since this upgradation exercise helps to reduce the air pollution, the expenditure incurred on this was expected to be made eligible for 100% depreciation under section 32.

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 31 March 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.

Deduction under section 80-IB(9): Income from government subsidy and discount on LPG/SKO from upstream companies to be treated as income from the business of the undertaking

The Government of India deregulated the prices of petrol, diesel, superior kerosene oil (SKO) and liquefied petroleum gas (LPG), and the prices were to be based on rates prevailing in international market.

The increase in input cost normally leads to an increase in the selling price of the output. However, due to volatile behaviour of prices of petroleum products in international market, particularly diesel (HSD), SKO and LPG, in spite of deregulating these products, the government of India did not permit oil marketing companies to raise the sale price in line with the prices prevailing in the international market.

As per the government's directives, oil marketing companies are required to sell diesel and SKO meant for public distribution system (PDS) and large quantities of LPG used for domestic consumption, to the consumers at the price fixed by the Ministry of Petroleum and Natural Gas.

The sale price of such products is lower than even the raw material cost. This results in operating losses for the oil marketing companies. Under the circumstances, the Ministry, from time to time, provides a subsidy to recoup the under-recovery of sale price. Similarly, oil marketing companies are also allowed subsidy and discount on purchase of SKO/LPG from upstream companies.

Some tax authorities took the view that government subsidy and discount cannot be said to be derived from the business of the undertaking refining mineral oil and therefore such income is not eligible for deduction under section 80-IB(9).

This government subsidy and discount received by the PSUs are nothing but recovery of part of the sale price of products sold to customers at discounted price. Therefore, subsidy and discount should be considered as derived from the business of undertaking refining mineral oil.

In view of the above, it was expected that a clarification would be provided that subsidy and discount received by public sector undertakings on purchase of SKO/LPG from upstream companies would be regarded as income derived from the business of undertaking and will be eligible for deduction under section 80-IB(9).

Interest under section 234B and 234C exemption to oil companies

As per the provisions of Act, interest under section 234B is applicable when an assessee who is liable to pay advance tax has failed to pay such tax, or an assessee who has paid advance tax, but the amount of advance tax paid by him is less than 90% of the assessed tax. Interest under section 234C is chargeable when the assessee defers the payment of advance tax.

Presently, the oil industry determines the prices of the products on the basis of the market-driven pricing mechanism, which is nowadays facing wide fluctuations in the prices of input material such as crude oil and resulting in the volatility of prices of the products. So it is very difficult for oil marketing companies (OMCs) to determine the projected profits for the financial year although every effort is taken to estimate the profits near to actual.

Similarly, the timing for issuance of oil bonds or cash subsidies for the purpose of partial recovery of losses suffered on SKO, HSD and LPG (domestic) is done after a long period of time after actual sales takes place. This difference in time lag puts additional constraint on the OMCs to estimate the profits nearer to the actual.

Thus, shortfalls occurring in respect of payment of advance tax are not intentional but a result of the fluctuation of profits due to various reasons beyond the control of the OMCs.

It was expected that the government would consider the situation and difficulties that the companies are facing and would take appropriate steps to provide the specific exemption from applicability of provisions of these sections or provide some relaxation in the payment of advance tax so that undue hardship faced by the OMCs can be reduced to some extent.

Deduction for Expansion and up-gradation of refineries

GDP growth of around 8% as envisaged in the 12th five-year plan will require an increase in energy availability across the country. Plans for faster and inclusive growth will result in higher consumption of energy, which will entail infrastructural preparedness by the OMCs.

Given the large expected step-up in fuel demand, the OMCs are required to reinforce their infrastructure in terms of capacity augmentation and fuel-quality upgradation in line with environmental norms. Needless to say, commensurate investments will be required for supporting the expansion.

The government, in an attempt to protect the common man from the volatility and fluctuations of crude prices, has been controlling the prices of sensitive products like petrol, HSD, SKO and LPG resulting in huge losses to OMCs. The gap between the costs and sales realisation is partially compensated through discounts from upstream PSUs, cash and bonds from the government resulting in varying amount of under-recoveries being absorbed by the OMCs, leading to unpredictability in the profit levels of the OMCs. In addition to the under-recoveries, there is an additional impact on the profitability on account of increased interest costs due to delay and uncertainty in receiving compensations, delay and loss on liquidating the bonds, etc. As a result, the borrowing capability of these companies, to support above investments and meet working capital requirements, also gets marginalised.

