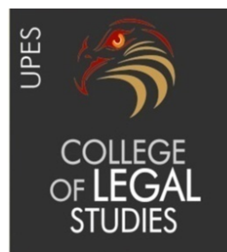
FISCAL REGIME IN OIL AND GAS (UPSTREAM) SECTOR

Submitted By: Anand Sharma

Submitted under the guidance of: Mr. Sujith P Surendran

This dissertation is submitted in partial fulfillment of the degree of B.A., LL.B. (Hons.)



College of Legal Studies

University of Petroleum and Energy Studies

Dehradun

2015

CERTIFICATE

This is to certify that the research work entitled **"Fiscal Regime in Oil and Gas (Upstream) Sector"** is the work done by **Anand Sharma** under my guidance and supervision for the partial fulfilment of the requirement of B.A., LL.B. (Hons.) degree at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

(Mr. Sujith Surendran)

Designation

Date

DECLARATION

I declare that the dissertation entitled **"Fiscal Regime in Oil and Gas (Upstream) Sector"** is the outcome of my own work conducted under the supervision of Mr. **Sujith P Surendran**, at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

Signature & Name of Student

Date

Contents

ABBREVIATIONS 6

ACKNOWLEDGEMENT 8

INTRODUCTION 9

INDIAN PETROLEUM SECTOR- AN OVERVIEW 13

Imports and Domestic Oil Production in India 15

Gas Reserves and Gas Consumption 16

Domestic Gas Production and Imports 17

Upstream Segment Crude Oil and Gas Production 18

Revenue From Oil & Gas Sector 20

REGULATORY FRAMEWORK FOR OIL AND GAS (UPSTREAM) SECTOR 22

Regulatory Bodies for Upstream Sector 22

Ministry of Petroleum and Natural Gas 23

Director General of Hydrocarbon 24

Regulatory Legislations for Upstream Sector 24

The Oil Field (Regulation and Development) Act, 1948 24

Petroleum and Natural Gas Rules, 1959 25

The Territorial Waters, Continental Shelf, Exclusive Economic Zone and Other Maritime Zones Act, 1976 26

The Oil Industry (Development) Act, 1974 27

Policy Framework Governing The Upstream Sector 28

Hydrocarbon Vision 2025 28

New Exploration and Licensing Policy 28

FISCAL FRAMEWORK FOR OIL AND GAS UPSTREAM SECTOR 32

Taxation Scenario in Pre NELP and Post NELP Era: 33

Pre – NELP Production Sharing Contract Regime: 35

Cost Recovery: 35

Participating Interest: 35
Time Period: 36
Relinquishment: 36
Supplementary Benefits: 36
Current Fiscal Regime in Upstream Sector: 37
Royalty Regime: 37
Income Tax Regime: 38
CONCLUSION 59

ABBREVIATIONS

1. **BB** : Billion Barrels
2. **BCM** : Billion Cubic Meters
3. **BP** : British Petroleum
4. **CAGR** : Compound Annual Growth Rate
5. **CBM** : Coal Bed Methane
6. **DGH** : Directorate General of Hydrocarbon
7. **Edn**. : Edition
8. **EEZ** : Exclusive Economic Zone
9. **EPC** : Engineering, Procurement and Construction
10. **E&P** : Exploration and Production
11. **FDI** : Foreign Direct Investment
12. **FY** : Financial Year
13. **GAIL** : Gas Authority of India Limited
14. **GDP** : Gross Domestic Product
15. **GoI** : Government of India
16. **INR** : Indian Rupee
17. **IOC** : Indian Oil Corporation
18. **IT Act** : Income Tax Act, 1961
19. **JVC** : Joint Venture Company
20. **JVEP** : Joint Venture Exploration
21. **LNG** : Liquified Natural Gas
22. **Ltd.** : Limited
23. **MAT** : Minimum Alternate Tax
24. **MBPD** : Million Barrels Per Day
25. **MMBTU** : Million Metric British Thermal Unit

26. **MMT** : Million Metric Ton
27. **MoPNG** : Ministry of Petroleum and Natural Gas
28. **MPSC** : Model Production Sharing Contract
29. **NELP** : New Exploration and Licensing Policy
30. **NM** : Nautical Miles
31. **NOC** : National Oil Company
32. **No.** : Number
33. **OIL** : Oil India Limited
34. **ONGC** : Oil and Natural Gas Corporation
35. **PSC** : Production Sharing Contract
36. **PSU** : Public Sector Undertaking
37. **PEL** : Petroleum Exploration License
38. **PI** : Participating Interest
39. **RIL** : Reliance Industries Limited
40. **R & D** : Research & Development
41. **SC** : Supreme Court of India
42. **UOI** : Union of India
43. **US** : United States
44. **VAT** : Value Added Tax
45. **Vs.** : Versus

ACKNOWLEDGEMENT

I sincerely convey my deepest gratitude to my mentor Mr. Sujith P Surendran, who has actively & consistently helped me in the preparation of this Dissertation. He has been the source of motivation and encouragement and the one who generated interest in the specific field.

