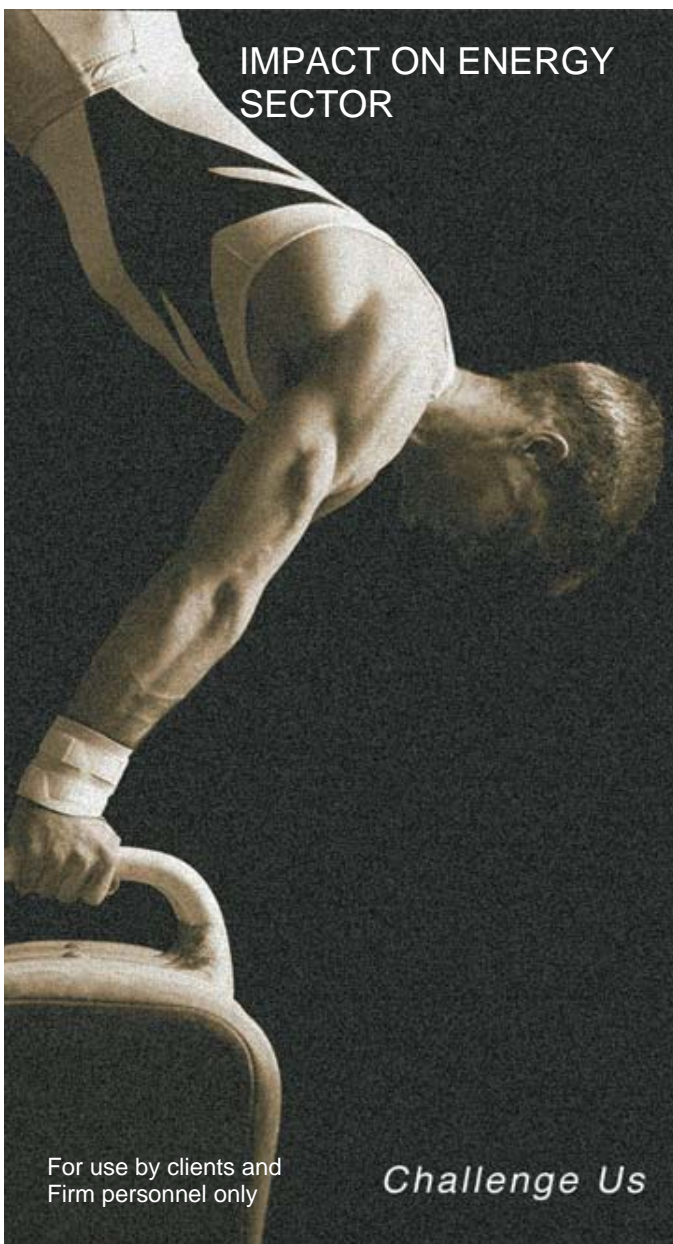




# India BUDGET 2007

## IMPACT ON ENERGY SECTOR



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Firm personnel only

*Challenge Us*

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# Foreword

The Energy Industry, comprising Oil & Gas and Power, received the attention of the policy makers over the past several months, with several policy announcement and related regulatory developments.

In the backdrop of the Union Budget 2007 is the Economic Survey which highlighted only a marginal improvement of 1.85 percent in oil & gas production and 7.5 percent growth of electricity generation in the country. Therefore, there were expectations of fiscal and non-fiscal incentives to boost the development of the industry. The Finance Minister neither disappointed nor enthused the industry with the proposals, the highlight of which was roll-out of infrastructure tax holiday for laying and operating cross-country natural gas distribution network. The disappointment lay primarily with service tax which continues to be the bug-bear of the industry, especially as it constitutes an adverse cost to the exploration efforts in the country.

The broad tax framework for the industry remains stable in view of the broad *status quo* in the corporate tax rates and in the income tax provisions directly related to oil & gas, power and oilfield services.

# Energy at a glance

India has embarked on an ambitious growth trajectory. As per the Ministry of Finance the GDP grew at 7.5 percent, 8.1 percent and 9.0 percent in 2004, 2005 and 2006 respectively. The robust performance of the economy continued during 2006-07 and India's GDP grew at 9.1 percent in the second half of fiscal 2006-07. Increased economic activity was witnessed across every sector, with growth led by manufacturing and services sector. This ongoing momentum in economic growth is likely to remain robust for the remaining part of the year.

GOI is increasingly focused on infrastructure development. The current rate of infrastructure investment in India is 3.5 percent of GDP, which is well below the target rate of 8 percent proposed by the EGCIP. India's multi-billion dollar drive to upgrade its neglected infrastructure is gathering momentum and the recognition of the need to provide world class infrastructure that keeps pace with 8 percent plus economic growth is clearly evident in policy formulation and implementation.

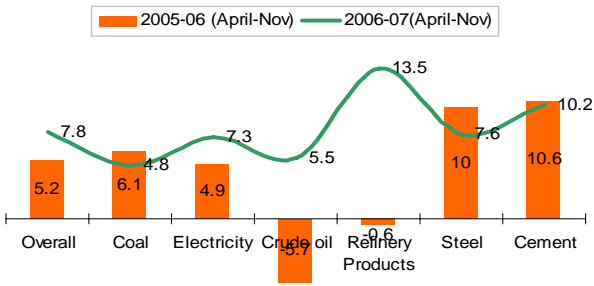
Going forward over the next six to seven years, the GOI has mapped out ambitious investment outlays to the tune of USD 350 billion. Significant infrastructure development is expected to be undertaken through public-private-partnerships. Key areas of infrastructure development include road, rail, ports, power, telecommunications, pipelines and several other related sectors. The initiatives to augment infrastructure development across the country are at macro as well as micro level.

## Performance during the year

Looking back at 2006, the core infrastructure industries, in the month of November 2006, have registered a growth of 9.5 percent which is noticeably higher compared to the growth of 5.7 percent in November 2005.

On a Y-o-Y basis, during April-November 2006-07, 6 core infrastructure industries registered a growth of 7.8 percent as against a 5.2 percent during the corresponding period of the previous year.