In order to sustain the existence and to be a part of the inclusive growth plans of the nation, it was expected that either a profit-based or investment-based incentive would be provided to OMCs for expansion and upgradation of their refineries.

Service providers

Clarification that the income of oil and gas service providers shall not be chargeable to income tax at 10% on gross basis and will be eligible for presumptive tax regime

Section 44BB 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 44DA 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 CBDT 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 44BB of the Act.

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

Service tax

Levy of service tax on production sharing contracts (PSC)

Typically, the government and private oil companies enter into PSCs, whereby the government retains ownership of the petroleum produced and the oil companies assume the exploration risk. Frequently, instead of one oil company entering into a PSC, three to four companies form an unincorporated consortium, which jointly enters into a PSC with the government. One of the oil companies acts as a lead consortium member and raises cash calls on the other members to meet the operating expenses.

Section 65B (44) of the Finance Act, 1994 (as amended) defines the term 'service'. As per explanation 3 of the definition of 'service', an unincorporated association or a body of persons, and a member thereof shall be treated as distinct persons. By virtue of this explanation, the service tax authorities are demanding service tax on the cash calls between the members of the consortium on the basis that the association of persons (AoP) and members are distinct persons. Thus, there is a great degree of ambiguity regarding applicability of service tax on transactions, between the members and the unincorporated joint ventures (UJVs). Examples include supply of manpower and other resources by members of the UJV and recovery of proportionate expenses incurred by UJV from its members. Such an interpretation is harming the sector as service tax is levied in the absence of provision of any services.

Recommendation: It is expected that a clarification be issued to the effect that mere cash transactions between members and UJVs and between the members *inter-se* shall not qualify as services; hence, it will not be leviable to service tax.

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

Exemption from service tax on input services consumed by E&P companies has been a recurring demand of the oil and gas sector. The recent shift in the taxation of services from select services to all services has further increased the service tax burden on this sector. The sector has been exempted from paying CENVAT or service tax on the output leg on crude oil and natural gas production. This has resulted in a break in the credit chain which has increased the operating costs for the exploration companies. Hence, the service tax paid on the procurement of taxable services by E&P companies is a sticking cost.

Recommendation: It is recommended that in line with the other concessions the central government should exempt the input services consumed by the E&P sector from the levy of service tax. Alternatively, the possibility of refunding the service tax paid on input services consumed by the E&P sector may also be considered.

Exemption from payment of service tax on transportation of petroleum products by road or pipelines

Transportation of petroleum and petroleum products by rail or vessel from one place in India to another are exempt from the levy of service tax. However, no such service tax exemption is available when the transportation of petroleum or petroleum products takes place through road or pipelines. Also, the selling price of petroleum products being controlled by the government, the oil companies do not have the ability to recover the service tax so paid on the freight charges. Thus, the service tax on transportation activities via road or pipelines becomes a cost in the hands of oil companies.

Recommendation: It is recommended that the exemption from payment of service tax on transportation of petroleum products via rail or vessel should be extended to transportation of these goods through road and pipelines.

Service tax on recoveries made by an employer from employee

Services provided by an employee to an employer in relation to the employment has been kept outside the purview of service tax. It is common for companies to provide certain facilities or benefits to their employees and recover a token amount from them for such facilities.

Within the present framework of service tax, the token amount recovered by the employer from its employees is subject to service tax. Taxing these perquisites which are provided as an integral part of employment is not only irrational but also results in double taxation in the hands of employees as it would be subject to indirect tax as well as income tax. This also poses a challenge in compliances (in the form of registration and other procedural requirements) especially for companies who do not have any other output service tax or CENVAT liability except the service tax on these facilities or benefits to employees.

Recommendation: It is recommended that the government should carve out service tax exemption on services provided by employer to its employees on similar lines as provided for services rendered by employees to its employer during the course of employment.

No benefit of service tax paid on amounts written off as bad debts

Rule 6(3) of the Service Tax Rules, 1994 provides for adjustment of service tax already paid if the services are not provided by the service provider. However, there is no corresponding provision for service tax adjustment when the amount is written off as bad debts. As the amounts written off as bad debts affect the cash flows of the assesses.

Recommendation: It is recommended that suitable amendment should be made to service tax rules to provide for service tax adjustments for amounts written off as bad debts.