Without his valuable insights and comments, this dissertation would not have been possible. His active words of advice and his guidance not only helped for this research work but also for my future and career.

I would also like to acknowledge and extend my heartfelt gratitude to all the persons whose participation has made the completion of the dissertation possible.

Anand Sharma,
B.A.LLB. (Hons.) with specialization in Energy Laws,
Sap ID – 500011994,
Enrollment No. – R450210016
College of Legal Studies,
University of Petroleum & Energy Studies, Dehradun.

CHAPTER-I

INTRODUCTION

Exploration for hydrocarbons in India dates back to 1866, when Assam Oil Company initiated the exploration efforts in upper Assam and oil was first struck at Makum. Be that as it may, the quest for the hydrocarbons was confined to North Eastern part of the nation. till the formation of National Oil Company ONGC[1] in 1956.

In the decade of sixties a lot of "huge" and "medium-size" fields were discovered and fascinating investigation lead were obtained to escalate future exploratory endeavors. Then, the decade of Seventies marked by exploration in offshore basins, in this decade a number of medium to large off shore basins were discovered including the "giant" like Bombay High Basin and the decade of late eighties manifested growth in number of discoveries and thus, marked as "Decade of Prosperity".

The exploration and production of oil and natural gas was under the jurisdiction of National Oil Companies like ONGC and OIL) in compatibility of the Industrial Policy Resolution, 1954[2]. As the policy prescribes, that:

"Whenever cooperation with private enterprise is necessary, the State will ensure, either through majority participation in the capital or otherwise, that it has the requisite powers to guide the policy and control the operations of the undertakings."and

"Industrial undertakings in the private sector have necessarily to fit into the framework of the social and economic policy of the State and will be subject to control

[1] In the year 1956 the Oil and Natural Gas Directorate was established which was uplifted as a commission and finally made as a statutory body by the parliament.

[2] *Industrial Policy Resolution* (30th April, 1956), *available at* http://eaindustry.nic.in/handbk/chap001.pdf.

and regulation in terms of the Industries (Development and Regulation) Act and other relevant legislation."[3]

They discovered noteworthy amounts of oil and gas reserves. In the mid 70s, they supplied about 70% of the domestic necessity. However before the end of 80s, they had come to the phase of consistent losses. Oil production had started to decrease while there was a consistent increment in consumption requirements. The Government of India left with no money for the purpose of development of newly discovered oil fields along with various other problems like lack of technology, Infrastructure etc[4].

With a respectable number of discoveries, the widening gap between the demand and supply was also additionally expanded which pushed the legislators to frame policies in order to attract much needed foreign and domestic capital investments and government announced several policies/legislations including The Oilfields (Regulation and Development) Act, 1948, Petroleum and Natural Gas Rules, 1959, The Oil Industry (Development) Act, 1974, Hydrocarbon Vision 2025, New Exploration and Licensing Policy Etcetera. All these regulations strengthen the Oil and Gas sector in India.

The Oil and Gas business is divided into three categories which includes Upstream Sector, Midstream Sector and Downstream Sector[5]. Upstream activity involves exploration and production. All the stages from exploration to production come under upstream activity.[6] The present dissertation will discuss and analyze the present fiscal framework in Oil and Gas (Upstream) sector of India.

The fiscal framework determines the volume of the private and foreign player in a particular sector. Prior to 1997 i.e. pre NELP era the fiscal framework of Oil and Gas Industry in India were not at all investor friendly. But, the year of 1997 brought drastic

---

[3] *Id.*

[4] PIYUSH JOSHI, LAW RELATING TO INFRASTRUCTURE PROJECTS (2nd Edn) , LexisNexis Butterworths Wadhwa, Nagpur 2012

[5] *Oil and Gas, available at* http://www.reportsure.com/oil-and-gas-reports/oil-and-gas.aspx.

[6] *Id.*

changes in, the then prevailing fiscal framework and forced the government to acquire a consumer friendly approach which lead to the birth of NELP[7] and prompted the Central Government to take a liberal approach.

Even though the government tried to attract the investors through certain relaxations and liberties still the three recent round of NELP i.e. NELP VII[8], VIII[9], IX[10] failed to generate enthusiasm as expected; thus, there certain ***issues which urges for the need to relook*** the fiscal framework of the upstream business in India, Like:

1. The participation of foreign investors is comparatively lesser in upstream sector as expected.
2. The shortage of skills, technology and equipments in upstream sector.
3. The enthusiasm for acquiring Oil and Gas assets abroad is also diminishing as speed for decision making process and various clearances are slow.[11]
4. Incapable Taxation regime to deal with the tax incidents of PSC's with efficacy.
5. India is having the well density 20% per 10000 km and it is still the among the regions of the world which are least explored.[12]

The list of above mentioned issues is not exhaustive and forced to look after the present Upstream sector in relation to the following ***questions***:-

1. Whether the regulatory bodies managing the upstream oil and gas sector are sufficiently empowered to regulate fiscal issues being faced by upstream industry.

