

# India Union Budget 2010

## Implications on Oil & Gas Industry



“India Union Budget 2010 – Implications on Oil & Gas Industry” has been prepared by Oil & Gas Industry team of PricewaterhouseCoopers Pvt. Ltd., a specialty practice established to serve the unique requirements of the oil & gas industry. This publication is brought out on the eve of a Senior Management Meet to discuss the implications on the Oil & Gas Industry of proposal made by the Government of India in the Union Budget on February 26, 2010. It provides a broad view of implications of India Union Budget 2010 on the stakeholders of Oil & Gas industry.

The information in this publication is for guidance only and should not be considered as a substitute for appropriate professional advice. We suggest readers seek professional advice before making any decision.

For further information, please contact the PricewaterhouseCoopers offices in India.

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# India Union Budget 2010 perspective

The backdrop against which Finance Minister Mr. Pranab Mukherjee presented the first budget of UPA II government was dramatically different. In Budget 2010, although sustenance of growth was an important agenda, unabated rise in food prices coupled with high fiscal deficit emerged as a major challenge for the government. The Finance Minister in his budget speech did try to touch upon both the challenges. While he did lay out a road map to bring down the fiscal deficit to 4.1 per cent by 2012-13, he did not spell out any such target to bring down the prices. This is understandable; the economic survey presented in parliament on 25th February 2010 has also pointed out that there is no easy way out of the current bout of inflation. Thus FM appears to have chosen to focus on the root cause of the price rise and highlighted the importance of the agricultural sector in providing food security.

In terms of new fiscal initiatives, the Finance Minister did not want to do much, ostensibly since government is as such to introduce new Direct Tax Code and GST by 1 April 2011. Nevertheless, the FM did propose changes in direct taxes, offering some concessions to personal income tax payers and reduction of surcharge whereas increasing the rate of minimum alternate tax for the corporate sector, which together with other maneuvers will result in a revenue loss of Rs. 26,000 Crore.

The proposals of the Budget 2010 have been lauded by most because of its focus on the infrastructure and the agriculture sector.

At the sector level, however, yet again, the demands of the oil & gas sector remain largely unmet by the proposals made in the Finance Bill.

It is imperative that domestic production of oil & gas goes up to securitize energy sources. Few in the Government and industry will disagree that effectiveness of attracting investments in the E&P sector has reduced over the last few years, not because of economic downturn alone but our domestic policies as well. Underground risk for exploration & production companies investing in India continues to remain high, and mitigating above ground risks is a must to attract investments. The Union Budget 2010 was a ray of hope for the incumbents and investors tracking India. The service tax and income tax related demands were serious; the sticking costs of service tax and discrimination between - oil and gas - and - gas from one round of awards and other - are considered as avoidable at all costs. The current regime is laden with ambiguity and uncertainty, a perfect recipe for allowing investors to put risk capital in other territories than in India. Let us hope against hope that the Government is relooking into the NELP regime and tackle the issues in one go and before the next round of awards, including make the gas pricing policy transparent and sustainable.

The industry was also expecting the Union Budget to reflect the direction of thinking of the Government as regards gas infrastructure development. In place of any announcements regarding National Gas Highway Development Authority and National Centre for Natural Gas Grid Management, the statement on Implementation of Budget Announcements of July 2009 states that the Ministry of Petroleum & Natural Gas is processing comments received from various Ministries, Departments and Organisations on the Cabinet Note on the subject. The ambiguity continues as regards interplay of the existing and future gas infrastructure related Government bodies.

During the budget run-up, a lot was discussed regarding how the Government will tackle fiscal deficit. Increasing of excise duty and customs duty rates for products and crude respectively is aimed at improving revenue collection. If one is to go by precedence, the Government should have announced a rise in petroleum prices to be able to pass on the duty hikes to the consumers. In absence of that, under-recoveries of OMCs will grow. However, the Government may have held back any rise in prices of fuels to be able to take such decision soon and once in for all, by accepting the recommendations of the Expert Group on studying the Pricing of Petroleum Prices. If so, the retailing companies would consider it wait worth it. The duty protection having gone up, the refineries would benefit. Similarly, the marketing companies would find working capital management relatively easier with cash reimbursement of under-recoveries as opposed to by oil bonds.

We pin our hopes back on to the Ministry of Petroleum & Natural Gas to resolve numerous open issues in the sector and to work miracles.



# Economic Survey 2009-10

Economic Division of Ministry of Finance, Government of India released Economic Survey 2009-10 on the February 25, 2010. The following excerpts of the Survey analyse and put in perspective the oil and gas sector.

## State of economy

Indian economy witnessed recovering trend with 7.9 percent growth rate in the second quarter of 2009-10. Manufacturing sector grew by 8.9 percent which is significantly higher than 3.2 percent in 2008-09 while the agricultural output declined by 0.2 percent. Welfare measures like per capita income and consumption have shown a declining rate in the last two years. Growth in per capita income, measured in terms of GDP at constant market prices, recovered to 5.3 per cent in 2009-10, per capita consumption growth as captured in the private final consumption expenditure (PFCE) shows a declining trend as 2.7 % in 2009-10 then 5.4 % in 2008-09. Policy measures are afoot to put the economy back on the 9 percent growth path.

## Commodity price and inflation

The slowdown in the industrial sector starting from 2007-08 got escalated by the global commodity price shock and the impact of the global slowdown during the year 2008 was arrested at the beginning of 2009-10. The recovery is evident by the industrial growth estimated at 7.7 per cent for the period April-November 2009-10, significantly up from 0.6 per cent during the second half of 2008-09.

Average international crude oil prices increased from 44.11\$/ bbl in January-March 2009 to 75.5\$/bbl in October- December 2009. The year-on-year WPI inflation rate has been fairly volatile in 2009-10. It was 1.2 per cent in March 2009 and then declined continuously to become negative during June-August 2009, assisted in part by the large statistical base effect from the previous year. It turned positive in September 2009 and accelerated to 4.8 per cent in November 2009 and further to 7.3 per cent in December 2009. For the fiscal year so far (March 09- December 09) WPI inflation is estimated at 8 per cent.

In December 2009, nearly 67 per cent of the overall WPI inflation could be attributed to food items (primary and manufactured), followed by 12 per cent in the fuel and power commodity group, the remaining 21 per cent being explained by manufactured nonfood and primary non-food articles. Among food items the major contributors to inflation are milk (20 per cent), eggs, meat and fish (over 20 per cent), rice (about 10 per cent), wheat (6 per cent), pulses (about 9 per cent), potatoes (9 per cent) and tomatoes (6 per cent).

As of now, the outlook for inflation is conditioned by supply-side pressures in the near term, possible return of pricing power with stronger recovery in growth, further revival in private demand with improving consumer and business confidence, and possible spurt

## External trade

International oil prices recorded unprecedented rise during 2008 and remained considerably volatile during the entire ensuing period. The price of Indian basket of crude oil which moved in tune with international oil prices was also volatile,

averaging at 83.57 per barrel during 2008-09 after reaching an unprecedented US \$ 142 per barrel on July 3, 2008 before declining sharply following the global recession. The monthly movements in oil prices during 2007-08 to 2009-10 (April-December) clearly reflect this volatility.

POL import growth was low mainly due to both low volume growth by 6.2 per cent and low growth of import price of the Indian crude oil import basket by 5.5 per cent. India's merchandise imports were also affected by the global recession though with a slight lag and grew by 20.7 per cent to US\$ 303 billion in 2008-09. This was due to the moderate growth of 23.5 per cent in import of non-petroleum, oil and lubricants (non-POL) products and 14.7 per cent in POL products. POL import growth was low mainly due to both low volume growth by 6.2 per cent and low growth of import price of the Indian crude oil import basket by 5.5 per cent

The share of petroleum, crude and products in export fell from 17.8 per cent in 2007-08 to 14.9 per cent in 2008-09 and 14.2 per cent in the first half of 2009-10, while the share of primary products fell from 15.5 per cent in 2007-08 to 13.3 per cent in 2008-09 and further to 12.7 per cent in the first half of 2009-10. The share of manufactured exports increased by 2.3 percentage points to 66.4 per cent in 2008-09 and further to 69.2 per cent in the first half of 2009-10.

The first half of 2009-10 when the global recession was in full swing, also saw an accentuation in the fall of India's export growth resulting in negative growth of (-) 29.7 per cent compared to the positive 48.1 per cent in the corresponding period of the previous year. All the three sectors were badly affected during this period with petroleum, crude and products being the worst affected at (-)44 per cent export growth due to the low crude oil prices in the first half of 2009-10, which started declining from the high reached in the first half of 2008-09.