Service tax payment under modified reverse charge mechanism

Effective 1 July 2012, the concept of reverse charge mechanism ('modified reverse charge') has been made applicable to select domestic transactions. Under the modified reverse charge, a company is liable to pay service tax under reverse charge mechanism on certain services received by a corporate entity from a service provider who is an individual, partnership firm or HUF. This poses an administrative hassle for the companies especially for those who do not have any other output service tax liability except these services. Such companies will need to register and undertake the compliances for depositing service tax under the reverse charge mechanism.

Recommendation: It is recommended that this onerous requirement for payment of service tax under partial reverse charge be withdrawn.

Customs

Expanding the list of goods that can be imported duty-free

Select goods which are specified under list 13/14 to the customs notification no 12/2012 dated 17 March 2012, when imported by the E&P companies or sub-contractors or service providers in relation to E&P activities are exempt from custom duty.

Recommendation: It is recommended that such exemption be extended to all goods imported in relation to petroleum operations.

Removal of National Calamity Contingent Duty (NCCD) on crude oil

The NCCD of 50 INR per tonne was imposed on domestic and imported crude oil in the Union Budget 2003-04. This was done in order to augment funds available with the government to support relief work in the natural calamity affected areas. This results in stranded cost to the refining sector.

Recommendation: It is recommended that the NCCD on crude oil should be abolished in this budget.

Exemption from payment of customs duties on import of liquefied natural gas (LNG)

Being a clean fuel, LNG is used extensively in majority of the sectors. Presently, customs duty exemption is available on import of LNG by the power sector.

Recommendation: It is recommended that import of LNG should be exempt from the levy of customs duty.

Excise duty

Availability of CENVAT credit on crude and product pipelines belonging to refineries

In terms of the CENVAT Credit Rules, 2004 (CCR), credit in respect of inputs and capital goods is allowed only if such goods are received and used in the production factory. Typically, oil refineries have huge networks of crude and product pipelines spread across India and not limited to the oil exploration plant. The fact whether CENVAT credit in respect of such pipelines which are spread outside the exploration plants is available or not has been a matter of intense judicial scrutiny as such pipelines are not physically located in the factory.

Recommendation: It is recommended that necessary amendments be carried out in the CCR to enable the eligibility of CENVAT credit in respect of both crude and product pipelines to the oil refineries.

CENVAT credit on cement and steel articles

In the Union Budget 2011-12, the definition of 'inputs' as contained under the CCR was amended whereby no CENVAT credit was available on goods used for construction of buildings or supporting capital goods. The shift in the service taxation from positive list to the negative list is a step in the direction of the introduction of nation-wide Goods and Services Tax (GST) whose basic idea is to have seamless credits across goods and services. Restriction of CENVAT credit is a road block in the successful implementation of GST.

Recommendation: It is recommended that credit admissibility be extended to all goods and services including those which are used for construction of buildings and supporting capital goods keeping in view that there is huge investment in buildings and capital goods by this sector.

Central sales tax

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

Presently, public sector undertakings (PSUs) are investing heavily in developing the national gas grid to transport natural gas.

Recommendation: Considering the impetus of huge investments in this sector it is recommended that natural gas pipeline or network products should be included within the purview of section 8(3) of the CST Act on similar lines as telecom network. The inclusion of natural gas pipeline or network products under section 8(3) of the CST Act, will enable the industry to purchase these goods at a concessional rate of CST against form C.

Declared goods status to natural gas and naphtha

Natural gas and naphtha are primary sources of energy for fertiliser, petrochemicals, power and several other industries. The importance of natural gas is likely to increase in the 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 industry and ultimately the consumers are bearing the load of high taxes.

Over the years, natural gas and naphtha have become costlier and non-competitive in comparison to other fuels such as coal and crude oil which have been declared as 'goods of special importance' in terms of section 14 of the CST.

Recommendation: To provide a level playing field among different primary energy sources it is recommended that natural gas (including R- LNG) and naphtha must be accorded the 'declared goods' status under the CST Act. It will also help in maintaining the uniformity in the VAT rates on these products across India.