---

[7] NELP was introduced in the year 1997

[8] New Exploration and Licensing Policy, 7th Round of Bidding, 2007.

[9] *Id,* 8th Round, 2008.

[10] *Id,* 9th Round, 2009.

[11] Federation of Indian Chambers of Commerce and Industry, *India's energy security: Key issues impacting the Indian oil and gas sector*, *available at* http://www.ey.com/Publication/vwLUAssets/Indias_energy_security/$FILE/India-s_energy_security.pdf.

[12] Saibal Dasgupta, *India E&P gaining international interest, available at* http://www.oilandgasonline.com/doc/india-ep-gaining-international-interest-0001.

2. Whether the introduction of new policy regime governing the upstream oil and gas segment i.e. the NELP has fiscal provisions efficacious enough to attract investment to one of the most high profit and high risk ventures of Indian economy.

3. Whether the taxation regime prescribed by various taxing statutes and regulations is competent enough to cope with tax incidents arising out of upstream oil and gas activities.

The dissertation provides an insight into the fiscal framework of earlier period i.e. PRE-NELP and significant changes perpetuating over the years has also been highlighted. Besides, the present dissertation will analyze critically, the present fiscal regime of Oil and Gas (Upstream) Sector in India and to answer the questions/issues above mentioned.

CHAPTER-II

INDIAN PETROLEUM SECTOR- AN OVERVIEW

India, over the years owing to rapid socio-economic advancement has developed the unquenchable thirst for Oil and Gas. Lately, Indian Oil & Gas needs were fulfilled by the imports from foreign countries, although the country has decent reserves for conduction the Exploration & Production operations. The requirement of oil and gas is very high in India and thus, it import more than 70% of its unrefined petroleum requirement.[13] In order to intensify exploration activities the GoI launched New Exploration and Licensing Policy (NELP) in the year 2000.

The Indian Government in the year 1997 introduced The New Exploration and Licensing Policy (NELP) which brought private participation in the oil and gas sector through International competitive bidding[14] under a production-sharing contract with GoI. The introduction of The New Exploration and Licensing Policy (NELP) restructured the Indian Oil sector with drastic changes including the fiscal regime of the sector.

The Income Tax Act of 1961 contains provisions to regulate the taxation scenario of upstream sector.[15]. It has a broad network of tax treaties with over 90 countries across the globe including even those to avoid double taxation of income. During the phase of economic reforms i.e. the period of past 10-12 years, huge changes are faced by the Indian taxation system. During this time period the prevailing tax rates were revised

---

[13] Sakshi Parashar, *Legal Aspects of Oil and Gas Sector, available at* http://www.manupatrafast.com/articles/PopOpenArticle.aspx?ID=3b9928f3-1807-4916-b783-33b3c38992db&txtsearch=Subject:%20Oil%20And%20Gas

[14] *Award process for NELP Blocks, available at* http://petroleum.nic.in/docs/awardprocess.pdf

[15] The Income Tax Act, 1961.

and compared with other nations in order to get efficient regime and indeed with the time the taxation regime of India has been simplified and provoke better compliance.[16]

In India a personalized taxation regime prevails to deal with the relation of service providers (non-resident) and upstream sector incidents resultant of exploration and production activities. Further, the regime in India permit the parties engaged for 100% tax holiday for a period of seven years with respect to profits earned from production of mineral oils as Article 17 provides:-

"Subject to the provisions herein below, deductions at the rate of one hundred percent (100%) per annum shall be allowed for all expenditures, both capital and revenue expenditures, incurred in respect of Exploration Operations and drilling operations. The expenditure incurred in respect of Development Operations, other than drilling operations, and Production Operations will be allowable as per the provisions of the Income-tax Act, 1961."

The oil and gas sector is among the core industries of India which includes crude oil, coal, electricity, natural gas etc. Thus, it's role in the economy is of utmost importance and it causes variations and influence important decisions in the economy.[17] Among all the world wide consumers of energy, India stands at fourth largest position.[18] As per the statics of 2013, India is having proven oil reserves of s 5.7 billion barrel of proven oil reserves.[19]

---

[16] KMPG, *Oil and Gas Overview 2010, available at* http://www.kpmg.com/IN/en/IssuesAndInsights/ThoughtLeadership/KPMG_Oil_Natural_Gas_Overview_2010.pdf.