	POL import %	POL export %	Net POL import %
2006-07	30	59.3	19.1
2007-08	39.4	53.6	32.4
2008-09	14.7	-4.6	25.7
2009 (Apr- Sep)	-41	-44	-39.7

India's export-import ratio which had stabilized at above 2 till 2008-09 indicating a high trade surplus for India has suddenly turned into a trade deficit at 0.64 in the first half of 2009-10. The disaggregated data for April-June 2009 indicate that this was probably due to the sudden fall in India's exports of refined POL to Brazil because of softening of crude oil prices and the sudden high rise in imports from Brazil of crude petroleum, besides sugar to meet domestic needs. High growth in imports of beverages, iron and steel, fats and oils from Brazil also seems to have contributed to the trade deficit. The UAE has displaced the USA as the topmost destination of India's exports in 2008-09 and 2009-10 (April-September) with an export share of 13.1 per cent and 14.4 per cent respectively.

## Fiscal policy development

The fiscal expansion undertaken by the Central Government as a part of the policy response to counter the impact of the global economic slowdown in 2008-09 was continued in fiscal 2009-10. The expansion took the form of tax relief to boost demand and increased expenditure on public projects to create employment and public assets. The net result was an increase in fiscal deficit from 2.6 per cent in 2007-08 to 5.9 per cent of the revised GDP (new series) in 2008-09 (provisional) and 6.5 per cent in the budget estimates for 2009-10 (as against 6.8 per cent of the GDP on the old series, reported earlier). Thus the fiscal stimulus amounted to 3.3 per cent of the GDP in 2008-09 and 3.9 per cent in 2009-10 from the level of the fiscal deficit in 2007-08.

As part of the fiscal stimulus, the Government also enhanced the borrowing limits of the State Governments by relaxing the targets by 100 basis points. As a result, the gross fiscal deficit of the States combined rose from 1.4 per cent of the GDP in 2007-08 to 2.6 per cent in 2008-09 (revised estimates [RE]) and was estimated at 3.2 per cent of the GDP in 2009-10 (Budget Estimate).

In implementing the fiscal stimulus, the Central Plan expenditure was frontloaded. This is evident from its growth of 34.3 per cent and 18.0 per cent in 2008-09 and 2009-10 (BE), respectively. As a proportion of the GDP, the Plan expenditure at 5.3 per cent of the GDP in 2009-10(BE) was the highest in recent years. Non-Plan expenditure grew by 19.4 per cent and 14.8 per cent respectively in 2008-09 and 2009-10 (BE).

The relative success of the fiscal stimulus in supporting effective demand, particularly the consumption demand, in 2008-09 and 2009-10 could be traced to its composition. The approach of the Government was to increase the disposable income in the hands of the people, for instance by effecting reductions in indirect taxes (excise and service tax) and by expanding public expenditure on programmes like the National Rural Employment Guarantee Act (NREGA) and on rural infrastructure. The implementation of the Sixth Pay Commission recommendations and the debt relief to farmers also contributed to this end. The fact that the approach worked is attested to by the GDP growth rate and more specifically by the growth in private consumption demand in 2008-09 and also in 2009-10 as reflected in the relevant data on the NAS new series. Consumption expenditure, by its very nature, has short lags, and affects demand quickly, with little or no effect on productivity, while productive infrastructure expenditure takes much longer to translate into effective demand. The recovery having taken root now necessitates a review of public spending. It has to be geared towards building medium-term productivity of the economy and making up for the decline in investment growth in certain sectors of the economy.

The recommendations of the Thirteen Finance Commission (FC-XIII) have to be taken on board in shaping the fiscal policy for 2010-11 and in the medium term. The FC-XIII has recommended a calibrated exit strategy from the expansionary fiscal stance of 2008-09 and 2009-10 as the main agenda of the Central Government. Further, it has suggested that the revenue deficit of the Centre needs to be progressively reduced and eliminated, followed by emergence of revenue surplus by 2014-15. Perhaps for the first time, a cap on the overall debt of the Government has been recommended. It has suggested a target of 68 per cent of the GDP for the

combined debt of the Centre and the States to be achieved by 2014-15. Thus the fiscal consolidation path embodies steady reduction in the augmented debt stock of the Centre to 45 per cent of the GDP by 2014-15, and that of the States to less than 25 per cent of the GDP by 2014-15. The FC-XIII has also suggested the need for the FRBM Act to specify the nature of shocks that would require a relaxation of targets under the Act. It has recommended that the share of States in the net proceeds of shareable Central taxes be 32 per cent in each of the financial years from 2010-11 to 2014-15.

## Development of Oil and Gas Industry

With around 75 per cent of total oil consumption in the country being met through imports, the dependence on imports for petroleum and petroleum products continued to be high. The domestic supply of crude oil remained around 34 million metric tonnes (MMT) and natural gas at about 32 billion cubic metric tonnes (BCM) during the past five years. With 15 new oil and gas discoveries during the current financial year, domestic availability is expected to improve. During 2009-10, the projected production for crude oil is 36.7 MMT, which is about 11 per cent higher than the actual crude oil production of 33.5 MMT in 2008-09. This is primarily due to increase in crude oil production from Rajasthan (2.4MMT) and the KG deepwater (0.8 MMT).

The projected production for natural gas (including coal bed methane [CBM]) for 2009-10 is 50.2 BCM which is 52.8 per cent higher than the actual production of 32.8 BCM in 2008-09. The increase in natural gas production is primarily from the KG deepwater block.

### Progress of the New Exploration and Licensing Policy (NELP) and Coal Bed Methane Policy

Of the estimated sedimentary area of 3.14 million sq. km, at present 1.17 million sq. km is held under petroleum exploration licences. Since operationalization of the NELP in January 1999, 72 oil and gas discoveries have been made by private/joint venture (JV) companies in 21 blocks. Under the NELP, more than 600 MMT of oil equivalent hydrocarbon reserves has been added.

As on April 1, 2009, investment made by Indian and foreign companies was of the order of US \$ 11.9 billion. After concluding seven rounds of NELP, 203 production-sharing contracts (PSCs) have been signed. The area awarded under the NELP for exploration was 46 per cent of the Indian sedimentary basin. The eighth round of the NELP was launched in April 2009 offering the highest number of exploration blocks ever, that is 70 blocks covering a sedimentary area of about 1,63,535 sq. km. The offered blocks included 24 deepwater blocks, 28 shallow water blocks, 8 on-land blocks and 10 Type-S blocks. As part of the CBM policy approved in July 1997, 26 CBM blocks have been awarded in the first three rounds. As part of CBM IV, the Government offered 10 blocks covering an area of about 5,000 sq. km. spread over seven states, namely Assam, Jharkhand, Orissa, Madhya Pradesh, Chhattisgarh, Maharashtra and Tamil Nadu.

The Government has received 76 bids for 36 blocks out of 70 blocks offered under NELPVIII and 26 bids for 8 blocks out of 10 blocks offered under CBMIV by the

bid-closing date, that is October 12, 2009. In respect of 16 deep water blocks, 15 shallow water blocks and 3 on-land blocks, no bids were received. A total of 62 companies comprising 10 foreign and 52 Indian companies have made bids.

#### Domestic reserves and production

Balance recoverable crude oil and natural gas reserves in the country are 736.45 MMT and 1,119.55 BCM respectively. New oil and gas reserves found by private/JV companies in the KG deepwater and Rajasthan are in production.

#### Gas production from KG-D6 basin

Gas production from KG-D6 began on April 1, 2009. It is expected that production would be ramped up to 80 MMSCMD by the end of 2009-10. An Empowered Group of Ministers (EGOM) constituted to decide commercial utilization of gas under the NELP has allocated 61.611 MMSCMD of gas produced from KG-D6 on firm basis and 30 MMSCMD on fall-back basis to various priority sectors.

#### Crude oil production from Rajasthan

Crude oil production by the Rajasthan Cairn Energy India Pty. Ltd. has started in block RJ-ON-90/1 with effect from August 29, 2009 at the initial production rate of 3,500 barrels per day. Production from this block, which is of very high quality, is likely to increase during 2009 through 2011. The Government has designated IOC, MRPL and HPCL for lifting part of the crude oil production from this block after ascertaining the capacity of receiving refineries of the nominees. The production expected from this block during 2009-10 is 2.4 MMT.

#### Improved oil recovery/enhanced oil recovery (IOR/EOR)

Work programmes have been undertaken primarily by the Oil and Natural Gas Corporation (ONGC) for IOR/EOR in its 15 largest fields, which account for 80 per cent of its reserves and production. Eighteen IOR/EOR schemes have already been approved to increase the recovery factor from 14 ageing oil & gas fields of the ONGC at an estimated cost of about Rs14,510 crore.

