

Budget expectations of the energy value chain

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As the countdown to the Budget 2009 begins, industry and business houses across the sectors have built high hopes on the more stable 'new' Government for bold steps in the Finance Minister's speech, including a revisiting of the sectoral policies and fiscal reforms.

In view of the importance of oil and gas sector in the economy and the ever-growing energy needs of the nation it is vital that the Government revisits the extant policies and the fiscal framework in order for it to boost long-term investments and energy security of the country, says Gokul Chaudhri, Partner and Leader of the Energy and Infrastructure Practice at BMR Advisors. "This requires addressing the expectations span across the entire energy value chain," he explains, in a recent email interaction with Business Line.

Excerpts from the interview

On NELP

To boost domestic exploration and production (E&P) activities in the country, the Government initiated the New Exploration Licensing Policy (NELP) in 1999. Till date seven rounds of NELP and three rounds of Coal Bed Methane (CBM) have concluded. India is about to commence the eighth round of NELP and the fourth round of CBM for offering acreages for exploration of oil and gas.

Boosting domestic E&P activities on accelerated pace is high on the agenda of the new Government. To boost investments in the E&P sector, the Government needs to resolve several bugbears that continue to hamper attraction of risk capital and private participation, both domestic and foreign.

On tax holiday

The tax framework provides for a seven-year tax holiday for production of mineral oil. Due to the capital-intensive nature of the industry, investors are unable to fully take advantage of the tax benefits within the seven-year time frame. There is a need, therefore, to extend the income-tax holiday period for the E&P sector to ten consecutive years anytime during the first fifteen years and thereby bring the tax holiday on par with the infrastructure sector.

Another issue concerning the E&P sector is the uncertainty prevailing over tax holiday for natural gas. Existing and potential investors are unclear as to the Government's approach towards tax holiday for natural gas. With India gearing to become a gas-based economy, any ambiguity on taxation on natural gas disturbs the process for it to become India's most preferred fuel.

Take, for instance, the aberration in the definition of mineral oil which excludes natural gas, and thus denies it a tax holiday. This is disharmonious and needs to be suitably addressed by the Government for the eighth round of NELP to gain momentum.

While E&P income is sheltered by a seven-year tax holiday, the same is subject to Minimum Alternative Tax (MAT) thereby diluting the income-tax holiday shelter. E&P companies should be exempted from paying MAT during the tax holiday period in order for them to benefit meaningfully from the income-tax holiday.

On the indirect tax issues

The Government needs to pronounce in the forthcoming Budget that natural gas is a 'declared good' as the same will help it attract a uniform sales tax / VAT, which currently varies from eight per cent to 20 per cent across the states.

Extending of service tax to exploration activities in recent years has increased the cost of exploration in India, and it adversely impacts the competitiveness of India as a destination for global exploration capital. Therefore, the elimination of service tax cost on exploration, and the inclusion of natural gas as declared goods are key indirect tax reforms for the sector.

On refining capacity

India is currently self-sufficient in refining. Nevertheless, India has to gradually increase its refining capacity to meet the domestic requirements. Also the country has initiated ambitious plans to become a refining export hub.

In Budget 2008, the Government inserted a sunset clause that removes tax holiday to refiners commencing operations after April 1, 2009. Such a move is detrimental to private investments (both greenfield / brownfield) in the refining sector in the country. The Government should consider extending the sunset clause for the refining sector, as this sector could become a significant foreign exchange earner.

On oil pricing

Last year, we witnessed a surge in international oil prices with the WTI (West Texas Intermediate) crude prices touching an all-time high of \$147 per barrel. This led to the bleeding of the financials of the national oil companies and the Government resorting to issuing oil bonds. Private players scaled down their retail operations.

Over the years, despite the dismantling of the administered pricing mechanism, the Government has continued to materially influence prices of sensitive petroleum products. In the face of rising global crude oil prices, controlling the domestic prices of petroleum products (viz. petrol, diesel) does not augur well for the country, as these ought to reflect the global market prices.

The controlled environment discourages private investment in the sector. It is hoped that in this Budget the Government will spell out a clear policy for the full deregulation of prices, and target subsidy only for the vulnerable section to assure access to essential fuels.