[17] Ministry of External Affairs, *Oil and Gas, available at* http://indiainbusiness.nic.in/newdesign/index.php?param=industryservices_landing/345/1

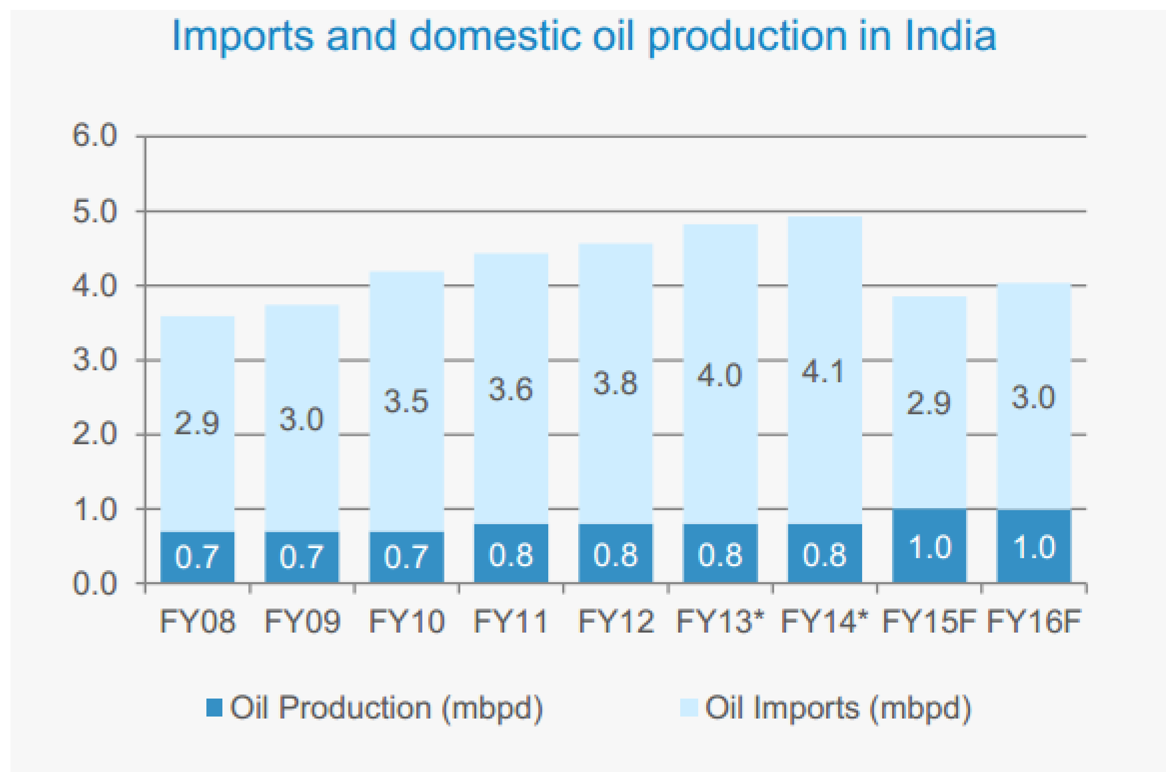
[18] U.S. Energy Information Administration, *India, available at* http://www.eia.gov/countries/cab.cfm?fips=in.

[19] India Brand Equity Foundation, *Oil and Gas Industry in India, available at* http://www.ibef.org/industry/oil-gas-india.aspx.

Imports and Domestic Oil Production in India

As far as oil supply and demand is concerned, it is deemed to expand at a compound annual growth rate of 3.3% and to be 4.0 Million Barrels Per Day by 2016 from financial year 2008. India's dependency on imported crude is increasing and the same is expected to increase as there is strong inflation in demad of oil and there is fast and strong growth in economy which will turn into better outcomes for production and transportation, which will further resulted into increase in demand of oil.

As it is evident from the graph below mentioned, that in the financial year 14, imports were around 80% of the basket and the production was confined to 20% only. While it is expected that during the FY 16 the import will be 75% of the scenario and the rest i.e. 25% will rely on the domestic production.