#### Development of marginal fields

Concerted efforts have been made to put new and marginal fields in production through in-house resources as well as through service contract. Out of a total of 165 marginal fields, ONGC has already monetized 56. Of the remaining 109 fields, 68 are being monetized in-house by ONGC, 20 through service contracts and 21 are likely to be offered. The marginal field policy is being finalized.

#### Underground coal gasification (UCG)

ONGC entered into an Agreement of Collaboration with the National Mining Research Centre-Skochinsky Institute of Mining in Russia. In the selected Vastan mine block, a seismic survey was carried out and 18 boreholes were drilled for detailed UCG site characterization. Vastan in Gujarat and Hodu Sindri in Rajasthan have been found suitable for UCG stations. Pilot production of UCG at Vastan by the ONGC would commence in 2010.

### Gas hydrate

India is a pioneer in the field of gas hydrate. In accordance with the roadmap for the National Gas Hydrate Programme (NGHP), India has already acquired core samples with the help of the US drill ship JOIDES Resolution. In December 2008, a memorandum of understanding (MOU) was signed between the Directorate General of Hydrocarbons and the U S Geological Survey for cooperation on exchange of scientific knowledge and technical personnel in the field of gas hydrate and research. The second NGHP expedition has been planned in 2010 to map the prospects of gas hydrate in Krishna Godavari and Mahanadi deepwater areas.

### Equity oil & gas from abroad

The Government is encouraging national oil companies to aggressively pursue equity oil and gas opportunities overseas. The Oil & Natural Gas Corporation Videsh Limited (OVL) produced about 8.75 MMT of oil and equivalent gas in 2008-09 from its assets abroad in Sudan, Vietnam, Venezuela, Russia, Syria and Colombia. In 2008-09, OVL has acquired seven blocks in five countries comprising two blocks each in Brazil and Columbia and one each in Myanmar, Venezuela and Trinidad & Tobago. The largest ever acquisition of a foreign company, Imperial Energy Plc. UK., (IEC) by an oil PSU, OVL has taken place. OIL-IOC alliance has also acquired one block in Timor Leste and two blocks in Egypt. BPCL along with Videocon has acquired participating interest in 10 blocks in Brazil.

### Equity Refining & pipeline capacity

The total installed capacity of refineries increased to 177.97 MMTPA as on April 1, 2009. The new refineries at Bhatinda, Paradip and Bina will further augment domestic refinery capacity. By the end of the Eleventh Five Year Plan, refinery capacity is expected to reach 240.96 MMTPA. The country has a network of 24 product pipelines with a length of 10,514 km and capacity of 62.91 MMT; 3 LPG pipelines of 2,197 km length and 4.50 MMT capacity; 6 crude oil pipelines of 5,795 km length and 52.75 MMT capacity.

### Rajiv Gandhi Gramin LPG Vitrak Yojana (RGGLVY)

The Ministry of Petroleum & Natural Gas has formulated a vision for the year 2015 'Customers Satisfaction & Beyond' wherein it is targeted to cover 75 per cent of the population with LPG by that year. The LPG customer base is targeted to increase from 10.6 crore as on April 1, 2009 to 16.0 crore by the year 2015. The focus would be on States and regions where coverage is below the national average. A new low-cost LPG distributor scheme, the RGGLVY was launched on October 16, 2009 with a view to releasing LPG connections in rural areas where operations with the present norms are economically unviable.

The scheme has been launched at locations having potential of up to 600 refills per month. Advertisements inviting applications for distributorship have been released in eight States covering 1,215 locations.

### Public grievances redressal system in Oil Marketing Companies (OMCs)

In order to streamline the public grievances redressal system, OMCs have started unique tollfree telephone numbers that are provided to register complaints and follow up. Customer contact with senior company officials is fixed on prescribed days of the month. For booking refill cylinders 24x7, SMS and interactive voice response system (IVRS) facilities have been introduced.

### Special efforts towards energy (oil & gas) conservation

The Petroleum Conservation Research Association (PCRA) is mandated to formulate and spread awareness on energy / petroleum conservation. This is carried out through field- level activities like energy audit, fuel oil diagnostic studies, service to small-scale industries, institutional training programmes, seminars, exhibitions, painting competitions and workshops. During 2009-10, 3,572 activities have so far been conducted. The PCRA has carried out technical/R&D interventions aimed at reducing energy intensity in the small and medium enterprises. A Technology Conservation Centre has been set up at the PCRA, New Delhi, for effective information dissemination on energy-efficient products and technologies for the general public. The Centre has been attracting a large number of visitors including international visitors. 10.56 The PCRA media campaign “Save Fuel Yanni Save Money” was adopted to develop a strong motivation for attitudinal change in favour of fuel efficient measures in petroleum-intensive sectors. An impact assessment survey showed that the PCRA campaign was very successful and resulted in significant fuel saving.



# Analysis of Union Budget 2010-11

## Direct Tax

### Corporate Tax Rates – Unchanged

There is no change proposed in the rates of Corporate Tax, Withholding Tax, Dividend Distribution Tax (DDT) and Capital Gains Tax except that the rate of surcharge for domestic companies is proposed to be reduced from 10% to 7.5%. Thus, the effective corporate tax rate for domestic companies will be reduced to 33.22% and effective DDT rate will be reduced to 16.61%.

### Minimum Alternate Tax – Increased

It is proposed to increase the rate of Minimum Alternate Tax (MAT) from 15% (effective 16.995%) to 18% (effective 19.93%). The period to carry forward tax credit under MAT remains unchanged that is 10 years.

### Royalty and Fee for technical services – situs of rendering not relevant

It is proposed to specifically provide that the income of non-residents in the nature of royalty and fee for technical services shall be taxable in India irrespective of situs of rendering services. This amendment is proposed to overrule the judgments of Supreme Court <sup>1</sup> and High Court <sup>2</sup>. The amendment is proposed to take retrospective effect from June 1, 1976.

### Restriction on investment linked incentive for pipelines

Investment linked incentive will not be available for any year if profit linked tax incentive has been claimed and allowed in respect of the business of laying and operating a cross-country natural gas or crude or petroleum oil pipelines network for any year.

### Common carrier capacity condition aligned with PNG Regulations

One of the conditions for availing the investment linked tax incentive in respect of the business of laying and operating a cross-country natural gas or crude or petroleum oil pipelines network is that not less than one-third of the total pipeline capacity is made available for use on common carrier basis. The PNG Regulatory Board however has specified a common carrier capacity condition of 'one-third' for a natural gas pipeline network and 'one-fourth' for petroleum product pipeline network of the entity's own requirement and contracted capacity.

It is proposed to align the proportion of the common carrier condition to that under the PNG regulations.

### Fee for technical services not eligible for presumptive taxation

It is proposed that fee for technical services rendered in connection with the prospecting for, or extraction or production of, mineral oils will not be eligible for presumptive taxation (@ 4.223% on gross basis. This may increase the tax burden of many oil and gas service providers to 42.23% on net basis.

<sup>1</sup>Ishikawajma-Harima Heavy Industries Ltd. vs DIT (288 ITR 408)

<sup>2</sup>Jindal Thermal Power Co. Ltd. vs DCIT (182 Taxman 252)

### Weighted deduction for scientific research and development - increased

It is proposed to increase the weighted deduction from 150% to 200% available on expenditure incurred on eligible in-house Research & Development by companies engaged in the business of manufacturing or production of an article or thing.

Also, it is proposed to increase the weighted deduction from 125 % to 175 % for payments made to approved institutions, colleges, etc for research programme.

### No disallowance of expenditure if tax withheld deposited by due date of filing return

It is proposed that no expenditure like interest, commission, brokerage, professional fees, etc paid to a resident would be disallowed if tax withheld from the payment is deposited with the Government treasury on or before the due date of filing of return of income for the previous year.

### Tax neutral conversion of small private/unlisted public company into limited liability partnership

The Limited Liability Partnership (LLP) Act was recently introduced. There are no specific rules covering the taxability of conversion of a company into an LLP under the Income-tax Act, 1961. In the absence of the same, such conversion may attract levy of capital gains tax.

It is proposed that the conversion of small private/ unlisted public company having turnover of not more than 6 million in any of the preceding three years to LLP would be tax neutral subject to fulfillment of specified conditions. It is also proposed to allow carry forward and set-off of business loss and unabsorbed depreciation to such successor LLP.

Further, it is proposed that the existing MAT tax credit of the company shall not be allowed to the successor LLP.

### Receipt taxed if consideration is inadequate

It is proposed that the receipt of property being shares of closely held company by a firm or a closely held company from any person without or for an inadequate consideration would be taxable in the hands of recipient. This applies if the difference in the consideration and the aggregate fair market value exceeds INR .05 million.