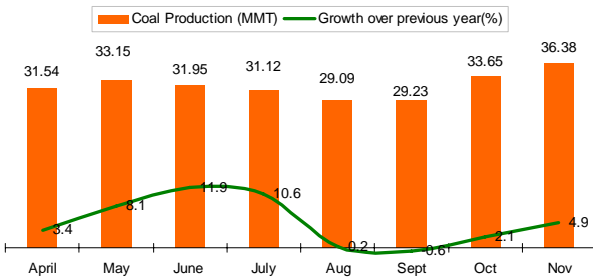
PERFORMANCE OF SIX INFRASTRUCTURE INDUSTRIES (PERCENT) (Weight in IIP: 26.68%)



## Coal

Coal production (weight of 3.22% in IIP) registered a growth of 4.9 percent in November 2006 compared to a growth of 6.9 percent in November 2005. On a Y-o-Y basis, during April-November 2006-07, it registered a growth of 4.8 percent as compared to 6.1 percent during the same period of the previous year.

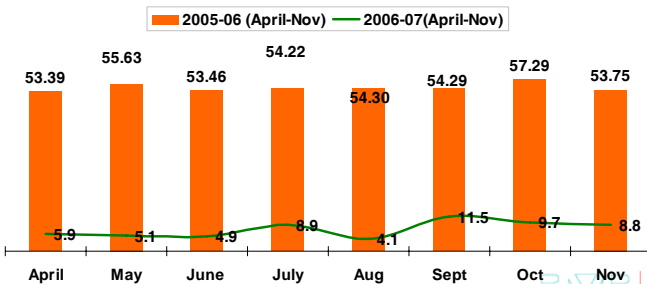
PERFORMANCE OF COAL PRODUCTION



## Electricity

Electricity generation (weight of 10.17% in IIP) registered a growth of 8.8 percent in November 2006 compared to a growth of 3.4 percent in November 2005. On a Y-o-Y basis, during April-November 2006-07, it registered a growth of 7.3 percent as compared to 5 percent during the same period of the previous year.

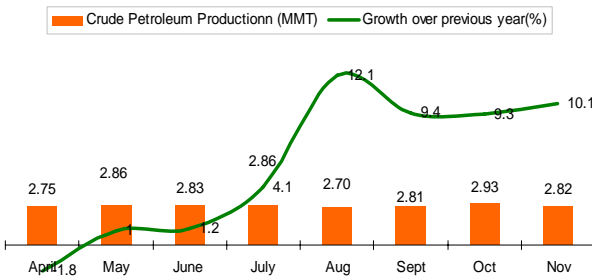
PERFORMANCE OF ELECTRICITY GENERATION



## Crude petroleum

Crude petroleum production (weight of 4.17% in IIP) registered a growth of 10.1 percent in November 2006 compared to a negative growth of 8.5 percent in November 2005. On a Y-o-Y basis, during April-November 2006-07, it registered a growth of 5.5 percent as compared to -5.6 percent during the same period of the previous year.

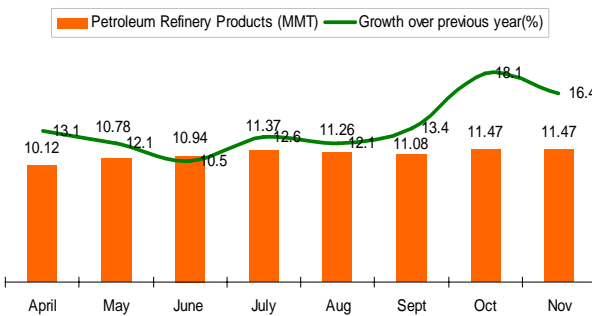
### PERFORMANCE OF CRUDE PETROLEUM PRODUCTION



## Petroleum refinery products

Petroleum refinery production (weight of 2.00% in IIP) registered a significant leap in growth to 16.4 percent in November 2006 compared to an insignificant growth of 1.5 percent in November 2005. On a Y-o-Y basis, during April-November 2006-07, it registered a double digit growth of 13.5 percent as compared to -0.6 percent during the same period of the previous year.

### PERFORMANCE OF PETROLEUM REFINERY PRODUCTION

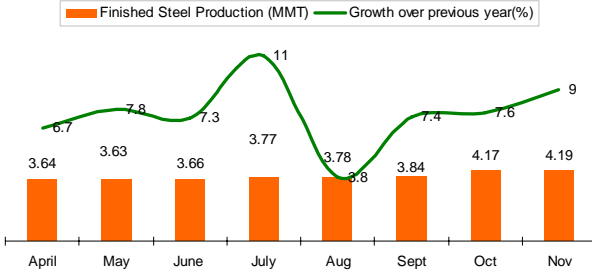


## Steel

Steel production (weight of 5.13% in IIP) registered a growth of 9 percent in November 2006 compared to a growth of 14.8 percent in November 2005. On a Y-o-Y

basis, during April-November 2006-07, it registered a growth of 7.6 percent as compared to 9.95 percent during the same period of the previous year.

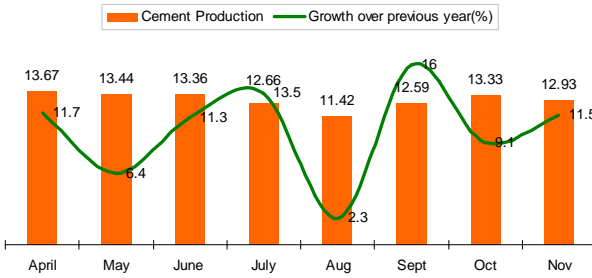
#### PERFORMANCE OF FINISHED STEEL PRODUCTION



## Cement

Cement production (weight of 1.99% in IIP) registered a growth of 11.5 percent in November 2006 compared to a growth of 7.8 percent in November 2005. On a Y-o-Y basis, during April-November 2006-07, it registered a growth of 10.2 percent as compared to 10.75 percent during the same period of the previous year.

#### PERFORMANCE OF CEMENT PRODUCTION



# Oil and gas

The year 2006 has been significant in the oil & gas sector as several important initiatives were taken for the development and growth of this sector. These include accelerating domestic exploration and production activities, acquiring equity oil abroad, bringing home the first consignment crude oil from Sakhalin-1, insulating domestic consumers from the debilitating impact of high global oil prices, taking effective steps for checking adulteration of petroleum products, formulating policy framework for natural gas pipeline and city gas distribution networks, etc.

## Upstream

### Sixth round of NELP

To give a major thrust to the E&P activities in the country, GOI made the highest ever offering of 55 exploration blocks under NELP VI.