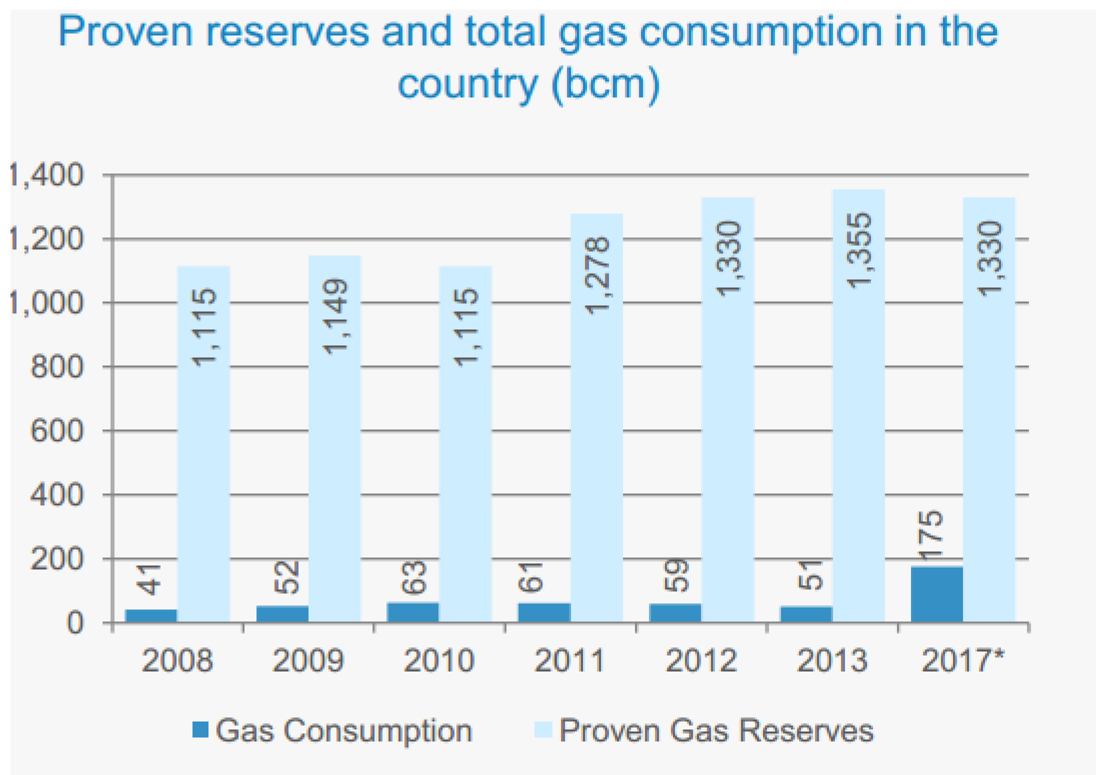


[20]

[20] *Ministry of Petroleum & Natural Gas, available at* http://petroleum.nic.in/.

Gas Reserves and Gas Consumption

With India developing gas-fired power stations, consumption is up more than 160 per cent since 1995 Demand is not likely to simmer down any time soon, given strong economic growth and rising urbanization. Gas consumption is likely to expand at a CAGR of 21.0 per cent during FY2008–17FY.

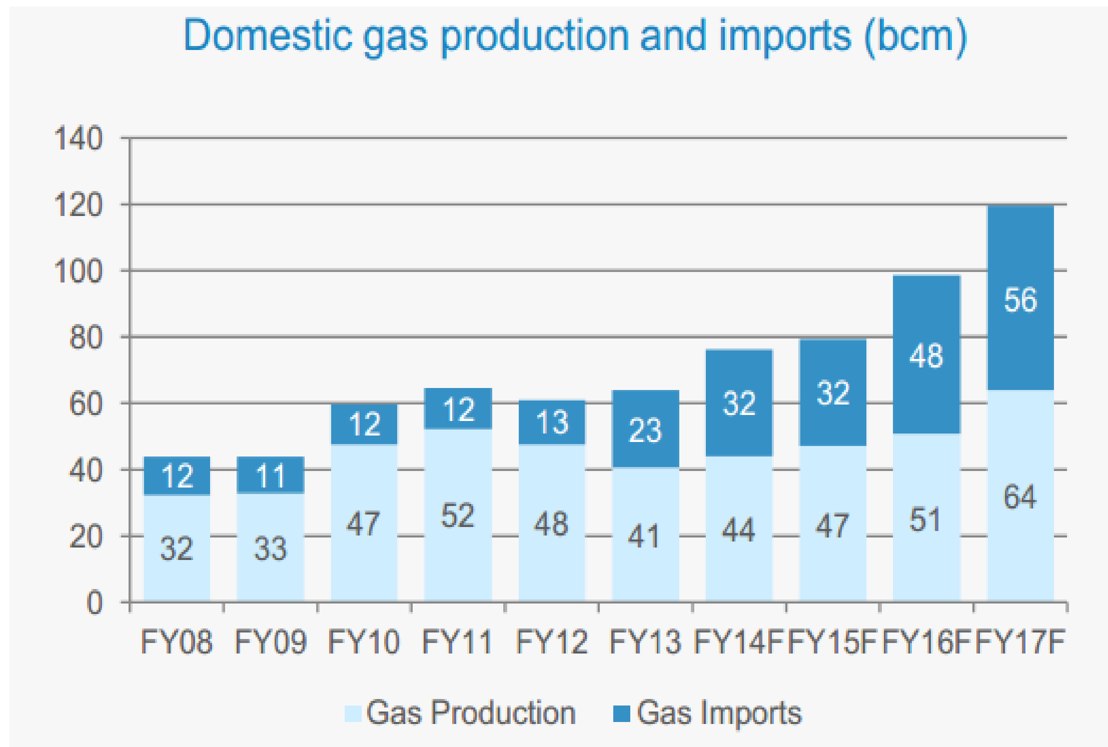


21

[21] *Supra n6*

Domestic Gas Production and Imports

In India, the total gas consumption is satisfied by both imports and domestic production. It is noteworthy that the dependence on Domestic production is higher than that of import as the domestic production constitutes around 75% of demand and the rest of the dependency is fulfilled by the imports. As per the statics the imports of LNG were 32 billion cubic meter while the gas production was 47 billion cubic meter in the year 2014. In India due to economic uplifting, it is expected that demand will also increase. It is expected that the imports of Liquified Natural Gas will be increase during 2012-2017 with a CAGR of 33%.