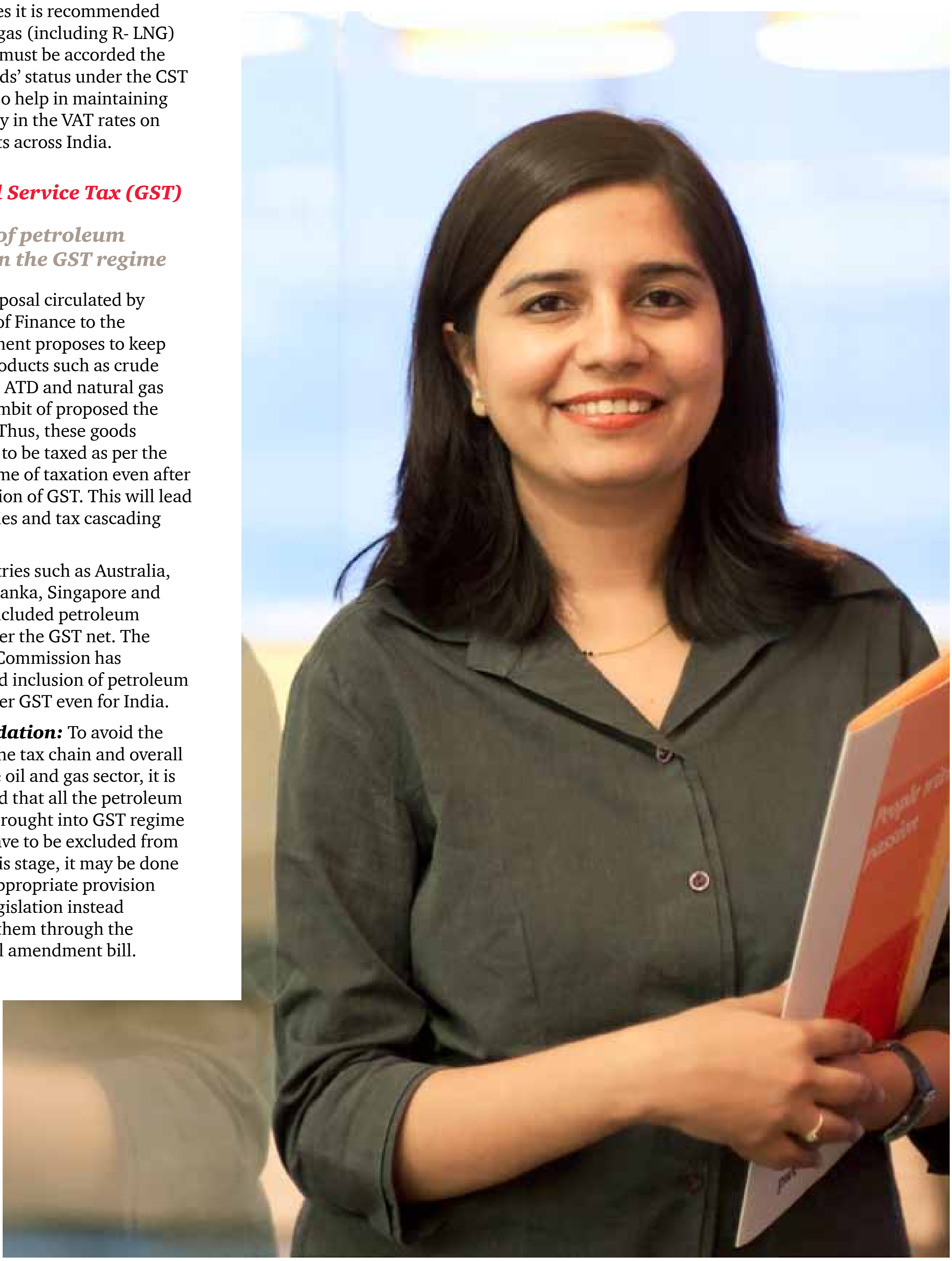
Goods and Service Tax (GST)

Inclusion of petroleum products in the 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, ATD and natural gas outside the ambit of proposed the GST regime. Thus, these goods will continue to be taxed as per the existing scheme of taxation even after the introduction of GST. This will lead to inefficiencies and tax cascading tax.

Several countries such as Australia, Canada, Sri Lanka, Singapore and Brazil have included petroleum products under the GST net. The 13th Finance Commission has recommended inclusion of petroleum products under GST even for India.

Recommendation: To avoid the breakage in the tax chain and overall growth of the oil and gas sector, it is recommended that all the petroleum products be brought into GST regime and 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.