The aggressive and effective projection of these investment opportunities resulted in the best-ever response from both Indian (public & private) and foreign companies. In the six rounds of NELP, a total of 162 production sharing contracts were awarded, involving investment of INR 970 billion in exploration.

### Third round of CBM

Under CBM III, 10 coal bed methane blocks have been awarded for exploration.

### New discoveries

The E&P activities in the blocks awarded earlier also saw a spurt and, as a result, significant oil and gas discoveries were reported during the year. In all, 31 oil & gas discoveries were made during 2006 by ONGC, Oil India Ltd., Reliance Industries Ltd., Cairn Energy India Pty Ltd, GSPC, British Gas Exploration and Production India Ltd and Focus Energy Ltd. These discoveries are under evaluation.

## International forays

As regards overseas equity oil, national oil company OVL collaborated with its Chinese counterpart to acquire interest in a producing property in Colombia, heralding a new cooperative approach by the two countries leading to reduced cost of acquisition. Further, an MOU was signed between the two Governments in December 2006 to boost greater collaboration for E&P assets in third countries.

Besides, oil PSUs obtained interests in more than 20 exploration blocks in several countries during the current year. OVL acquired blocks in Vietnam, Cuba, Nigeria, Brazil and Libya. The ONGC - Mittal joint venture which was created last year acquired interest in a block in Syria. OIL-IOC consortium obtained participating interest of blocks in Libya, Gabon and Nigeria. GAIL consortium including BPCL, HPCL and Videocon acquired an exploration block in Oman. In addition, HPCL, BPCL and GSPC consortium acquired participating interest in an exploration block in Australia and the consortium of BPCL, Videocon and GSPC has acquired participating interest in an exploration block jointly awarded by Timor and Australia.

## Equity oil arrives from Sakhalin -1

In a significant development this year, India brought home the first consignment of crude oil from Sakhalin-1 oil field in Russia, in which OVL has 20 percent stake, which not only marked the arrival of crude oil from equity oil investment but also opened up a new source / route for crude oil. The shipment of about 90,000 tonnes was received on 2nd December, 2006 at Mangalore.

## Cascading international prices

International oil prices continued to register unprecedented volatility during the year with crude oil prices touching all time highs. To insulate consumers from the impact of soaring global oil prices, GOI evolved a burden sharing package in June 2006 for the under-recoveries, estimated at INR 735 billion (USD 16.33 billion) for the whole year.

Of this, as much as 87 percent of the impact was shouldered by the GOI and the OMC and passing as much as 13 percent on to the consumers. During 2006, GOI was compelled to enhance the prices of petrol and diesel by INR 4 per liter and INR 2 per liter respectively with effect from June 6, 2006.

The prices of common man's fuels LPG (domestic) and PDS Kerosene were kept unchanged even though global prices crossed record levels. The Government also decided to issue bonds worth INR 283 billion to oil marketing companies for losses suffered due to non-revision of prices in respect of certain sensitive petroleum products.

In addition, state governments were impressed upon to rationalize sales tax to forego additional revenues from price increase, to which several States responded positively.

However, in light of the declining international prices, the prices of petrol and diesel were reduced by INR 2 per litre and Re 1 per litre in November 2006. A further reduction of the same magnitude was made effective from February 16, 2007.

## Refining

### Boost to refining capacity

The year witnessed addition of 16.5 million tonne refining capacity to maintain surplus over demand for products in the country as the refining capacity increased to about 149 MMTPA with commissioning of a greenfield refinery by Essar Oil at Vadinar in Gujarat (10.5 MMTPA) and completion of Panipat Refinery expansion project by IOC (6 MMTPA). This enabled higher exports of petroleum products.

With 19 refineries (17 in the public and 2 in the private), the domestic refining capacity in December 2006 rose to 148.97 million tonnes per year. During April –December 2006, the refinery throughput was pegged at 107.42 million tonnes.

### Oil sector emerging as a major exporter

In the first five months of 2006 ( April – August ) the petroleum sector emerged as number one exporter overtaking gems and jewellery sector with exports valued at about INR 383 billion (USD 8.3 billion) moving ahead from exports worth about INR 510 billion (USD 11.05 billion) with a quantity of 21.5 MMT during the whole year 2005-06.

This strength is expected to be maintained with a number of projects to set up new grass-roots refineries under implementation along with expansion and modernization projects.

# Creation of strategic petroleum reserves

## Strategic petroleum reserves

Taking into account the oil security concerns of India, the Government in January 2006 approved funding mechanism for setting up Strategic Crude Oil Storage of 5 MMT at various locations in the country, Mangalore (1.5 MMT), Vizag (1.0 MMT) and Mangalore or nearby location (2.5 MMT).

It was also decided to implement the project through a subsidiary of OIIB. This strategic storage would be in addition to the existing storage of crude oil and petroleum products, with the oil companies and would provide an emergency response mechanism in case of short-term supply disruptions. The proposed storage would be in underground rock cavern / concrete structures and is projected to come up in a period of four years.

## LPG storage capacity

Oil PSU HPCL completed excavation work of underground LPG cavern storage facility at Visakhapatnam which is the first of its kind in the South and South East Asia. Being implemented by a joint venture of HPCL with oil major TOTAL of France, this 60,000 tonne capacity storage will increase LPG cover by about a month for Andhra Pradesh, by about two and a half days for whole of the country. Other works are progressing fast and the facility is expected to be ready by middle of 2007 at a cost of about INR 3.33 billion (USD 74 million).

# Natural gas

## Pipelines

Efforts to source natural gas from abroad were pursued vigorously with Petroleum Minister meeting his Iranian and Pakistani counterparts in Doha in April so that discussions on Iran-Pakistan-India gas pipeline project move on fast track. The Secretaries of Petroleum of three countries, who were earlier discussing the project bilaterally, commenced Trilateral talks and meetings were held at Tehran in March, Pakistan in May and in India in August 2006. The three countries are right now engaged in talks on the critical issue of gas pricing, project structure, framework agreement, etc.

India attended the steering Ministerial Committee meeting on Turkmenistan-Afghanistan-Pakistan gas pipeline project in March and later decided to join the project which is at an initial stage.

On the domestic front, the Government notified a policy for Development of Natural Gas Pipelines and Natural Gas Distribution networks for promoting competition and arm's length business.

## LNG

Options are being pursued to import natural gas from Myanmar. India has been seeking implementation of 5 MMT LNG contract signed in June 2005 at Tehran, at various levels.