### Withholding Tax

It is proposed to increase the threshold limits for deduction of tax at source for certain payments as follows (with effect from July 1, 2010 :

Nature of Payment	Existing Limit (INR)	Proposed Limit (INR)
Payment to contractors		
- Single Transaction	20,000	30,000
- Aggregate throughout the Financial Year	50,000	75,000
Insurance Commission	5,000	20,000
Commission and Brokerage	2,500	5,000
5,000	120,000	180,000
Fees for professional or technical services	20,000	30,000

It is further proposed to increase the interest rate for delay in deposit of withholding tax after deduction from 1% to 1.5% for each month or part of the month.

#### Personal Income Tax

The basic exemption limit is proposed to be raised for all individual, Hindu Undivided Family and Association of Persons assessee as follows:

Tax Rates	Existing Limit (in INR)	Proposed Limit (in INR)
NIL	Upto 1,60,000	Upto 1,60,000*
10%	1,60,000 to 3,00,000	1,60,000 to 5,00,000
20%	3,00,000 to 5,00,000	5,00,000 to 8,00,000
30%	Above 5,00,000	Above 8,00,000

\* Basic exemption limit for women would be INR 190,000 and for senior citizens INR 240,000

It is proposed that investment in specified long-term infrastructure bonds to the extent of INR 20,000 shall be allowed as deduction in computing the income of an individual or a Hindu undivided family. This deduction will be over and above the existing overall limit of tax deduction on savings of up to INR 100,000.

#### Others

- It is proposed to increase the
  - threshold limit for mandatory audit from INR 4 million to INR 6 million for persons carrying on business and from INR 1 million to INR 1.5 million for the persons carrying on profession.
  - penalty leviable on failure to get accounts audited or to furnish a report of such audit from INR 0.1 million to INR 0.15 million.
  - threshold limit of gross receipts from INR 4 million to INR 6 million for applicability of presumptive taxation regime applicable to assessee engaged in the business of civil construction or supply of labour for civil construction.

## SCORE CARD (DT)

Availability of tax holiday under Section 80IB (9) on the gas produced from all the blocks awarded under NELP / CBM or in any other manner by Central or State Government	No
Tax holiday should be given to each well treating as a separate 'undertaking'	No
Tax Holiday to E&P Companies to be Enhanced to Ten Years from Seven Years and Flexibility to Choose Period of Ten Years of Tax Holiday out of 15 Years	No
Exemption from MAT to the companies eligible u/s 80IB(9)	No
'Farm-in costs' be specifically recognized as intangible asset eligible for depreciation	No
Weighted deduction be extended to expenditure in respect of drilling and exploration activities u/s 42 in line with R&D expenses	No
Expenditure incurred on drilling and exploration activities by an Indian company on overseas production block be allowed u/s 37	No
Deduction for infructuous or abortive exploration expenses u/s 42 be delinked with the surrender of block	No
Grant of profit linked tax holiday to business of laying and operating Cross Country Pipelines for natural gas, crude and petroleum oil	No
Common carrier capacity u/s 35AD for cross country pipelines should be amended from 1/3rd to 1/4th of the total capacity to align with PNG Regulatory Board	Yes
Benefit u/s 35AD to be extended to intra-city and inter-state distribution network	No
Extension of depreciation benefit to capital investments made by refineries for producing fuels in accordance with stringent emission norms similar to pollution control equipment	No

## Indirect Taxes

### GOODS AND SERVICE TAX (GST)

The Finance Minister has announced the date of introduction of the dual GST to be April 1, 2011. He indicated that concerted efforts of the Empowered Committee and the Finance Commission in the last few months has led to a broad consensus on the introduction of GST and has carved a platform for future discussions in finalising the structure of GST and the modalities surrounding its introduction. The Budget 2010 is a landmark one in the history of indirect reforms as it not only brings clarity on the introduction of GST but marks the Government's commitment to expedite its introduction

As a step towards introduction of GST, various measures have been announced in the Union Budget. These include increase in the level of excise duty to 10% signifying a single rate of tax for goods and services, rationalization of duties and broadening of the tax base by way of introduction of new taxable services

### CUSTOMS

#### Tariff

Basic custom duty rate ('BCD') on import of petroleum products has been increased as follows:

Crude Oil- from Nil to 5%

Re-levy of basic customs duty on crude oil will result in increased cost to the downstream sector which is dependent on import of crude oil. On one side the move is negative for refinery, it is blessing for domestic upstream sector as price charged by domestic producer of crude oil to refinery is directly linked to the import price of crude.

Petrol and Diesel – from 2.5% to 7.5% and other specified petroleum products from 5% to 10%

Increase in basic customs duty on diesel and petrol works as refinery protection. This will also incidentally mitigate the impact of increase in cost of crude oil.

Naptha, Liquefied Natural Gas, Liquefied Petroleum Gas, and Pet Coke, continue to attract 5% BCD.

#### Non Tariff

Scope of Settlement Commission expanded by removing restriction on the nature of cases that may be settled and the number of times the Commission may be approached by an assessee. Time period for disposal of applications by the Settlement Commission extended.

## EXCISE

### Tariff

The Excise duty general rate on non petroleum products has been increased from 8% to 10%.

Increase in excise duty rate from 8% to 10% on non petroleum products will result in additional cost burden to oil and gas sector. Impact of increase would be mitigated to the extent set off available against output excise/ service tax liability.

Excise duty rate on petrol and diesel have been increased by Re. 1/ litre. The OMCs will not be able to pass on the increased burden to customers until the Government approves retail petroleum price rise or allows free market pricing.

Comparative analysis of excise duty rates on petrol and diesel due to this change is as under:

Description	Effective rate of excise duty (pre-budget)	Effective rate of excise duty (post-budget)
Unbranded Petrol for Sale	Rs 13.35 per litre (5.35 BED + 2 AED + 6 SAED)	Rs 14.35 per litre (6.35 BED + 2 AED + 6 SAED)
Branded Petrol for Sale	Rs 14.50 per litre (6.50 BED + 2 AED + 6 SAED)	Rs 15.50 per litre (7.50 BED + 2 AED + 6 SAED)
Unbranded High Speed Diesel	Rs 3.60 per litre ( 1.60 BED + 2 AED)	Rs 4.60 per litre ( 2.60 BED + 2 AED)
Branded High Speed Diesel with brand name	Rs 4.75 per litre ( 2.75 BED + 2 AED)	Rs 5.75 per litre ( 3.75 BED + 2 AED)

*Note: BED, AED and SAED denote basic excise duty additional excise duty and special additional duty respectively.*

Education cess of 2 % and secondary and higher education cess of 1% would also be chargeable

## SERVICE TAX

### Service tax rate to continue at 10%

Service tax imposed on 8 new services - to be effective from a date to be notified after enactment of the Finance Bill, 2010. Most of these services are not rendered by Oil and Gas Sector. The introduction will increase the overall cost to the Oil and Gas Sector subject obviously to any set off available against output excise/service tax liability.

Applicability of service tax in Continental Shelf (CS) and Exclusive Economic Zone (EEZ):

Areas Covered	Purpose
Whole of CS and EEZ	All activities pertaining to construction of installation, structures and vessels for the purpose of prospecting or extraction or production of mineral oil and natural gas and supply thereof
Installation, structures and vessels in CS and EEZ for purpose of prospecting or extraction or production of mineral oil and natural gas and supply thereof	Any service provided or to be provided by or to such installation, structures and vessels and for supply of any goods connected with the said activity

Service Tax on renting of immovable property service – definition of taxable service has been amended to levy service tax on renting activity itself w.e.f. 1st June 2007 and to levy service tax on rent of vacant land provided such land is used for furtherance of business or commerce



## SCORE CARD (IDT)

Enlarging the list of goods that could be imported, duty free, by E& P Sector by amendment of List 12 & List 13 of customs notification no 21/2002 dated 1.03.2002	No
Nil Custom Duty on Capital Goods imported for setting up new Petroleum Refinery, Pipelines or Green Fuel Projects	No
Customs Duty Concession for Pipeline Projects	No
Removal of National Calamity Contingent Duty on Crude Oil levied Rs.50/MT	No
Withdrawal of end- used based exemptions applicable to Industrial Units	No
VAT on Petroleum Products	No
Declared Goods' Status to Natural Gas/LNG under the Central Sales Tax Act, 1956	No
Exemption from Service Tax on Services Consumed by E&P Companies in relation to Exploration and Productions Activities	No
Inclusion of Petroleum products in GST regime	No

# Major Pre-Budget Expectation of Oil & Gas Industry

## Direct Tax

### Upstream

#### Income Tax Holiday under Section 80IB (9)

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

The Union's Finance Minister, during 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 has inserted new clauses to clarify that the tax holiday would be available on gas produced from blocks licensed under the eighth round of bidding under New Exploration Licensing Policy (NELP) and fourth round of bidding under the Coal Bed Methane (CBM). The insertion of these clauses may suggest that gas produced from the blocks other than those awarded under NELP VIII /CBM IV are not entitled to the benefit of tax holiday.