Chapter 5

Significant policy changes and initiatives in the oil and gas industry

The significant policy changes relating to the oil and gas industry were affected by the government of India in the FY 2012-13. Following are some of the key initiatives and developments:

Upstream

Award of exploration blocks under the NELP-IX

The ninth bid round of the New Exploration Licensing Policy (NELP-IX) was launched by the government on 15 October 2010. A total of 34 blocks including eight deepwater blocks, seven shallow water blocks and 19 onland blocks covering an area of about 88,807 sq km were offered under it. Bids were opened by Directorate General of Hydrocarbons DGH on 28 March 2011. A total of 74 bids were received for 33 exploration blocks both from national oil companies and private and foreign companies. No bid was received for one of the exploration blocks in shallow water. All the bids received for the 33 blocks were evaluated by DGH as per the notice inviting offers (NIO) and the bid evaluation criteria (BEC). The Cabinet Committee on Economic Affairs (CCEA) has approved the award of 21 blocks out of which 17 are onland, three are shallow water and one is deepwater.

Action initiated to formulate OALP

Action has been initiated by the Indian government to formulate the Open Acreage Licensing Policy (OALP) and offer open exploration acreages under it. The DGH has taken steps to establish the National Data Repository (NDR) which is a pre-requisite for the formulation of OALP.

Exploratory drilling in producing field

Taking a cue from the global best practices where exploratory drilling is permitted in producing fields to keep adding new reserves to replenish ones that have been produced, the Petroleum Ministry issued formal orders permitting exploration in the already existing producing oil and gas fields to help companies such as Reliance Industries Limited (RIL) and Cairn India Limited (CIL). Therefore, companies will be allowed to drill exploration wells within a producing field but with the condition that cost recovery of such wells would be allowed only in case there is a commercially exploitable discovery.

Formation of the Rangarajan Committee

A committee was constituted by the Prime Minister's Office (PMO) under the Chairmanship of Dr C Rangarajan, Chairman of the Economic Advisory Committee of the Prime Minister to carry out a review of production sharing contracts (PSCs) for oil and gas exploration blocks in the country and recommend necessary modifications for future PSCs. The committee held deliberations with different upstream stakeholders on contentious issues such as monitoring of contractor's expenditure, contract implementation, gas pricing, etc. and came up with its findings. Currently, the government is exploring the merit of rolling out these recommendations in future PSCs.

Draft policy for exploration and exploitation of shale oil and gas

The exponential increase in the demand for natural gas in India has necessitated the need to explore vigorously for unconventional or alternate hydrocarbon resources such as coal bed methane (CBM), shale gas or oil, and gas hydrates, etc. Technological advancements in the field of hydraulic fracturing and horizontal drilling have led to path breaking development of shale gas in the USA.

It is imperative to have a good framework to facilitate and regulate shale oil and gas exploration and exploitation. The government has come up with the draft policy for exploration and exploitation of shale oil and gas and invited suggestions from the general public, stake holders, sector and environmental experts, NGOs, other persons and concerned entities.

Oil diplomacy in high gear

The Ministry of Petroleum and Natural Gas (MoPNG) engaged several countries in bilateral and multi-lateral talks to achieve the objective of oil security. These include attending and holding international meets such as the Petrotech 2012 at New Delhi, the 5th OPEC International Seminar at Vienna, the 30th ASEAN Energy Ministers on Energy Meeting (AMEM) and the 3rd EAS Energy Ministers Meeting at Cambodia. The Indian delegations also had bilateral talks with various oil rich countries including Iran, Saudi Arabia, Algeria, Qatar, Sudan, Russia, Turkmenistan, etc.

Major successes in the oil diplomacy include signing of a memorandum of understanding (MoU) with the Qatar's Ministry of Energy and Industry on co-operation in the field of oil and gas and an inter-government protocol with Kazakhstan for enhancing mutual cooperation.

Midstream

Natural gas pipeline network

More than 11,000 km of cross-country natural gas pipeline network have been laid so far in the country to connect the different consumption centers with the supply sources and another 14,000 km of pipeline infrastructure is under various stages of implementation.

Progress on the Turkmenistan Afghanistan Pakistan India (TAPI) pipeline

The realization of the 1,800 km long TAPI pipeline project has come one step closer to reality with the signing of a Gas Sales and Purchase Agreement (GSPA) between India's GAIL and Turkmenistan's TukmenGaz. A GSPA was also signed between Pakistan's Inter State Gas System (Private) Limited and Turkmenistan's TukmenGaz while Afghanistan signed a MoU on long-term gas cooperation with Turkmenistan. Around 90 MMSCMD of natural gas is expected to be supplied via the TAPI pipeline with both India and Pakistan getting 38 MMSCMD each and 14 MMSCMD flowing to Afghanistan.