Iran made fresh LNG pricing proposals at a meeting between Indian Petroleum Minister and the Iranian Foreign Minister in November 2006.

## Gas hydrates

India joined US and Japan, becoming only the third country, to carry out the specialized activity of drilling/coring for gas hydrates, an alternative and potentially exciting source of natural gas in India.

The specialized drill ship 'JOIDES Resolution' along with scientists and equipments arrived in India from US for coring from April to August 06. DGH obtained the drill ship from U.S. under the IODP, as this type of specialized services is not available commercially in the world. Based on results of scientific studies on the gas hydrate cores, pilot test production is expected to be carried out in 2009-10

## Gas pricing

In so far as India is concerned, over 75 percent of the gas produced by NOCs in the country is being sold at controlled prices. Apart from this, the gas produced by JVs is sold at market determined prices. Similarly, regasified LNG is also sold at market prices which are much higher.

But going forward, the APM gas is going to decline and the new giant gas discoveries in the Krishna-Godavari basin would go on stream from 2008 and beyond. Simultaneously more and more LNG and possibly transnational pipeline gas is likely to enter the country in the years to come.

Towards this end, a committee was constituted in late 2006 to formulate transparent guidelines for approving gas price formula for giving Government approval under the PSCs.

The committee in its recommendations has given a detailed suggestion on the principles of natural gas pricing. It has concluded that all fresh natural gas produced should be sold in the open market at a competitively determined price. Only in respect of cases where price determination through competitive bidding is not possible should the question of adopting guidelines for valuation arise.

The committee has also recommended that once a market determined price has been discovered between the parties through a transparent competitive bidding process, there should be no need for the Government to interfere. For transactions, where valuation of gas has necessarily to be done by the Government / DGH, the committee has recommended that it should be done based on the most recent competitively determined price in the region duly indexed to the present.

## Policy

### Empowering DGH to promote E&P

GOI delegated certain powers vested in it under Oilfields (Regulation and Development) Act, 1948 and Petroleum and Natural Gas Rules, 1959, as amended from time to time, to the DGH.

This was done to empower DGH so that it could effectively oversee the ever-increasing exploration and production activities in India with more areas coming under exploration with successive rounds of NELP and CBM.

Delegation of powers to DGH mainly covers:

- Monitoring of upstream activities including CBM operation
- Review and monitoring of exploration and development programmes
- Reservoir monitoring with a view to optimizing hydrocarbon recovery
- To maintain data repository
- Lay down norms for declaration of hydrocarbon discoveries and

- Monitor Government revenue such as royalty and profit petroleum

## Petroleum & Natural Gas Regulatory Board Act, 2006

The Government enacted the PNGRB Act in 2006. This Act envisages setting up of Petroleum & Natural Gas Regulatory Board to regulate the refining, processing, storage, transportation distribution, marketing and sale of petroleum, petroleum products and natural gas excluding production of crude oil and natural gas.

The objective of the Act is to protect the interests of consumers and regulate specified activities relating to petroleum, petroleum products and natural gas and to ensure uninterrupted and adequate supply of petroleum, petroleum products and natural gas in all parts of the country and to promote competitive markets, and for matters connected therewith or incidental thereto.

Necessary action for setting up the Board is under way.

## Policy for gas pipelines and CGD projects announced

GOI took a major step forward to promote growth of natural gas pipelines and CGD projects by formulating a policy in this regard.

The policy aims to:

- Enhance competition and produce a competitive and efficient industry structure
- Promote investment from public and private sector in natural gas pipelines and city natural gas distribution networks
- Facilitate open access for all players on a non-discriminatory basis and avoiding abuses of the dominant position by an entity
- Consumer interest in terms of gas availability and reasonable tariff

With significant gas discoveries in the recent times, the policy will ensure linkage between the producing points and the consumer centres across the country for this environmentally benign and preferred fuel.

A number of city gas projects for CNG supply to vehicle and PNG to household are expected to come up which

would not only bring down pollution level but will also improve the quality of life with smooth, efficient and economical supply of gas through pipelines.

# Power

Infrastructure is recognized as being crucial for sustained growth rate of 9-10 percent and within infrastructure, electricity is the most crucial as it is the prime mover of the economy. Significant efforts are being made to overcome peaking shortage which is currently 12 percent and overall energy shortage of 8 percent in the country.

To bridge this gap, Mega Power Policy has been initiated which provides for concessions such as duty free import of capital equipments, deemed export benefits to the domestic bidders, liberal income tax holiday etc. The Government has also simplified the clearance procedure for hydro projects.

In addition, the country has a huge hydro power potential of about 1, 50,000 MW of which only about 33,600 MW has been harnessed till now which is 22.4 percent of the total potential. Efforts are being made towards harnessing of untapped hydro potential in the country in order to achieve the goal of "Power for all by 2012".

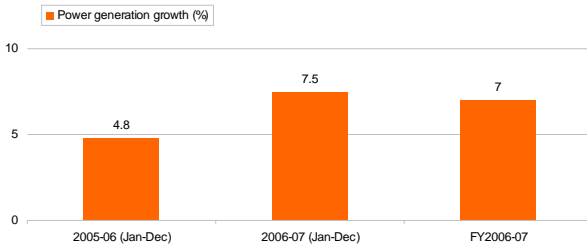
## Power generation

As per the Power ministry generation of power this year reflected an accelerated growth. Power generation in the month of December, 2006 was 57.095 BU, about 9.3 percent higher than the generation of 52.257 BU recorded in December, 2005.

During the fiscal year 2006-07 (April-Dec), the actual generation of electricity was 493.419 BU, registering a significantly higher growth of 7.5percent as compared to growth rate of 4.8% during the corresponding period of the previous year. The actual growth in total generation during the current year could have been higher but for lesser growth of about 2.9% in nuclear generation.

The current trend in the growth in generation indicates that during the fiscal year 2006-07, a 7 percent growth in generation is likely to be achieved.

## GROWTH IN POWER GENERATION (PERCENT)



During April – December 2006, PLF of SEBs increased to 68 percent as compared to the 64.8 percent achieved during the same period in 2005. However, the variation among the states was substantial with eastern and north-eastern states accounting for a significantly lower PLF.

The rate of return of SEBs deteriorated to (-) 24.7 percent in 2006-2007 from (-) 24.8 percent in 2005-2006.