It was therefore expected that this year budget will 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 Government.

#### Availability of Tax Holiday to Each Well

As per legal pronouncements and general provisions of the Income Tax Act, 1961(Act), each well can be considered as a separate undertaking for the purpose of tax holiday under section 80IB(9). However, the Finance (No. 2) Act, 2009 has amended the provisions of Act to clarify that all blocks licensed under a single contract, which has been awarded under the New Exploration Licensing Policy or has been awarded in pursuance of any law for the time being in force or has been awarded by the Central or a State Government in any other manner, shall be treated as a single "undertaking" for the purpose of claiming a tax holiday under section 80IB(9). This amendment has virtually overturned the already decided cases which have gone in the favour of assessee by making retrospective legal amendments to re-write the law from financial year 1999-2000, pre-judging the matters pending before courts and tribunals. These changes are detrimental to the nation's energy security and also cause hardships to the taxpayers who have acted upon the pre-amendment provisions of the Act.

However, if at all the meaning of "undertaking" is to be defined to reflect a change in government policy in regard to the oil and gas sector, a clarification was expected that such change will operate only on a prospective basis i.e., from financial year 2009-10.

#### Tax Holiday to Exploration & Production(E&P) Companies to be Enhanced to Ten Years from Seven Years and Flexibility to Choose Period of Ten Years of Tax Holiday out of 15 Years

Tax holiday u/s 80-IB(9) is available to E&P companies for seven consecutive years starting from the year in which commercial production commences. The period of seven years of tax holiday is less than the tax holiday period available to companies

in the infrastructure sector, such as power generation and distribution companies. Furthermore, during the initial seven years, companies have large expenditure to set off and hence the actual benefit of the tax holiday does not reach them.

Like Infrastructure, E&P Industry is also highly capital intensive with a long gestation period. Thus, it was expected that the provisions of Section 80-IB (9) would be amended to extend the period of seven years of tax holiday to ten years and to allow flexibility to E&P companies to choose the period of a tax holiday during the initial fifteen year period of their operation. Alternatively, it was expected that Section 80-IA benefits will be extended to E&P companies engaged in the exploration and production of oil and gas.

#### Exemption from Minimum Alternate Tax (MAT) (Section 115JB)

The exploration and extraction of mineral oil has been given a tax holiday u/s 80-IB (9). However, this provision has been nullified to an extent by applying 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 exploration and drilling expenditure are granted on an accelerated basis. It was therefore expected that the business of the exploration and extraction of mineral oil will be exempted from MAT under Section 115JB of the Income Tax Act, 1961.

#### Introduction of Specific Provisions in the Income Tax Act Regarding 'Farm-in costs'

Another long pending demand of the E&P sector is the introduction of specific provisions in the Income Tax Act, 1961 regarding the treatment of 'farm-in costs'. The tax treatment of such payments remains unclear and gives rise to disputes between the industry and the tax department. It discourages acquisitions in the E&P sector since the magnitude of tax costs are high and can result in proposed transactions becoming uneconomical. A 'farm-in' is a transaction unique to the E&P sector. As a result of a farm-in in an existing exploration block, the company gets a share in the licenses and rights on it which are originally granted to the company farming out of a block. Thus, it was expected that to avoid possibility of any dispute, these costs would be specifically be recognized as an intangible asset eligible for depreciation under section 32 of the Income Tax Act, 1961.

#### Weighted Deduction in Line with R&D Expenses to be Introduced under Section 42 of the Income Tax Act

Section 42 of the Act allows deductions in respect of capital and revenue expenditure actually incurred by the assessee in respect of drilling and exploration activities. The fact that capital expenditure is also allowed as a deduction beginning with the year of commercial production only amounts to an accelerated deduction of the expenditure incurred and does not amount to any additional deduction or incentive being granted to the assessee.

It is important that expenditure in respect of drilling and exploration activities be treated the same as R&D expenditure to encourage the E&P sector to adopt a more aggressive approach to invest in areas even where the probability of striking oil reserves is lower than in other areas. It was therefore expected that weighted deduction of 150% of the actual expenses incurred by the assessee in respect of

drilling and exploration activities would be allowed to the assessee under section 42 of the Income Tax Act.

#### [Deduction for Expenditure Incurred on Drilling and Exploration Activities by an Indian Company with an Overseas Production Block under Section 37 of the Income Tax Act](#)

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

However, where they have already started their exploration activities, the deduction for the expenditure incurred on drilling and exploration activities in respect of the overseas blocks should be available under section 37 of the Income Tax Act, 1961. It was therefore expected that the Government of India, by way of an amendment to the Act, will clarify this matter.

#### [Deduction for Infructuous or Abortive Exploration Expenses u/s 42](#)

Typically the provisions of the Production Sharing Contract does not require the area to be surrendered as a prerequisite for claiming the deduction of unsuccessful exploration cost. However, under section 42 of the Income Tax Act, 1961 provides for a deduction for infructuous or abortive exploration expenses is not allowed until the surrender of the area, even though the expenses are already charged off in the books of accounts as per the company's accounting practices. As a result of the requirement to surrender the area prior to the beginning of commercial production, the assessee is not able to avail the deduction, from taxable income, of expenses on account of abortive exploration in the year when expenditure is incurred. It was expected that the requirement to 'surrender' the area will be deleted from Section 42(1)(a) and that deduction will be allowed from the year in which the area is abandoned as abortive.

### Midstream

#### [Grant of Profit Linked Tax Holiday to the Business of Laying and Operating of Cross Country Pipelines for natural gas, crude and petroleum oil](#)

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

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

Since, pipelines have several distinct advantages over other modes of transport in terms of safety, eco-friendliness, lower product losses etc, it was therefore expected

that the benefit of tax holiday under section 80-IA will be granted to the companies engaged in laying and operating of pipelines used for transporting natural gas, crude and petroleum oil.

#### Minimum Common Carrier Capacity under section 35AD

According to the newly inserted section 35AD in the Finance (No. 2) Act, 2009, in order to promote investment-linked tax incentives for specified businesses, 100% deduction will be allowed for any expenditure of a capital nature incurred, wholly and exclusively for the purpose of laying and operating a cross-country natural gas or crude/petroleum oil pipeline network for distribution.

Besides other conditions, it was provided that such business has to be approved by the Petroleum and Natural Gas Regulatory Board (PNGRB) established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 and notified by the Central Government in the Official Gazette in this behalf. Furthermore, this is subject to the condition that at least one-third of total pipeline capacity has been made available for use on common carrier basis by any person other than the assessee or an associated person.

The PNGRB Regulations, 2008, authorizes entities to lay, build, operate or expand petroleum product pipelines and prescribes minimum common carrier capacity as 25% as against one-third in case of natural gas.

It was therefore expected that the prescribed common carrier capacity for crude and petroleum oil pipelines be amended from one-third to one-fourth of the total capacity to bring it in line with the PNGRB Regulations.

#### 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 oil pipeline network for distribution, including storage facilities being an integral part of such network.

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

## Downstream

#### Extending depreciation benefits available to Pollution Control Equipment to Capital Investments made by Refineries for producing Fuels in accordance with stringent emission norms

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

## Indirect Tax

### Customs

[Enlarging the list of goods that could be imported duty free by E&P Sector by amendment of List 12 & List 13 of customs notification no 21/2002 dated 1.03.2002](#)

Department of Revenue vide Customs Notification 21/2002 dated 01.03.2002 allows contractors to claim customs duty exemption for all goods imported into the country for the use in operations related to exploration, development and production of petroleum and CBM operations. These goods have been specified in List 12 (for petroleum operations) and List 13 (for CBM Operations) in customs notification.

Operators contend that these Lists do not cover all goods required to be imported for the purpose of E&P & CBM operations and therefore operators have demanded inclusion of such items in the respective lists.

[Nil Custom Duty on Capital Goods imported for setting up new Petroleum Refinery, Pipelines or Green Fuel Projects](#)

Refineries would have to undertake substantial investment for fuel quality up-gradation to meet the stringent requirements of export destinations and also to meet the requirements as per the Auto Fuel Policy of the Government of India. With tariff protection at its lowest, customs duty on capital goods for new refineries increases the cost of refining. It is, therefore, expected that the Government would extend the benefit of 'Nil' import duties for new refineries as well as refinery modernization/expansion projects.