[22]

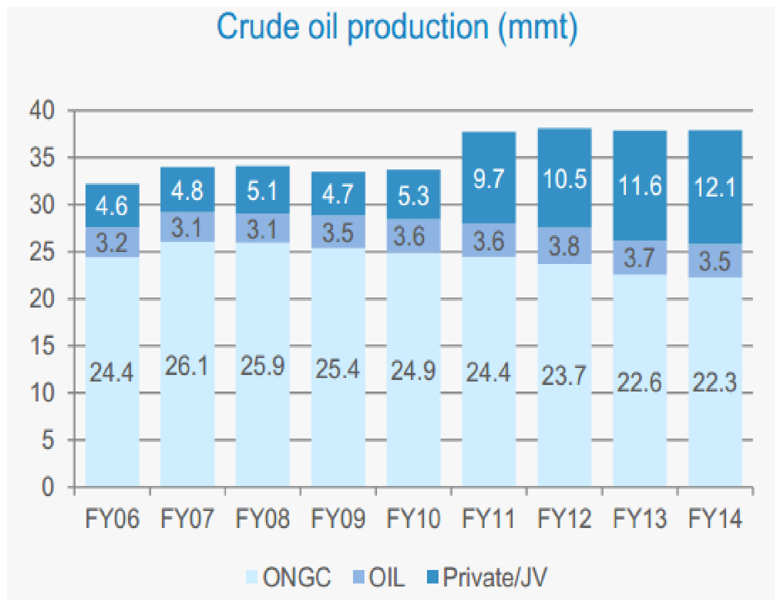
---

[22] *Supra n.6.*

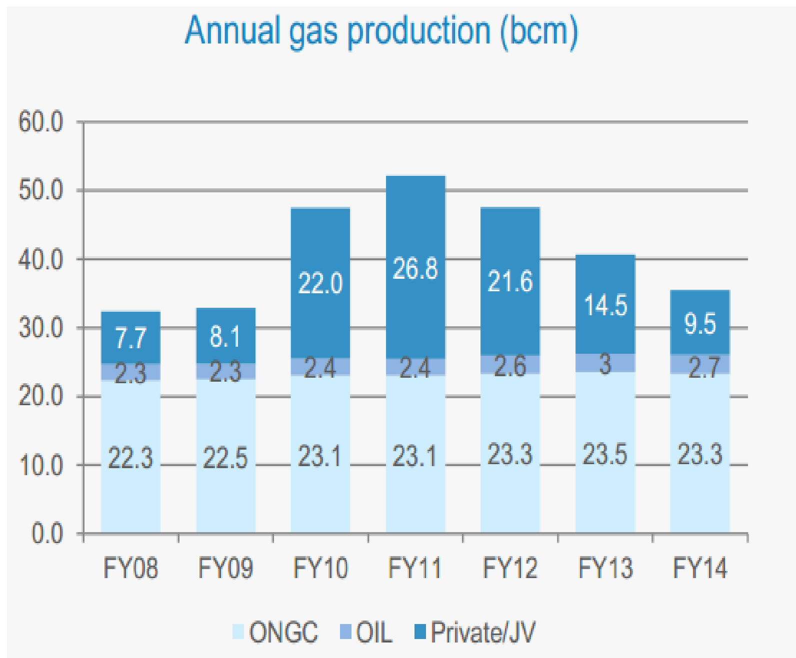
Upstream Segment Crude Oil and Gas Production

As far as Indian crude oil and natural gas production is concerned ONGC plays a very important role as it contributed up to 59% of the production in the financial year 14. In the financial year 2014, the total production of crude oil was around 37.9 million metric tons.

And the gas production in the FY 14 was around 35.4 billion cubic meter with lesser contribution from private sector.



[23]



[23] *Id.*

Revenue From Oil & Gas Sector

The Oil and Natural Gas sector is the largest sector in terms of contribution to state and centre funds.[24]. The Oil and Gas Sector contributes 15% of GDP.[25]

India, the fourth biggest oil consumer in the world, is a net exporter of fuel products. It is fifth largest oil consuming country after U.S., China, Japan with consumption at 3.1 million barrels per day.[26] India is dependent on imports to satisfy its petroleum and natural gas demands as the oil consumption in India is comparatively very higher than that of production in India. As far as oil consumption is concerned, it is dominated by the transportation sector of India.

The exploration and production of Oil and Gas benefits the concerned nation in many ways. It add profit to the treasuries of nation in various manner including the profit to the government through tax and other revenues, increase the employment in the nation, profits through the exports of petroleum and related products etc.