## Capacity additions

The Tenth Plan had targeted a capacity of 41,110 MW which was revised downward to 36,956 MW last year. Until now, units with a total capacity of 17,744MW have been commissioned and based on CEA reviews another 12,898 MW would be commissioned by March 2007. The country is likely to achieve a target of around 23,250 MW, which is about 57 percent of the original target set and 63 percent of the revised target. The anticipated shortfall (73 percent) is the highest in the private sector, while type of plant, it is the highest (43 percent) in hydro plants. During this plan, the private sector is expected to add capacity of 3,455 MW and the balance is to come from central and state initiatives.

During the year 2006 (Jan-Dec), capacity of 4,412 MW has been added which include 2,138 MW in Thermal Sector, 1,684 in Hydro Sector and 590 MW in Nuclear Sector.

During the same period, a fresh start up of 8,564 MW was made of which 7,164MW was in respect of Thermal and 1,400 MW in the Hydro segment. At present 43,600 MW is under execution with a total investment commitment of USD 51 billion.

The country has not been able to augment additional capacity primarily because of unavailability of coal and natural gas/ LNG. Demand for gas has outstripped supply and the power plants are unable to get the required allocations. The gas based plants have at times resorted to naphtha which is uneconomical. Demand-supply

imbalances have been a matter of concern even for coal. Non-availability of coal has resulted in generation loss.

The process of revival of Dabhol Power Project was initiated in 2005 with the establishment of a JV company RGPPL. Block –II of the project relating to generation of 740MW of power was already commissioned in May 2006. Balance capacity of the project is expected to be commissioned by March 2007.

The Government is encouraging the use of hydel and wind energy sources since a study indicates an estimated unutilized hydro power potential in the vicinity of more than 150,000 MW.

## Distribution reforms

Reforms in power distribution are identified as the key area to infuse efficiency and commercial viability into the power sector. The APDP rechristened as APDRP was initiated in the year 2000 for initiating a financial turnaround in the performance of state owned power sector.

The “investment component” of the reform program focuses on specific projects for up-gradation of sub-transmission and distribution network whereas; the “incentive component” incentivises State Governments through grants upto 50 percent of the actual total loss reduction by SEB. The total incentive amount released to 8 states till 2006 amounts to INR 15.75 billion.

## Initiatives to develop Ultra Mega Power Projects

India has envisaged a capacity addition of 1, 00,000 MW to meet its mission of ‘Power for All by 2012’. To achieve its target of meeting the requirements of power deficit state, GOI recognizes that economies of scale could lead to cheaper power which is secured through large size power projects. A unique initiative was launched in a big way for development of UMPP under tariff based international competitive bidding route. Development of 4,000 MW project through tariff based bidding process is a first of its kind in the world.

9 sites for development of 4,000 MW project each have been identified so far. These projects are expected to add about 36,000 MW within a span of 6-8 years.

The bidding process has been initiated in respect of three projects and the letter of intent in respect of first two sites

viz Sasan and Mundra were handed over to the successful bidders on December 28, 2006. The partnership between Ministry of Power, Central Electricity Authority and its CPSUs with prime movers of India's private sector has resulted in success in the form of finalization of the two UMPP's at Sasan and Mundra.

Hyderabad-based Lanco Infratech, in association with the Singapore-based Globeleq, has won the bid for the country's first UMPP - Sasan in Madhya Pradesh. Lanco beat Tata Power, Reliance Energy and NTPC by offering a price of INR 1.19 per unit. The Ministry of Power had set a benchmark of INR 1.60 per unit. The project would require a total outlay of INR 160-190 billion (USD 3.5 -4.2 billion). The project is likely to achieve a financial closure by December 2007 and first unit would become operational by 2011-12.

Tata Power was awarded the Mundra project in Gujarat. It outsmarted five rivals with a tariff of INR 2.26 per unit for the imported coal-based Mundra project. Generation from first unit is likely to start by 2011-12.

The award of the projects is an accomplishment in itself and going forward, what needs to be watched is the two projects start producing power at the tariffs that have been decided on.

## Power transmission network and national grid

The Government has recognized the requirement of a strong national power grid for steering the development of the power system for meeting the objective of provision of power to all at affordable prices.

The Government has notified Tariff –based competitive bidding guidelines for transmission service in order to encourage development of transmission projects. A Committee has been constituted in this regard which has identified 14 transmission projects which would be developed by private sector players through tariff based competitive bidding.

# Policy Initiatives

## Tariff policy

An important policy initiative notified in January 2006 is the Electricity Tariff Policy which is needed to give effect to the provisions of the Electricity Act.

This policy aims at:

- Promoting competition by laying the requirement of future procurement of power at competitive prices
- Laying down a specified time frame for rationalization of electricity tariffs
- Complete discouragement of provision of free electricity since the same results in wasteful consumption
- Management of subsidy and cross-subsidy encouraging renewable energy sources of generation

## New hydro policy

The Electricity Tariff Policy provides a special dispensation for project development by State and Central PSUs on the basis of capital cost and norm based tariff to be determined by the Regulatory Commission.

Such dispensation allowed to the PSUs, under the hydro power policy is proposed to be made available for the same period of 5 years to promote hydro power development through the private sector as well.

The Government shall select the developer and would have control over the project in order to ensure that the same is built in the most optimal and economic manner.

## Guidelines for procurement of electricity

The Central Government in January 2005 notified guidelines for procurement of power by Distribution Licensees through competitive bidding. Pursuant to this, it has also issued the standard bid document containing RFQ, RFP and model PPA for long term procurement of power from projects having specified site and location.

## Outlook

Electricity Act, 2003 has facilitated enhancement of investment in the power sector. Steps are being taken to ensure adherence to timelines with respect to commissioning of projects.

# Budget expectations

The major demands of the industry from the budget are outlined below:

## Income tax

### Infrastructure status to E&P business / LNG import and re-gasification projects / cross-country pipelines for crude, gas and petroleum products

Various infrastructure projects such as roads, ports etc are eligible for income tax holiday being infrastructure. In this regard, in view of the strategic importance of oil and gas facilities such as LNG terminals and pipelines should also be eligible for 10 years income tax holiday and exemption from taxability of interest / dividend / capital gains income earned from the project.