[Customs Duty Concession for Pipeline Projects](#)

In a deregulated scenario, oil companies are expected to build large number of cross-country pipelines for reaching to consumers at lower costs. To build such facility, it was expected that the Government would waive customs duty applicable on all materials required for building cross-country pipelines meant for petroleum product and gas movement. Though pipeline projects for transportation of crude oil, petroleum products or natural gas is covered under project imports and is subject to basic customs duty of 5 percent, the Government is expected to extend the benefit of NIL project import duties to pipeline projects.

[Removal of National Calamity Contingent Duty on Crude Oil levied at Rs.50/MT](#)

The National Calamity Contingent Duty (NCCD) of Rs.50 per metric tonne was imposed on domestic and imported crude oil, amongst various other goods, in the Union Budget for 2003-04 in order to augment the fund available with the Government to provide support to the relief work in the areas affected by natural calamity. NCCD continues to be levied on crude imports even after the withdrawal of customs duty on import of crude w.e.f. 04.06.2008. It is therefore expected that NCCD thereon may be abolished.

### Excise

[Withdrawal of end- use based exemptions applicable to Industrial Units](#)

Petroleum Products supplied for specific end uses are eligible for full exemption from duty e.g. Naptha for fertilizer and LSHS for generation of electricity etc. Many of

the customers eligible for such exemption have no facility to lift the product directly from the refineries. Some products have to be moved to the customers only through pipeline and there are some customers who have pipeline connection only with the oil marketing terminals and not with the refineries. When warehousing provisions were available, the oil marketing terminals could receive and store, non-duty paid products, which could then be conveniently supplied to these customers without payment of duty.

However after withdrawal of the warehousing facility for petroleum products, there are practical difficulties viz. oil marketing terminals can only receive duty paid products from the refineries and in many cases direct supplies to the end use based exempted customers can not be effected from the refineries, due to logistic and infrastructural problems.

It is suggested that the notification exempting the goods based on the end use be withdrawn instead the beneficiaries be given duty subsidy by the Government. If this is not possible, then warehousing provisions may be reintroduced for products viz. ATF/ LSHS/ Naphtha/Furnace Oil so that the oil companies can meet the requirement from locations other than refineries.

## Sales Tax / Value Added Tax (VAT)

### VAT on Petroleum Products

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

In view of the intention of the Government to implement Goods and Services Tax (GST) in the year 2010-2011, it is important that the Government, as a step towards GST, brings all items under the ambit of the VAT regime. It is, therefore, recommended, that petrol and petroleum products are brought under the VAT regime and taxed at multipoint, with credits available for the tax paid on purchase thereof. Considering that these are items of mass consumption, the Government may consider levying VAT on these products at the revenue neutral rate of 12.5 percent. However, if this is not feasible due to revenue constraints, the Finance Ministry should make a request to the Empowered Committee to ensure that the variation in revenue neutral rate (i.e. 12.5 percent and the VAT rates in case of diesel and petrol should not exceed 3 percent to 4 percent.

### 'Declared Goods' Status to Natural Gas/LNG under the Central Sales Tax Act, 1956

Post introduction of VAT in India, natural gas / LNG have been classified at the revenue neutral rate of 12.5 percent under most State VAT laws. Some States have also kept natural gas out of the VAT regime and are levying VAT at a high rate of 20 percent.

Natural gas is an important source of energy for fertilizer, petrochemicals, power and several other industries. Importance of natural gas is likely to increase due to rise in domestic use in the coming years and consequently the inter-state trade of natural gas. However, the high and multiple point sales tax structure on natural gas, without input credits, is adversely affecting the consumers, the trade in natural gas

and the Indian economy as a whole. Therefore, suitable relief in sales tax is urgently required, not only to ensure that cost of gas to the end consumer is kept low but to also facilitate development of associated infrastructure.

It may be mentioned that natural gas is a primary energy source. As of now, the other primary energy sources like coal and crude oil are declared as 'goods of special importance in Inter-State trade or commerce' U/s 14 of the Central Sales Tax Act, 1956. Natural gas, therefore, notwithstanding its environmentally benign nature, becomes costlier and non-competitive with such other fuels. In order to provide a level playing field amongst different primary energy sources, natural gas including R-LNG should be accorded the "Declared Goods" status under the Central Sales Tax Act, 1956.

The tax rates on natural gas at par with coal and crude oil was expected, particularly since natural gas is used in production of goods used by the common-man, like electricity, fertilizers, auto and domestic fuels. This will help in rational and economic choice of fuels by the consumers.

## Service Tax

### [Exemption from Service Tax on Services Consumed by E&P Companies in relation to Exploration and Productions Activities](#)

There has been a recurring demand of the Oil and Gas sector to eliminate service tax on services consumed by E&P companies. However, service tax has been gradually made applicable to more and more services used in the upstream sector thereby resulting in significant increase in the costs of carrying out various E&P activities. The beginning was made in the year 2004 when survey and exploration of mineral, oil and gas service was introduced. Thereafter, in 2005, the taxable category of site formation and clearance, excavation and earthmoving and demolition services was brought within the ambit of service tax. And with effect from June 1, 2007, the Government brought 'Mining Services' i.e. services provided in relation to mining of mineral, oil or gas, under the service tax net. The position even worsened in view of extension of provisions of service tax to the installations, structures and vessels in the continental shelf of India and the exclusive economic zones of India in 2009.

As a result, service tax now comprehensively covers the upstream sector. Most of these E&P services are generally outsourced by E&P companies to third party service providers. Further, there is no output CENVAT/service tax liability with regard to the crude oil and natural gas production activities of the upstream sector. This has resulted in break in the credit chain which eventually results in substantial increase in operating costs for exploration companies. Hence, service tax paid on procurement of taxable services by E&P companies end up as a sticky cost.

In view of the above, it is expected that the Central Government, in line with other concessions in respect of income tax, would exempt services consumed by the E&P sector. Alternatively, the possibility of refund of the service tax paid on input services consumed by the E&P sector should also be considered. However, it is recognized that the refund mechanism is not a convenient procedure.

## Goods and Service Tax (GST)

### Inclusion of Petroleum Products in GST regime

It is indicated by the First Discussion Paper on GST that the petroleum products would be kept out of GST net and the taxation of these goods would continue as provided under the existing scheme of taxation. This would lead to inefficiencies and would lead to tax cascading.

The inputs for the petroleum industry would be taxed under the proposed GST but the output of petroleum industry would continue under the existing structure of Indirect tax. It is relevant to consider the comments of the Department of Revenue (DoR) on the First Discussion Paper on GST, it is evident that the revenue department is in favour of bringing the petroleum products under the GST.

“Keeping crude petroleum and natural gas out of the GST net would imply that the credit on capital goods and input services going into exploration and extraction would not be available resulting in cascading. Diesel, ATF and motor spirit are derived from a common input, viz., crude petroleum along with other refined products such as naphtha, lubricating oil base stock, etc. Leaving diesel, ATF and motor spirit out of the purview of GST would make it extremely difficult for refineries to apportion the credit on capital goods, input services and inputs. These products are principal inputs for many services such as aviation, road transport, railways, cab operators etc. As such, these may be levied to GST and in select cases credit of GST paid on these items may be disallowed in order to minimize the possibility of misuse.”

Thus, to avoid the breakage in the tax chain and overall growth of Oil and Gas Sector, it is suggested to include all the petroleum products should be brought into GST regime.



# Significant Policy Changes and Initiatives in Oil & Gas Industry

Following significant policy changes relating to oil & gas industry were effected by the Government of India in the Financial Year 2009-10. Cited below are also some important initiatives taken during the year.

## Exploration & Production

### Bids under NELP VIII and CBM IV received; bids under evaluation

8th round of awards under NELP and 4th round of awards under CBM Policy were undertaken in the face of global recession. Government of India received 76 bids for 36 blocks out of 70 blocks offered under NELP VIII and 26 bids for 8 blocks out of 10 blocks offered under CBM IV. A total of 62 companies 10 foreign and 52 Indian have bid either on their own or as a part of consortia. In NELP VIII, total committed investment is to the tune of US \$ 1.34 Billion. After formal awards under these rounds, India will still have 32% of total 3.14 MM km<sup>2</sup> sedimentary basins to offer.

### OALP and NDR

Government is moving gradually towards Open Acreage Licensing System (OALS) which will enable bidders to bid for any blocks at any time of the year. Data for these blocks would be made available to the bidders through the National Data Repository (NDR), process of procurement of which has been initiated this year.

The Government has recognized the need and importance of gathering all the available geo-scientific data available in India under one roof so that it is easily and transparently available to all the agencies that require it. The DGH has initiated the process of establishing an NDR mainly to cater to the needs of E&P sector, research institutes and for academia. NDR is expected to play a much larger and significant role in the E&P scenario in the years to come.