It is well known fact that the availability of hydrocarbon resources is not very high but due to constant efforts of Indian government towards oil and gas sector in the last 20-25 years provided it with 9,650 crore during the year 2009-2010 in the form of non-tax revenue from the companies engaged in exploration and production. It is noteworthy that the non- tax contribution consisting of various exploration fees, royalty and share in profit petroleum of the sector was 9,423 crore during the year 2008-2009.[27]

---

[24] Business Maps of India, *Role of Oil and Natural Gas Industry in India GDP, available at* http://business.mapsofindia.com/india-gdp/industries/oil-natural-gas.html.

[25] Invest India, *Oil and Gas Investment Opportunities, available at* http://www.investindia.gov.in/oil-and-gas-sector/.

[26] World Energy Council, *India Energy Handbook, 2012, available at* http://www.indiaenvironmentportal.org.in/files/file/ieb2012.pdf.

[27] Jyoti Mukul, *Govt. Non-tax Revenue from Oil Sector over Rs. 9,650 Cr.* BUSINESS STANDARD, Apr. 20, 2010, *available at* http://www.business-standard.com/article/economy-policy/govt-non-tax-revenue-from-oil-sector-over-rs-9-650-cr-110042000050_1.html.

India is having rich resources and it always lure investors across all the nations to invest in the sector. The rich resources and the policies of the industry have attracted the foreign direct investment to a great extent. It can be well infirmed from the record that it attracted foreign direct investment (FDI) worth US$ 3, 332.78 million during April 2000 to December 2011, and as per Department of Industrial Policy and Promotion (DIPP) further US$ 196 million were invested in the sector during April-December 2011-2012.[28]

[28] *India Brand Equity Foundation, Oil and Gas*, *available at* http://www.ibef.org/archives/detail/b3ZlcnZpZXcmMzExODQmNDg5.

CHAPTER-III

REGULATORY FRAMEWORK FOR OIL AND GAS (UPSTREAM) SECTOR

The petroleum sector has played major role in the growth of Indian Economy. All the major industries being directly or indirectly dependent on petroleum sector for meeting their requirements has given oil and gas sector a paramount importance.

The Indian petroleum sector has been a managed one with the exploration and production being dealt in the hands of Government endeavors. Throughout the years different regulations and policies are formulated and adopted by the Government to control, regulate and develop the Oil and Gas sector of India.

In the present time the major issue is the increasing space between the demand of petroleum & petroleum products and the production within the country. This concern made the government to push the sector by formulating various policies in order to decrease the gap between these two factors. The formulation and declaration of various policies resulted into attraction to the much needed requirement i.e. the investment of risk capital in the sector by the private players including the foreign participator. Thus, the objective which was to drive the sector at full swing has been achieved to some extent.

The present section will discuss the regulator, regulations and the policies governing the Upstream sector along with their evolution and fiscal framework embedded within them in order to enhance the sector.

Regulatory Bodies for Upstream Sector

The Government of India (GoI) is empowered by the Constitution of India, 1950 "***to make laws with respect to regulation and development of oil fields and mineral oil***

***resources, and petroleum and petroleum products*"[29]**. In furtherance of these powers conferred by List 1 to government of India, the government has formulated a number of petroleum laws and policies to regulate different activities in the sector. The MoPNG[30] is accountable in relation to the sector as all the powers and duty to administer the sector is vested within it.

Ministry of Petroleum and Natural Gas

The Ministry of Petroleum and Natural Gas is assigned with following duties:

1. To manage the exploration and production activities in the sector.
2. To manage and ensure proper refining, distribution and marketing of petroleum and petroleum products.
3. To regulate the import, export and preservation of petroleum and related products along with the liquefied natural gas.

The MoPNG is into the regulation of allocation of gas along with its production from national oil companies by its orders with power derived from statutes, at the very same time it govern the gas provided by the joint ventures by the provisions of Production Sharing Contract (PSC). A number of organizations falls under the jurisdiction of MoPNG including around fourteen public sector undertakings (ex. GAIL) and other entities like Petroleum Planning and analysis cell (PPAC) and the Director General of Hydrocarbon.[31]

---

[29] Jurisdiction to regulate oilfields is vested with the Central Government, *See* Entry 53 -List 1, Constitution of India, 1950.

[30] Ministry of Petroleum and natural Gas, Government of India.

[31] Anne-Sophie Corbeau, *Natural Gas in India, available at* https://www.iea.org/publications/freepublications/publication/natural_gas_india_2010.pdf.

Director General of Hydrocarbon

Director General of Hydrocarbon (DGH) was established in the month of April, 1993. It functions under the executive authority of Ministry of Oil and Natural Gas. It was established for the purpose to act as an advisory cum technical regulator for the Upstream sector. It is the duty of DGH to ensure proper management of hydrocarbon resources with balancing the various other aspects like economy, technology, environment etc. of upstream sector.

The financial year 06 brought drastic changes in the role of Director General of Hydrocarbon. The DGH was empowered with statutory powers under the Act of 1948[32] along with the expectations that it will promote new exploration and licensing policy and administer the production sharing contracts with efficacy. .[33]

The following paragraphs seek to highlight the key regulations governing the sector along with the policy regime existing in the sector to govern the fiscal scenario of Oil and Gas (Upstream)

Regulatory Legislations for Upstream Sector

The key role of the upstream sector is to attract the private Indian and foreign players for capital investment in the Upstream Sector and to provide a level playing field for exploration and production activities in the country. This section briefly outlines the regulatory framework governing India's upstream sector.