At present the tax holiday for undertakings engaged in the exploration, extraction, production or refining of mineral oil has been restricted to first seven years after commencing commercial production. During the initial period companies have large expenditure to set off and benefit of tax holiday can not be effectively utilized. It is recommended to provide 100 percent tax holiday for 10 consecutive years at anytime during first 15 years bringing these infrastructure projects at par with other infrastructure sector.

### Allow higher depreciation

The plant and machinery items used in petroleum and coal industry are highly corrosive in nature, involving heavy repairs and replacements. In this rate, high depreciation rates are were sought for facilities used in the industry in line with higher depreciation rates for machinery used in specific industries like textile industry, semi conductor industry etc.

Reduced depreciation rate has increased tax liability in power and infrastructure industries despite reduction in corporate tax rates and allowability of MAT credit. ASSOCHAM suggests increase of depreciation rate upto 100 percent for equipments used in the sub-transmission and distribution network

## Permit maintenance of the reserve monies in foreign exchange for SRFS

Under the SRFS, deductibility of provisions for site restoration is permitted subject to deposit of Indian Rupee amounts with the SBI. However, blocking scarce resources in the fund and associated exchange risks prevented oil and gas players from availing of the scheme. The sector has sought the relaxation of the conditions by permitting maintenance of the reserve monies in foreign exchange.

## Uniform corporate tax rate for all players to bring in a level playing field

In view of the Government's commitment to providing level playing field, a uniform corporate income tax rate for domestic and foreign oil companies has been sought.

## Oil field service providers should be taxed as individual units

The tax laws in India provide that the Government can make special income tax provisions in respect of exploration and production companies as well as oil field service providers. In this regard, the Government has notified that exploration and production companies operating in a consortium would be taxed on an individual basis and not as a collective tax unit.

Similar provisions were sought for oil field service providers to provide that where such service providers operate in consortiums; these would be taxed as individuals and not a collective unit.

## Elimination of MAT on E&P companies

While upstream income is sheltered by a 7 year tax holiday, the same is subject to a MAT thereby diluting the income tax holiday shelter. A long standing demand is that E&P companies should be exempted from paying MAT during the tax holiday period and should be given a higher tax holiday of 10 years. The MAT rate was increased from 7.5 percent to 10 percent in the previous Budget 2016.

Similarly, power projects are eligible for a tax holiday; however, the income is subject to a MAT thereby diluting the income tax holiday shelter. In this regard, it was sought that MAT should not apply during the tax holiday period to enable the enjoyment of the tax holiday

## Service tax

### Exemption from levy of service tax on oil field services procured by E&P companies under the Production Sharing Contract

Exploration for oil & gas is a risky investment with uncertain rewards. The Government is making every effort to extend exploration coverage, which is progressively in high risk areas such as deepwater / ultra deepwater areas, frontier areas etc. In order to attract maximum investment for exploration it is imperative to incentives exploration by minimizing taxes and duties on inputs required for exploration.

Levy of service tax on exploration activities, results in

- Increase in unsuccessful costs of dry wells
- Absence of service tax credits
- Burns the exploration budget by adding to cost

It makes exploration uncompetitive for private participation and dilutes government's objective of developing indigenous hydrocarbon resources.

## Excise and customs

### Expansion of duty free list of items for exploration and production of oil & gas / CBM

E&P is major thrust area considering the country high dependence on imports. It is imperative to garner massive investments in order to prop up domestic E&P activities. Department of Revenue has issued notifications along with the list of items for granting duty exemption for the items imported for E&P activities. However a close scrutiny of items provided under the list suggest that all capital items and goods required in connection with petroleum & CBM operations are not covered.

### Nil import duty on capital goods Imported for Greenfield Refineries / Brownfield Refinery Expansions and Green Fuel Projects mandated under Auto Fuel Policy

During the year 2007-12, 92 MMT of new refining capacity is expected to be added. With tariff protection at its lowest, customs duty on project imports for new refineries;

currently BCD 5 percent plus additional duty (countervailing) of customs 16 percent plus 2 percent education cess may structurally increase the cost of refining for the new projects.

Refineries need to be cost effective, as most of the production would have to be exported. It is essential that project cost be not inflated due to taxation on project imports.

## Nil basic custom duty for capital goods for hydrocarbon infrastructure projects

Capital goods for projects generally carry a BCD of 15 percent, besides CVD and education cess of 16 percent and 2 percent respectively. Further, cenvat credit is unavailable for pipeline projects on the grounds that manufacturing activity is not carried out, even for crude pipelines.

With a view to facilitate investments in the petroleum sector, particularly in petroleum infrastructure it is suggested that for the following projects, the BCD on project imports should be reduced to Nil:

- Crude, product and gas pipelines
- Environmental / pollution control projects
- Developing CNG / auto LPG infrastructure.
- Pilot projects for producing hydrogen / GTL

## Duty and tax waiver for power plants

To tap on unutilised 13,500 MW gas-based power generation capacity the Power Ministry has suggested duty waivers of LNG and LNG regasification plants. This will result in reduction of 6 paise per unit in fuel cost for power generation.

In order to bring down the input cost, it has been proposed to abolish electricity duty on captive power generation plants.

## Central sales tax

### Declared goods status to natural gas / LNG

Post introduction of VAT effective April 2005, natural gas has been classified under revenue neutral rate of 12.5%. Some states have kept natural gas out of VAT and are levying sales tax at the rate of 20 percent. Besides VAT

laws do not permit avilment of input credit in case natural gas is used as fuel. In the case natural gas is transferred after purchase on inter-state basis, full tax credit is not available.

It may be mentioned that natural gas is a primary energy source and its importance in the primary energy basket is likely to increase due to increased availability. as of now, the other primary energy sources like coal, crude oil declared goods of special importance. Therefore, suitable tax relief should be extended to natural gas / LNG.

## Eliminate CST on sensitive petroleum products

Sensitive petroleum products such as MS, HSD, domestic LPG and PDS kerosene are prone to dual taxation, one in the originating state (CST) and the other in the consuming state (LST).

Post April 2002, marketing rights have been granted to 4 new companies. These companies are in the process of gradually setting up the retail selling infrastructure all over the country but the phenomena of inter-company, interstate transactions is likely to continue. Inter-state inter-company transactions are unavoidable, leading to CST levies. These levies cannot be recovered from consumers, as local state players pay just the local tax, where as interstate transaction involves CST and local tax, leading to under-recoveries.