### Marginal Field Policy (MFP)

A draft MFP has been evolved and is submitted to Cabinet Committee on Economic Affairs (CCEA).

## Natural Gas

### Gas utilisation policy and order of priority of supply of natural gas from RIL's KG D6 field

Empowered Group of Ministers (EGoM) was constituted for finalizing the price formula as was required under the Production Sharing Contract (PSC) and to finalise the Gas Utilization Policy. The intention of the Government being to operationalize all gas based assets which were lying idle/unutilized due to non-availability of gas, the EGoM decision announced on June 25, 2008 stated that the distribution of the first 40 mmscmd from this block as follows:

- 15 mmscmd to existing gas-based Fertiliser Sector
- 18 mmscmd to existing gas-based Power Sector
- 5 mmscmd to City Gas Sector
- 3 mmscmd for existing gas-based LPG plants

EGoM further decided that any shortfall in utilization should be allocated to gas-based steel plants and to existing power plants, including captive power plants.

#### EGoM decision regarding commercial utilization of gas produced under NELP

The Empowered Group of Ministers (EGoM) met on 27th October, 2009 to decide on issues pertaining to commercial utilization of gas produced under NELP.

The following decisions were taken :-

1. In view of the present actual requirement of RGPPL, it was decided that 5.67 mmscmd from KG D-6 should be supplied on firm basis to RGPPL. The additional requirement of RGPPL arising at a later stage could be considered subsequently.
2. Gas from KG D-6 should be supplied on firm basis to all the existing gas-based power plants connected to KG D-6 (excluding RGPPL and NTPC's plants in Kawas & Gandhar) so as to enable the plants within Andhra Pradesh to operate at 75% PLF and those outside Andhra Pradesh to operate at 70% PLF.
3. EGoM decided that 2.71 mmscmd of APM/PMT gas should be diverted from NTPC's plants in the Northern part of the country to its Kawas & Gandhar power plants, and an additional quantity of 2.71 mmscmd KG D-6 gas should be supplied on firm basis to NTPC's plants in Northern part of the country.
4. KG D-6 gas should be supplied on firm basis to power plants to be commissioned in 2009-10, viz., Lanco Kondapalli Extn. (366 MW) - Andhra Pradesh, Tanir Bavi (220 MW) (now GMR Energy Kakinada) - Andhra Pradesh, Rithala 108 MW - Delhi, Bawana 250 MW - Delhi & Utran CCPP 374 MW - Gujarat, so as to enable the plants within Andhra Pradesh to operate at 75% PLF and those outside Andhra Pradesh to operate at 70% PLF.
5. Government of Andhra Pradesh had requested for allotment of 1.05 mmscmd KG D-6 gas to four gas-based power projects in the State, viz., M/s Sriba Industries Ltd., Chigurukota (30 MW), M/s RVK Energy Pvt. Ltd., Nandigama (32.7 MW), M/s Silkroad Sugar Pvt. Ltd. Vakalapudi (35 MW) and M/s LVS Power Ltd., Pendurthi (55 MW). It was decided that Ministry of Power (MoP) should examine the request & make recommendations and thereafter MoPNG should decide on firm allocation of KG D-6 gas for these power plants for their operation at 75% PLF.
6. All existing gas-based power plants and those to be commissioned this year could draw gas on fallback basis, up to a maximum of 12 mmscmd, to further increase their PLF.
7. As regards request of Department of Fertilizers (DoF) for replacement of RLNG contracted by Urea Companies with comparatively cheaper KG D-6 gas, it was decided that Offtakers, viz., GAIL, IOC & BPCL, and Urea Companies should jointly explore the possibility of supplying the said RLNG to customers in other sectors on the same conditions. In case such customers are identified and the Offtakers can execute the necessary GSPAs with them, then the urea plants could be allowed to terminate their RLNG contracts and the urea plants could be allotted KG D-6 gas.

8. The only existing gas-based plant producing subsidized fertilizers other than urea is Deepak Fertilizers, which should be supplied 0.178 mmscmd KG D-6 gas on firm basis.
9. It was decided that 0.44 mmscmd KG D-6 gas should be supplied on firm basis to meet the shortfall of existing gas-based steel plants, viz., M/s Essar Steel (Hazira), M/s Ispat Industries (Dolvi) and M/s Vikram Ispat (Salav).
10. It was decided that 1.918 mmscmd KG D-6 gas should be supplied on firm basis to petrochemicals plants to meet their feedstock requirement, i.e., 1.168 mmscmd to Reliance Industries Ltd., Gandhar, Gujarat and 0.75 mmscmd to Reliance Industries Ltd., Nagothane, Maharashtra. As gas produced from KG D-6 is lean and petrochemicals cannot be extracted from this gas, GAIL & other transporters would undertake a swapping arrangement, whereby rich & semi-rich gas available with them would be supplied to petrochemicals plants and lean gas from KG D6 field will be supplied to other existing customers as a makeup for the shrinkage in rich gas by the petrochemicals plants.
11. Firm allocation of 5 mmscmd and fallback allocation up to 6 mmscmd was made to partially meet the requirement of refinery sector. The requirement of various units in the sector would be met on a pro rata basis, subject to economic viability and the units being in a position to use the prorated quantity. In case a unit is unable to utilize the gas, it should be prorated among other units which can use it.
12. Allotment of 10 mmscmd on fallback basis was made to Captive Power Plants. Details of Captive Power Plants and gas supply to these would be decided by MoP&NG in consultation with MoP within a period of one month.
13. Allocation of 2 mmscmd KG D-6 gas on fallback basis was made to City Gas Distribution (CGD) entities for supply to their industrial and commercial customers, whose total consumption of natural gas (including KG D-6 gas) does not exceed 50,000 scmd. The said quantity would be allotted amongst CGD entities by MoPNG. Price of natural gas sold to industrial and commercial customers by a particular CGD entity should be on the basis of the delivered price of KG D-6 gas to the said entity.
14. Amongst all fallback customers, the requirement of power sector would be firstly met and, thereafter, all the remaining customers should be supplied gas on pro rata basis.
15. As regards demand of natural gas for conversion of Naphtha-based & fuel oil-based fertilizers plants, for expansion & revamp of fertilizer plants and revival of closed fertilizers plants, it was decided that they would be supplied natural gas as and when they are ready to utilize the gas. Further, it was decided that trunk natural gas pipelines, which are needed to connect Naphtha-based, fuel oil-based and closed fertilizers plants to sources of gas, would be constructed expeditiously and MoPNG would involve DoF in reviewing the progress of the same.
16. MOP&NG would take decisions on the basis of orders of EGoM with which the Contractor would comply. Consultations as and when necessary would be held with the concerned Ministries and other stakeholders.

17. MoPNG would take decisions regarding supply of natural gas to sectors/ individual customers consequent to gas available on account of short offtake, delay and any other unforeseen circumstances.
18. The requirement of natural gas for plants to be completed beyond 2009-10 would be reviewed from time to time by the EGoM for making firm allotments to such new plants from the fallback quantity available.

#### Regulations notified by Petroleum and Natural Gas Regulatory Board (PNGRB)

The PNGRB notified the following regulations during the FY 2009-10:

##### Technical Standards and Specifications including Safety Standards for Gas distribution for Natural Gas Pipelines

PNGRB notified regulations on technical standards and specifications including safety standards for natural gas pipelines vide notification No. G.S.R. 808(E) 11/11/2009 focusing primarily on the safety aspects of the employees and public and facilities associated with natural gas pipelines.

##### Technical Standards and Specifications including Safety Standards for Gas distribution

PNGRB notified regulations on procedure for development of technical standards and specifications including safety standards for gas distribution vide notification No. G.S.R. 323(E) 14/05/2009

##### Gas Pipeline Authorisation

PNGRB notified regulations on guiding principles for declaring or authorizing natural gas pipeline as common carrier or contract carrier for the objective of developing a competitive natural gas market vide notification No. G.S.R. 273(E) dated 21/04/2009



## Refining & Marketing

### Kirit Parikh Committee's report on petroleum product pricing

The Government considered it important that a viable and sustainable pricing policy is evolved for the four major oil products, namely, petrol, diesel, kerosene and LPG, which constitute 63% of total consumption of petroleum products in 2008-09 and whose market prices are currently controlled by the Government. In this context, the Expert Group led by Dr Kirit Parikh was set up by the Ministry of Petroleum & Natural Gas on 31 August 2009. The group submitted its report to the Ministry of Petroleum early this month.

