

**Implications
Of
Union Budget 2010
on Oil Industry**

Mumbai

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R. Ganapathisubramanian
Convenor, Tariff Committee, Petrofed

Downstream Sector – Refinery & Marketing

Customs

Amendments in the Budget

5% Basic customs duty (BCD) on crude oil and increase in BCD on MS & HSD from 2.5% to 7.5% and other petroleum products from 5% to 10%.

Impact of the amendment

BCD continues to be nil on SKO (PDS), LPG (Domestic), ATF, Naphtha (for fertiliser / power) –

Inverted duty structure i.e. raw material subject to import duty, but 30% to 35% of finished products are not.

Industry imports approx 100 Million MT of crude oil. 5% BCD imposed on the raw material expected to yield the Union Rs. 10,000 Crores. Yet the finished products of SKO (PDS), LPG (Domestic), ATF, Naphtha (for fertiliser / power) continue to have nil BCD.

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Impact of the amendment

Therefore on roughly 30% to 35% of a typical refinery's production, incidence of duty on raw material cannot be "passed on" in product prices, since products are not liable to duty. Under-recovery approx Rs. 6,000 Crores per annum to be borne by the Oil Industry.

The mopping up tax from consumers of MS & HSD could have been achieved by specifically targeting MS & HSD. The existing SAED on MS is Rs. 6/- per litre, accruing fully to the Union Govt., like BCD. This could have been increased to Rs. 7.25 per Litre.

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Impact of the amendment

The existing SAED on HSD of Re. 1/- per litre is currently exempt. This exemption could have been removed and a duty of Re. 1.25 per litre could have been levied on HSD.

Thus the equivalent of 5% BCD on crude oil (Rs. 10,000 Crores) could have been recovered specifically from consumers of MS & HSD. We suggest the above amendments.

This course of action would have been more equitable on many counts:

1. The entire duty would have been MS/HSD centric and not on crude

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Impact of the amendment

2. No loss of revenue to the Govt. since no Cenvat credit is available on MS & HSD
3. The entire increase in tax accrues to Centre, since SAED is to be retained by Centre.
4. No stranding of taxes at Refinery level and no problem of ‘inverted duty structure’ of raw materials being subjected to 5% customs duty but more than 30% to 35% of finished goods are subject to 0% BCD.
5. SAED is fully passed on to the Consumers

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Impact of the amendment

Another alternative, is to allow Crude oil equivalent to the production of SKO (PDS), LPG (Domestic), ATF, Naphtha (for fertiliser / power) be imported duty free

Oil Industry – An industry plagued by stranded taxes

Rs. In Crores per annum

1.	Additional stranding due to inverted duty structure on SKO (PDS), LPG (Domestic), ATF, Naphtha (for fertiliser / power)	6,000
2.	NCCD @ Rs 50/- per MT on 100 MMT of Crude oil cannot be “passed on” in the prices, since prices are either controlled or are on IIP basis.	500
3.	Non availment of CENVAT credit on inputs / input services, since SKO (PDS), LPG (Domestic), Naphtha (for fertiliser) are exempt from ED	200
4.	Additional stranding of the service tax levied in Budget 2010 on prospecting, extraction and production of oil & gas.	1,000
Total		7,700

In addition, as per the latest reports, the under recovery of OMCs is Rs. 4.72 per litre on MS and Rs. 1.94 per litre on HSD.

On the 5% import duty on crude oil, the Hon'ble Finance Minister has said *“I wanted to give a message that when prices go down, we should be ready to pay duties”*.

As per the Hon'ble Finance Minister, *“If the decision to continue with the subsidy is taken, the necessary provisions will have to be made. It is as simple as that”*.

As per the Hon'ble Prime Minister, *“the economy has the capacity to absorb the increase without triggering an inflationary spiral”*.

We agree. We only request that the method of recovery of duty could be MS/HSD centric in the form of Special Additional Excise Duty (SAED) and not through the route of taxing the raw material namely crude oil.

Expectations from Budget

Outcome

<p>Regulatory</p> <p>1. Decontrol of pricing of petroleum products</p>	<p>To await Govt's position on Kirit Parikh Committee report</p>
<p>Indirect taxes</p> <p>1. Refund of service tax incurred by E&P Companies for carrying out petroleum operations under NELP</p>	<p>Govt. promised a tax free regime in 1998 NELP. A refund mechanism would be in line with the said policy.</p> <p>No scheme for refund has been notified. Instead service tax burden has been increased by extending provisions of service tax to the whole of CS & EEZ.</p> <p>As per the amended provisions, service tax is applicable on prospecting, extraction & production in the CS & EEZ.</p>

Expectations from Budget

Outcome

Indirect taxes

1. Refund of service tax incurred by E&P Companies for carrying out petroleum operations under NELP

Logic appears to be that once a block is ready for prospecting and extraction or starts producing, it can afford to pay; but it is against the stated policy that E&P under NELP would be given a tax free regime.

Additional stranding of service tax paid in prospecting, extraction and production, since crude oil / natural gas is not subject to excise duty — Approx Rs.1,000 Crores p.a.

Downstream Sector – Refinery & Marketing

Excise	
Petrofed's expectation	Budget outcome
<p>Amendment to Rule 6 (6) of Cenvat Credit Rules – Inclusion of LPG (Domestic), SKO (PDS), Naphtha (supplied to fertilizer plants)</p> <p>Exemptions given by Govt. for socio-economic reasons should not result in denial of the benefit of full CENVAT credit to the manufacturer of these products</p>	<p>No change</p> <p>The biggest tax payer does not get full Cenvat credit</p>

Service tax

1. New services / amendments to existing services

- Transport of goods by rail
- Renting of immovable property
- Air passenger transport
- Sponsorship of sports events

Availability of Cenvat credit could neutralise the additional tax Impact

2. Amendment with retrospective effect

- Renting of immovable property

Availability of Cenvat credit could neutralise the additional tax Impact

Thank you