# Budget Proposals

The budget proposals include the following:

## Income tax

### Effective tax rate

Taxable entity	Present rate	Proposed rate (for income > INR 10 mio)
Domestic Company	33.66%	33.99%
Foreign Company	41.82%	42.23%

- Companies with income less than INR 10 million not liable to surcharge of 10 percent
- Education cess remains unchanged
- Additional levy of “Secondary and Higher education cess” on income tax (other than education cess) at the rate of 1 percent
- DDT rate increased from 12.5 percent to 15 percent; effective rate being 16.99 percent with 10 percent surcharge and 3 percent cess

### Tax holiday

- Tax deduction of ten years out of a block of fifteen years available in respect of an undertaking engaged in the business of laying and operating cross-country gas distribution network. Following additional conditions to be satisfied by the enterprise:
  - Commence operation after April 1, 2007
  - Owned by an Indian company or a consortium or specified authorities
  - Approved by Petroleum and Natural Gas Regulatory Board
  - 1/3 of pipeline capacity to be available for use on common carrier basis
- Tax deduction extended to undertakings engaged in development, operation and maintenance of

navigational channels. Deduction available for a period of 10 years in a block of 15 years.

- Enterprises engaged in development, operation and maintenance of infrastructure facility, industrial parks, or distribution and transmission of power to lose tax holiday for the unexpired period on merger/ de-merger. The amendment applies to mergers/de-merger effected after March 31, 2007
- Enterprises engaged solely in executing works contract in relation to infrastructure projects, and not owning such projects, not eligible for tax holiday
- Enterprises set-up for reconstruction/revival of power generating plants eligible for tax holiday if it begins generation, transmission or distribution before March 31, 2007. The time limit is extended to March 31, 2008
- Rationalization of tax holiday provisions for units set-up in SEZs, tax holiday not available to units formed by splitting up/ reconstruction of existing business or transfer of old plant and machinery in excess of 20 percent
- 'Status quo' in following provisions:
  - Computation of tax liability in case of enterprises engaged in prospecting/ extraction/ production of mineral oil
  - Computation of deemed income of non resident oilfield service providers
  - Tax holiday available to companies engaged in commercial production/ refining of mineral oil
  - Tax holiday available to companies engaged in generation of power using bio-fuels

## Other proposals

- The pass through status of VCFs now only available for investments in VCUs engaged in specified businesses viz production of biofuels, nanotechnology, IT, seed R&D, etc. Therefore investment in energy sector not to be treated as pass through income for VCFs
- Definition of India amended to include territorial waters, seabed and subsoil underlying such waters, continental shelf, exclusive economic zones, maritime zones and airspace above the territory and territorial waters. This definition was earlier

applicable to companies engaged in specified upstream and oilfield services. However, now it is applicable across all industries

- Income arising to a non resident in the nature of Interest, Royalty and FTS is taxable in India if services are utilized in India. Recently, a Supreme Court judgment held that services will not be taxed in India if not rendered in India. It is now clarified in law that such payments will be taxed in India regardless of whether the non-resident has a residence/place of business/business connection in India
- Amendments made in the domestic withholding tax rates as follows:
  - Obligation to withhold tax extended on contractual payments by individuals in certain cases
  - Withholding tax rate on technical/professional services/ commission increased to 10 percent from 5 percent
  - Withholding tax rate on hire of plant, machinery and equipment reduced to 10 percent from 15/20 percent
- Provision of ESOPs brought within the purview of FBT. FBT payable on the date of exercise at the fair market value of the option less amount recovered from the employees
- In computing capital gains on sale of shares allotted to employees under ESOP, cost of acquisition to be the value at which FBT is computed on the date of exercise
- Extension of time limit for undertaking transfer pricing audits and tax scrutiny audits by 12 months
- Interest on default in deduction/ late deposit of withholding taxes to be computed on a monthly basis instead of yearly basis

## Indirect tax

### Education cess

- A Secondary and Higher education cess at the rate of 1 percent has been introduced on Excise duty, Customs duty as well as Service tax. While for Customs and Excise duty purposes, it would be effective from March 1, 2007, for purposes of Service tax, it would be leviable from the date the Finance Bill, 2007 is enacted
- Credit Rules suitably amended to provide for credit of Secondary and Higher education cess.

## Service tax

### Rate of service tax

- Effective rate of service tax increased from 12.24 percent to 12.36 percent with the levy of Secondary and Higher Education Cess of 1 percent
- Increase would be effective once the Finance Bill 2007 is enacted

### New taxable services

- New taxable category of “mining of mineral, oil and gas” introduced; the term ‘mining’ has however not been defined
- Clarification issued by the CBEC suggests that services provided in relation to exploration and exploitation of mineral, oil or gas has been comprehensively brought under the service tax net. While service tax at the exploration stage was already covered, service tax on exploitation stage is now added
- Debate on applicability of service tax on turnkey contracts put to rest with the introduction of new taxable category of “services involved in the execution of works contract”
- Works contract to include, amongst others:
  - Turnkey projects including Engineering Procurement and Construction or Commissioning projects
  - Installation of plant and machinery, equipment and structures, whether pre fabricated or otherwise

- Other installations for transport of fluids
- Service tax under the above category to apply only to those cases where transfer of ownership in goods is liable to VAT/sales tax
- However, contracts where transfer of ownership does not occur (i.e. contracts for pure services) could be covered under other taxable category of services viz erection, commissioning & installation, construction services etc
- Works contract in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams excluded from service tax. However, such exclusion not extended to oil & gas installations/ platforms, construction of pipelines, power plants etc
- Composition rate of service tax at 2 percent without availability of credit proposed for services involved in the execution of works contract. Details of this composition scheme, awaited
- Hiring immovable property for use in business or commerce notified as taxable service with specific exclusions
- “Financial lease” explained under the Finance Bill. However, debate on taxability of “operating lease” subsists
- New taxable categories effective from a date to be notified

## Customs

### Reduction in duties

- Peak rate of BCD on most non - agricultural goods reduced from 12.5 percent to 10 percent, to reach ASEAN levels in a gradual manner
- Reduction in BCD on dredgers from 5 percent to Nil. Dredgers are exempt from excise duty and therefore, imports of dredgers would now be duty free
- All forms of coking coal (regardless of ash content) exempt from duties of customs

