

Shift in focus on energy tax

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Whilst reading the fine print of Budget 2009 proposals, I figured out that there are far reaching changes and shift in our Energy tax policy.

Uncertainty on tax holiday continues

Whereas, the Bill has clarified that from April 1, 2009, the 7 year tax holiday would be available for production of gas, it is restricted to production sharing contracts (PSC) signed in pursuance to NELP VIII rounds. In other words, all concessions signed under previous rounds of NELP, including prior to 99 NELP rounds would not get covered. This is disappointing, particularly given that the controversy for existing producers of gas would continue. Besides a tenable position that in hydrocarbons industry mineral oil includes 'natural gas', we could have easily avoided continuing impasse if the bill had proposed a retrospective amendment.

Another important aspect that seems to have been missed out is availability of tax holiday on coal-based methane (CBM) blocks. The CBM concessions are an integral part of government's hydrocarbon policy, to open exploration and development of alternate sources of fuel for private participation. I cannot understand the rationale for such discrimination, particularly since gas from all sources are equally important fuels, besides the fact that CBM exploration is capital intensive and high risk.

Restricting 'undertaking'

When an oil and gas concession is granted, blocks measuring several hundreds or thousands of square miles are licensed for prospecting. The PSC between the government and operators entail distinct phases of activity; important ones being survey, exploration, production and development. Even in an exploration phase, there are situations where certain areas or wells are dry, certain areas don't produce commercial viable quantities of oil and others are successful. In addition, for enhanced production, explored wells require intense use of technology and heavy capital investment. Investment in each well could range between \$ 5 to \$ 50 million. Further, though it may sound amusing, one can be exploring for crude oil and land up with a gas find - both are hydrocarbons and equally relevant fuels for our energy-starved economy. The reason I am getting deeper into the nuance of this industry is that energy companies have successfully argued before judicial authorities that each well is an independent undertaking and hence, the tax holiday provisions should apply to each. It is now proposed that granting of a block (no matter how many sq. miles or how many wells are drilled in each such block) would be deemed to be a single undertaking and tax holiday provisions would apply accordingly. To add insult to injury, the amendment is retrospective from 1999. It's clearly a retrograde step and unsettles established principles of law.

How can concession for several thousand square miles be deemed to be a single undertaking? Particularly, when two software technology parks operating in the same premises are viewed as separate undertakings for IT and ITEs businesses.

Cross-country gas pipeline loses tax holiday

The Bill suggests that 10 year tax holiday conferred in Finance Act, 2008 for cross-country natural gas pipelines shall be discontinued from April 1, 2009. Though, it has been substituted by an alternate provision which grants 100 per cent amortisation for capital expenditure, the rationale for discontinuance is unclear. If a business enterprise has commenced mega project like laying a gas pipeline network, in anticipation of tax holiday, it would be bewildered to experience change in tax holiday provisions. Another salient feature of the alternate provisions allowing capital

amortisation for gas pipeline projects is that losses, if any, cannot be set off against other business income. For instance, an integrated energy company cannot set off capital expenditure against profits of other businesses.

Sunset clause for power generation and distribution

The budget proposals provide for March 31, 2011 as the terminal date for tax holidays to power generation, distribution and transmission projects. Whereas, the terminal date is aligned to sunset clause for other tax holidays, it is important to understand that unlike setting up a manufacturing facility, development of power projects is time consuming. From commencement of feasibility study to clearance by Central regulatory authority and state regulatory commission, construction and commissioning of plant to signing power purchase agreements, including tying up for fuel agreements, it is an extremely complex supply chain. What happens when an entrepreneur, in the midst of completing several steps, now finds that he is unable to generate power by March 31, 2011, and shall not be entitled to tax holiday? How ridiculous!

After all, power generation is not akin to churning shoes from the factory - such incentive provisions have to be thought through carefully as well as its discontinuance.

Extension of service tax levy to continental shelf of India

In line with the Income-tax law, the Bill has extended reach of service tax on 'installation, vessels and structures' to 200 nautical mile zones (as opposed to 12 nautical mile zones) under the continental shelf and exclusive economic zone law. Whereas, the legislature is well within its constitutional power to extend the jurisdiction, the only industry impacted by this move is energy, particularly oil and gas exploration.

A combined reading of all changes suggests that this industry has run out of favour. Whereas we keep talking about large gaps in our energy needs, need to attract private capital, reforms and not to forget power cuts (in the capital) this summer, our energy tax policies need alignment and budget proposals need reflection. The industry would anxiously await findings of expert group on petroleum pricing and its implementation.