Major recommendations of the Group include deregulation of transport fuel (petrol and diesel) pricing linked to market movements, and an increase in the price of cooking fuels, with targeted subsidy mechanisms going forward. Currently, compensation by the Government towards subsidies is treated like an off-balance sheet item, thereby suppressing the true deficit picture. This may have positive implications for the overall debt position and thus sovereign credit ratings.

### Vision 2015

Government approved Vision 2015 in June 2009 aiming at expanding the marketing network as well as quality of the products and services specially in rural areas. The year saw implementation of the Vision with launching of a smaller six digit toll free complaint number for all the three Oil Marketing Companies (OMCs). A facility for booking LPG through SMS and getting timely information about delivery status was also launched in August this year.

### Rajiv Gandhi Gramin LPG Vitruk Yojna

With a view to increase the reach of LPG specially in rural areas, this dedicated Scheme was launched with a view to benefit the rural population to have access to the convenient cooking fuel at their doorstep and help local inhabitants particularly youth and women to get the dealerships.



# Commodity Balance of Petroleum and Petroleum Products

Commodity Balance of Petroleum and Petroleum Products

(Million Tonnes)

Item	1980-81	1990-91	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10 (Apr.- Nov.)	
1	2	3	4	5	6	7	8	9	10	11	12	
<b>I. Crude Oil</b>												
1	Refinery Throughput	25.8	51.8	107.3	112.6	121.8	127.4	130.1	146.6	156.1	160.8	105.7
2	Domestic Production	10.5	33.0	32.0	33.0	33.4	34.0	32.2	34.0	34.1	33.5	22.2
(a)	On-shore	5.5	11.8	11.9	11.5	11.5	11.6	11.4	11.3	11.2	11.3	7.7
(b)	Off-shore	5.0	21.2	20.1	21.5	21.9	22.4	20.8	22.7	22.9	22.2	14.5
3	Imports	16.2	20.7	78.7	82.0	90.4	95.9	99.4	111.5	121.7	132.8	98.9
4	Exports	—	—	—	—	—	—	—	—	—	—	—
5	Net Imports (3-4)	16.2	20.7	78.7	82.0	90.4	95.9	99.4	111.5	121.7	132.8	98.9
<b>II. Petroleum Products</b>												
1	Domestic Consumption @ of which	30.9	55.0	100.4	104.1	107.8	111.6	113.2	120.7	128.9	133.6	90.8
(a)	Naphtha	2.3	3.4	11.8	12.0	11.9	14.0	12.2	13.9	13.3	13.9	7.2
(b)	Kerosene	4.2	8.4	10.4	10.4	10.2	9.4	9.5	9.5	9.4	9.3	6.2
(c)	High Speed Diesel Oil	10.3	21.1	36.5	36.6	37.1	39.7	40.2	42.9	47.7	51.7	36.7
(d)	Fuel Oils	7.5	9.0	13.0	12.7	12.9	13.5	12.8	12.6	12.7	12.6	8.1
2	Domestic Production \$ of which	24.1	48.6	100.0	104.1	113.5	116.6	119.8	135.3	144.9	150.5	98.4
(a)	Naphtha	2.1	4.9	9.2	9.7	11.3	14.1	14.5	16.7	16.4	14.8	9.7
(b)	Kerosene	2.4	5.5	9.7	10.0	10.2	9.3	9.1	8.5	7.8	8.2	5.6
(c)	High Speed Diesel Oil	7.4	17.2	39.8	40.2	43.3	45.9	47.6	53.5	58.4	62.9	40.6
(d)	Fuel Oils	6.1	9.4	12.2	12.2	13.4	15.0	14.3	15.7	15.8	17.7	11.6
3	Imports	7.3	8.7	7.0	7.2	8.0	8.8	11.7	17.7	22.5	20.3	9.6
4	Exports	Neg.	2.7	10.1	10.2	14.6	18.2	21.5	33.6	40.8	38.6	26.1
5	Net Imports (3-4)	7.3	6.0	-3.1	-3.0	-6.6	-9.4	-9.8	-16.0	-18.3	-18.3	-16.5

@ Excluding refinery fuel consumption. Including import by private parties.

\$: Excludes LPG production from fractionators.

Neg. : Negligible.

Source : Ministry of Petroleum and Natural Gas.

		Item	Unit	2007-08	2008-09	2009-10
Reserves (Balance Recoverable) <sup>a</sup>	(i)	Crude oil	MT	725	770	736.45
	(ii)	Natural gas	BCM	1055	1090	1119.55
Production	(i)	Crude oil	MT	34.117	33.5	22.2 <sup>An</sup>
	(ii)	Petroleum products <sup>b</sup>	MT	144.93	150.5	98.4 <sup>An</sup>
Consumption	(i)	Crude oil <sup>c</sup>	MT	156.1	160.77	133.255 <sup>Aj</sup>
	(ii)	Petroleum products	MT	128.95	133.6	102.73 <sup>Ad</sup>
Refinery installed capacity			MT	132.47	148.97	177.97
Refinery Production (Throughput)	(i)	Public sector	MT	112.54	112.22	93.4 <sup>Aj</sup>
	(ii)	Private sector	MT	43.56	48.55	39.855 <sup>Aj</sup>
		Total	MT	156.103	160.8	133.255 <sup>Aj</sup>
Natural Gas	(i)	Gross production	BCM	32.402	32.85	38.486 <sup>Aj</sup>
	(ii)	Utilization	BCM	31.478	31.77	33.67 <sup>Ad</sup>

Source:

1. Ministry of petroleum and Natural Gas

2. PPAC

3. Economic survey 2009-10

a As on April 1st of the Initial year

b Excludes LPG production from fractionators

c Refinery crude throughput

An: Apr 09- Nov 09

Aj: Apr 09- Jan 10

Ad: Apr09-Dec 09

## Abbreviations

AED – Additional Excise Duty  
ATF - Aviation Turbine Fuel  
BBL – means a Barrel  
BCM – Billion Cubic Meters  
BE - Budget Estimate  
BED – Basic Excise Duty  
CBM- Coal Bed Methane  
CCR - CENVAT Credit Rules  
CENVAT – Central Value Added Tax  
CNG – Compressed Natural Gas  
E&P- Exploration and Production  
FC – Finance Commission  
FCI – Fertilizer Corporation of India  
FRBM Act – Fiscal Responsibility and Budget Management Act, 2003  
GAIL – Gas Authority of India Limited  
GDP – Gross Domestic Product  
GoI – Government of India  
GSPA - Gas Sale Purchase Agreement  
GST – Goods and Service Tax  
HSD – High Speed Diesel  
EGoM – Empowered Group of Ministers  
HSE – Health Safety Environment  
IOR/EOR - Improved Oil Recovery/ Enhanced Oil Recovery  
LNG – Liquefied Natural Gas  
LPG – Liquefied Petroleum Gas  
LPG (DOM)- Liquefied Petroleum Gas for Domestic supply  
LSHS- Low Sulphur Heavy Stock  
MAT – Minimum Alternate Tax  
MMBTU - Million British Thermal Units  
MMSCMD - Million Metric Standard Cubic Meter Per Day  
MMTPA - Million Metric Tonnes Per Annum  
MoP&NG – Ministry of Petroleum and Natural Gas  
MT/MMT –Metric Tonnes/ Million Metric Tonnes  
NCCD - National Calamity Contingent Duty  
NCERT – National Council of Education Research and Training

NELP – New Exploration Licensing Policy  
NGHP – National Gas Hydrate Programme  
NTPC – National Thermal Power Corporation  
OISD - Oil Industry Safety Directorate  
OMC – Oil Marketing Companies  
PDS – Public Distribution Scheme  
PFCE - Private Final Consumption Expenditure  
PNG – Piped Natural Gas  
PNGRB - Petroleum and Natural Gas Regulatory Board  
POL – Petroleum Oil & Lubricants  
PSC – Production Sharing Contract  
RIL – Reliance Industries Limited  
RLNG – Regasified Liquid Natural Gas  
SAED – Special Additional Excise Duty  
SEZ – Special Economic Zone  
SKO (PDS)- Super Kerosene Oil supplied through Public Distribution System  
UCG - Underground Coal Gasification  
VAT – Value Added Tax  
WPI – Wholesale Price Index

## About PetroFed

It is a Registered Society of Indian and International Companies / Associations in the Hydrocarbon Sector to promote member interests in line with Public / National Policies through a self regulatory environment with consumer interest in sight.

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

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

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

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# About PricewaterhouseCoopers

PricewaterhouseCoopers Pvt. Ltd. ([www.pwc.com/india](http://www.pwc.com/india)) provides industry - focused tax and advisory services to build public trust and enhance value for its clients and their stakeholders. PwC professionals work collaboratively using connected thinking to develop fresh perspectives and practical advice.

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