## Change in export duties

- Export duty on iron ores & concentrates fixed at INR 300 per tonne (earlier rate being 10 percent plus INR 50 per tonne)
- Export duty on Chromium ores and concentrates fixed at INR 2,000 (earlier rate being 10 percent)

## Other significant changes

- With the reduction in excise duty on HSD ( Diesel) and MS (Petrol), effective rate of customs duty on these goods to reduce
- Certification requirement for import of Naphtha for specific power plants dispensed with. Rate of BCD continues at 10 percent

## Excise duty

### Reduction in duties

- Ad-valorem rates of excise duty on MS and HSD reduced from 8 percent to 6 percent. No change in specific duty rates
- Bio – diesels exempted from payment of excise duty

### Other significant changes

- E-payment of excise duty made mandatory with effect from April 1, 2007 for tax payers who have paid excise duty of INR 5 million or more in cash during the previous financial year
- Suitable provisions made in the Valuation Rules to provide for basis of valuation in case of job-work (for finished products). Value for payment of excise duty to be based on sale price of the principal manufacturer. Prior to amendment valuation was based on cost construction method

## CST

- Reduction in rate of CST from 4 percent to 3 percent proposed. Notification awaited
- ATF sold to an aircraft with a maximum take off mass of less than 40,000 kilograms operated by scheduled airlines notified as declared goods – to attract 3 percent CST from notified date

## BCD

Item	Crude	Petrol	Diesel	Dom LPG
As on 2.6.98	22	32	32	12
As on 28.2.99	20	30	30	10
As on 1.3.00	5	25	25	10
As on 30.9.00	10	20	20	10
As on 1.3.03	10	20	20	10
As on 19.8.04	10	15	15	5
As on 1.3.05	5	10	10	Nil
As on 1.3.06	5	10	10	Nil
As on 14.6.06	5	7.5	7.5	Nil
Post Finance Bill, 2007	5	7.5	7.5	Nil

## Excise duty

Item	Crude	Petrol	Diesel	Dom LPG
As on 2.6.98	INR 900 pmt as cess	32% + INR 1/Ltr	15%	10%
As on 28.2.99	INR 900 pmt as cess	32% + INR 1/Ltr	16% + INR 1/Ltr	8%
As on 30.9.00	INR 900 pmt as cess	16% + INR 1/Ltr	12% + INR 1/Ltr	8%
As on 1.3.02	INR 1800 pmt as cess	32% + INR 7/Ltr	16% + INR 1/Ltr	16%
As on 1.3.03	INR 1800 pmt as cess	30% + INR 7.50/Ltr	14% + INR.1.50/Ltr	16%
As on 16.6.04	INR 1800 pmt as cess	26% + INR 7.50/Ltr	11% + INR.1.50/Ltr	8%
As on 19.8.04	INR 1800 pmt as cess	23% + INR 7.50/Ltr	8% + INR.1.50/Ltr	8%
As on 1.3.05	INR 1800 pmt as cess	8% + INR 13/Ltr	8% + INR 3.25/Ltr	Nil
As on 1.3.06	INR 2500 <sup>1</sup> pmt as cess	8% + INR 13/Ltr	8% + INR 3.25/Ltr	Nil
Post Finance Bill 2007	INR 2500 pmt as cess	6% + INR 13/ltr	6% + INR 3.25/Ltr	Nil

<sup>1</sup> Crude oil produced in exploration blocks in NELP through competitive international bidding is exempt from payment of OIBD cess

# Glossary

APDP	Accelerated Power Development Programme
APDRP	Accelerated Power Development and Reforms Program
APM	Administered Price Mechanism
ATF	Aviation Turbine Fuel
BCD	Basic Custom Duty
BPCL	Bharat Petroleum Corporation Limited
BU	Billion Units
CBEC	Central Board of Excise & Customs
CBM	Coal Bed Methane
CII	Confederation of Indian Industries
CGD	City Gas Distribution
CNPC	China National Petroleum Corporation
CST	Central Sales Tax
CVD	Counter Vailing Duty
DDT	Dividend Distribution Tax
DGH	Directorate General of Hydrocarbons
E&P	Exploration and Production
EGCIP	Expert Group on Commercialization of Infrastructure Projects
FBT	Fringe Benefit Tax
FDI	Foreign Direct Investment
FIPB	Foreign Investment Promotion Board
GAIL	Gas Authority of India Limited
GDP	Gross Domestic Product
GOI	Government of India
GRM	Gross Refining Margin
GSPC	Gujarat State Petroleum Corporation Limited
HPCL	Hindustan Petroleum Corporation Limited
HSD	High Speed Diesel
IIG	Inter-institutional Group
IIP	Index of Industrial Production
IOC	Indian Oil Corporation
IODP	Integrated Ocean Drilling Programme
JV	Joint Venture
KG	Krishna Godavari
KWH	Kilo Watt Hour

LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
LST	Local Sales Tax
MAT	Minimum Alternate Tax
MMT	Million Metric Tonne
MMSCM	Million Metric Standard Cubic Meter
MMSCMD	Million Metric Standard Cubic Meter per Day
MMPA	Million Metric Tonne per Annum
MS	Motor Spirit
MW	Mega Watt
NABARD	National Bank of Agriculture and Rural Development
NELP	New Exploration Licensing Policy
NHAI	National Highway Authority of India
NHB	National Housing Board
NOC	National Oil Company
OIDB	Oil Industry Development Board
OIL	Oil India Limited
OMC	Oil Marketing Companies
ONGC	Oil and Natural Gas Corporation
OVL	ONGC Videsh Limited
P&NGB	Petroleum & Natural Gas Regulatory Board
PSC	Production Sharing Contract
PDS	Public Distribution Systems
PLF	Plant Load Factor
PPA	Power Purchase Agreement
PSU	Public Sector Undertaking
REC	Rural Electrification Corporation
RFP	Request for Proposal
RFQ	Request for Qualification
RGPPL	Ratnagiri Gas and Power Private Limited
SBI	State Bank of India
SEB	State Electricity Boards
SERC	State Electricity Regulatory Commission
SIDBI	Small Industries Development Bank of India
SPA	Sale Purchase Agreement
SRFS	Site Restoration Fund Scheme
STT	Securities Transaction Tax

UMPP	Ultra Mega Power Projects
USD	United States Dollar
VAT	Value Added Tax
Y-o-Y	Year-on-Year

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