The four countries involved in the TAPI Gas pipeline project also signed an inter-governmental agreement along with a gas pipeline framework agreement (GPFA). Turkmenistan had suggested the formation of a special purpose vehicle (SPV) by the TAPI members. GAIL India Limited has agreed to make an investment up to 5 million USD in the proposed SPV i.e. TAPI Limited after getting permission from the Union Cabinet to join the SPV.

PNGRB issues risk minimisation regulations for gas pipelines

The feedstock and fuel security for gas customers is expected to improve further under the draft Integrity Management System for Natural Gas Pipelines Regulations, 2012 issued by the Petroleum and Natural Gas Regulatory Board (PNGRB). The objective of the pipeline integrity management system (IMS) is to maintain integrity of gas pipelines at all times to ensure public safety, protect environment and ensure availability of pipeline to transport gas without interruptions and also minimise business risks associated with accidents and losses.

Flexibility in gas utilisation by power plants to enhance power generation

The acute shortage in the availability of domestic natural gas has led many power plants in the country to operate at low plant load factor (PLF) thereby leading to inefficient production of electricity. Thus the MoPNG notified guidelines for clubbing or diversion of allocated gas between two or more power plants of same entity (the ownership structure of the power plants involved in clubbing or diversion must be identical) to improve the PLF and increase the total generation of electricity.

Commissioning of liquefied natural gas (LNG) terminal

The 5 MMTPA Dabhol LNG terminal, which would serve as a gateway for entry of natural gas to the southern and western parts of the country, was successfully commissioned by GAIL (India) Limited in January 2013. The capacity of the LNG terminal will be expanded in a phased manner to 7.5 MMTPA and then to 10 MMTPA in the next two to three years.

Eligibility conditions for registration of LNG terminals

The rules on eligibility conditions for registration of LNG terminals were notified by the MoPNG with the objective of promoting the setting up of terminals in an environment of equitable access and commercial transparency to foster higher availability of imported LNG in the country. An important condition being that the LNG terminal must be willing to offer at all times, after registration, 20% of its short-term (less than a five-year contract) uncommitted re-gasification capacity or 0.5 MMTPA, whichever is higher, as the common carrier capacity.

Downstream

Maintaining surplus refining capacity

The refining capacity in the country has been augmented to about 215 MMTPA, with the completion of commissioning of the nine MMTPA Bathinda refinery in Punjab by HPCL-Mittal Energy Limited (HMEL), which is well above the annual demand of about 148 MMTPA.

The Indian Oil Corporation Limited (IOCL) and Nagarjuna Oil Corporation Limited (NOCL) are expected to commission their refineries at Paradip in Orissa (15 MMTPA) and Cuddalore in Tamil Nadu (6 MMTPA) respectively by the last quarter of 2013-14.

Partial deregulation of diesel prices

The government partially deregulated diesel prices to cut its ever increasing subsidy bill. It approved the charging of market price of diesel for bulk consumers such as railways and state transport undertakings, while the retail price is to be increased by around 50 paise per litre every month till its becomes equal to the market price.

Cap on subsidised LPG cylinder

Another bold reform decision was taken by capping the number of subsidised LPG cylinders provided to each household at six per year. However, owing to public pressure the cap was increased to nine cylinders per household per year. Consumers will have to buy LPG cylinders at market prices if they exceed the number allotted to each household.

Initiatives for better services and delivery of right quality and quantity

The oil industry invested over 32,000 crore INR in upgrading facilities in refineries for production of BS-III/IV auto fuels. The adoption of modern technologies by Indian refineries helped in increasing the distillate yield, quality upgradation of petrol and diesel and reduction in specific energy consumption.

The BS-IV fuels were successfully introduced in seven Indian cities till March, 2012. The MoPNG has taken a decision to progressively expand coverage of BS-IV fuels in 50 more cities by 2015.

The public sector oil marketing companies (OMCs) introduced the facility of refill LPG booking through short messaging service (SMS) and interactive voice response system (IVRS) in 18 states with a view to provide better services to the customers and reduce the scope for irregularities.

A very good initiative was taken by launching the LPG transparency portal which would host data on the last mile delivery of domestic LPG cylinders, supplied by PSU OMCs to nearly 14 crore households in the country. Through a single click, consumers will now know their individual pattern of LPG usage, booking status, refill history or request for surrender of their connection, subsidy availed, etc.

Several measures were undertaken to check the black-marketing of LPG. Efforts are being made to stop diversion of subsidized domestic LPG through regular monitoring and issuance of instructions to the OMCs and city gas distribution (CGD) companies.

General

Maharatna status for GAIL

In a major development during the year GAIL (India) Limited, a PSU under the MoPNG and India's largest natural gas company was accorded the 'Maharatna' status by the Indian government. With this it became the youngest PSU to be accorded this recognition.

Disinvestment

The government raised about 3,100 crore INR through the divestment of 10% stake in Oil India Limited (OIL). Nearly 60.1 million equity shares of 520 INR each were on offer in the 'further public offer' (FPO)

Dr. (Shri) M. Veerappa Moily assumed office as new Minister of Petroleum and Natural Gas and some of his initiatives include working towards energy security to the people of India and intensifying the pace of domestic exploration and production of crude oil & natural gas through new policy directives

Chapter 6

Commodity balance of petroleum and petroleum products

Commodity Balance of Petroleum and 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	2012-13 (April-Nov.)
1		2	3	4	5	6	7	8	9	10	11	12	13
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	211.4	144
2	**Domestic production**	10.5	32.2	33.4	34.0	32.2	34.0	34.1	33.5	33.7	37.7	38.1	25.4
(a)	*On-shore*	5.5	11.8	11.5	11.6	11.4	11.3	11.2	11.3	11.8	16.4	18.0	13.1
(b)	*Off-shore*	5.0	20.4	21.9	22.4	20.8	22.7	22.9	22.2	21.9	21.3	20.1	12.3
3	**Imports**	16.2	20.7	90.4	95.9	99.4	111.5	121.7	132.8	159.0	163.6	171.7	118.0
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	171.7	118.0
Petroleum Products													
1	**Domestic consumption@ of which**	30.9	55.0	107.8	111.6	113.2	120.7	128.9	133.6	137.8	141.0	148.0	102.1
(a)	*Naphtha*	2.3	3.4	11.9	14.0	12.2	13.9	13.3	13.9	10.1	10.7	11.1	8.2
(b)	*Kerosene*	4.2	8.4	10.2	9.4	9.5	9.5	9.4	9.3	9.3	8.9	8.2	5.0
(c)	*High speed diesel oil*	10.3	21.1	37.1	39.7	40.2	42.9	47.7	51.7	56.2	60.1	64.7	45.7
(d)	*Fuel oils*	7.5	9.0	12.9	13.5	12.8	12.6	12.7	12.6	11.6	10.8	9.2	5.4
2	**Domestic production$ of which**	24.1	48.6	113.5	116.6	119.8	135.3	144.9	150.5	179.8	190.3	196.7	137.6
(a)	*Naphtha*	2.1	4.9	11.3	14.1	14.5	16.7	16.4	14.8	17.1	17.5	17.2	11.0
(b)	*Kerosene*	2.4	5.5	10.2	9.3	9.1	8.5	7.8	8.2	8.5	7.7	7.5	5.2
(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	81.9	59.2
(d)	*Fuel oils*	6.1	9.4	13.4	15.0	14.3	15.7	15.8	17.7	18.3	20.1	19.5	11
3	**Imports**	7.3	8.7	8.0	8.8	13.4	17.7	22.5	18.5	14.7	16.8	15.0	10.4
4	**Exports**	—	2.7	14.6	18.2	23.5	33.6	40.8	38.9	51.0	59.1	60.8	41.1
5	**Net imports (3-4)**	7.3	6.0	–6.6	–9.4	-10.1	-15.9	-18.3	-20.4	-36.3	-42.3	-45.8	-30.7

Source: Economic Survey 2012-2013, Ministry of Petroleum & Natural Gas

@ Excluding refinery fuel consumption, including imports by private parties
$ Excludes LPG production from fractionators

About PetroFed

The Petroleum Federation of India is an apex hydrocarbon industry association to promote the interests of members through a self-regulatory environment with national and consumer interest in sight. It acts as an oil industry interface with Government, regulatory authorities and public and helps in resolution of issues and evolution of hydrocarbons related policies and regulations. It represents the industry on Government bodies, committees and task forces and organises seminars, conferences, workshops, training programmes, lectures and brings out study reports and technical publications. It has instituted 13 Annual Awards in eleven categories.

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