The Oil Field (Regulation and Development) Act, 1948

The Act of 1948 provides for "*Regulation of Oil Fields and Development of mineral oil resources.*" The Act authorizes to Government of India to provide the successful bidder with the required rights i.e. the mining rights in respect of Exploration and Production

[32] *Oil Fields (Regulation and Development)Act, 1948*

[33] *India's Energy Sector, Key Regulatory Policies, available at* http://59.160.19.131/IndiasEnergySector2012/KeyRegu.asp.

activities. The Act also deals with the royal aspect under petroleum operations. A brief outline of the Act is as follows-

- As per section 4 of the Act that the mining leases provided under the Act should be in consonance with the Act;[34]
- Section 4 of the Act also prescribes that if a mining lease is provided in violation of the provisions of this Act, then the same shall be null and void;[35]
- Section 5 of the Act auhorizes the Government of India to make rules for the purpose of protection and development of mineral oil.[36]
- Section 6A of the Act mandates that a mining lease holder will subject to pay royalty for mineral oil mines, quarry, excavated
- Or the holder is entitled to collect royalty from the leased area in accordance with the specified rates.[37]

Petroleum and Natural Gas Rules, 1959[38]

The grant of required exploration licenses and mining lease is governed by the Petroleum and Natural Gas Rules of 1959. It contains detailed provisions in this respect, some of them are:

- Rule 4 specifically prohibits the prospecting and mining of petroleum and petroleum products unless a license or a lease is specifically granted for the same purpose.
- Rule 5(1) empowers Central Government to grant license or lease for the purpose of exploration and production in off shore block as well as in the land specifically vested to it.

---

[34] Section 4, the Oil Field (Regulation and Development Act), 1948.

[35] *Id.*

[36] *Id,* Section 5.

[37] *Id,* Section 6A.

[38] Sakshi Parashar, *Legal Aspects of Oil and Gas Sector, available at* http://www.manupatrafast.com/articles/PopOpenArticle.aspx?ID=3b9928f3-1807-4916-b783-33b3c38992db&txtsearch=Subject:%20Oil%20And%20Gas.

- Rule 5(2) empowers the State Government to grant license or lease for the purpose of exploration and production in onshore blocks.
- The Petroleum and Natural Gas rules prescribes that an indic=vidual with a license have exclusive right to obtain lease for production in regard to the area mentioned in the license.

In exercise of the rule making powers under the Petroleum Act, Union Govt. framed the Petroleum Rules and along with the Petroleum Act, both were designed to regulate transport, distribution and storage of petroleum and petroleum products. Interestingly, the powers of the Union Govt. and State Govt. with respect to regulating petroleum and petroleum products was tested in Municipal Corporation[39] and the Bombay High Court ruled that the power of Union Govt. to legislate on this subject would supersede the power of State Govt. In the cases referenced above,[40]the terms of grant of license and cancellation of license in the event of non-compliance of conditions of license was also examined. It is important to note that Union Govt. has the power to regulate petroleum products as the same are hazardous material and also since petroleum products are covered by Essential Commodities Act, 1955[41] as it provides that essential commodity includes- Petroleum and Petroleum Products.

Another important point to note is that rules and regulations are subordinate to the parent statute and hence, a rule or a regulation cannot enforce a standard more than what the statute mandates.[42] This principle assumes significance in the context of interpretation and enforcement of provisions of statutes, rules and regulations.

<u>The Territorial Waters, Continental Shelf, Exclusive Economic Zone and Other Maritime Zones Act, 1976</u>

Deriving it's power from Article 297 of the Constitution. As the article prescribes:-

---

[39] Appeal No. 1114 of 1988 (High Court of Bombay).

[40] *Id.*

[41] Section 2 (a), Essential Commodities Act, 1955.

[42] Avinder Singh & Ors vs. State of Punjab (1979) 1 SCC 137

"Article 297 in The Constitution Of India 1949

Things of value within territorial waters or continental shelf and resources of the exclusive economic zone to vest in the Union

(1) *All lands, minerals and other things of value underlying the ocean within the territorial waters, or the continental shelf, or the exclusive economic zone, of India shall vest in the Union and be held for the purposes of the Union*

(2) *All other resources of the exclusive economic zone of India shall also vest in the Union and be held for the purposes of the Union*

(3) *The limits of the territorial waters, the continental shelf, the exclusive economic zone, and other maritime zones, of India shall be such as may be specified, from time to time, by or under any law made by Parliament."*

The Act of 1976 formulated and passed from the authority of Article 297 defines:-

"*The sovereign right of India over territorial waters upto 12 nautical miles measured from the appropriate baseline, to the seabed and subsoil underlying and the airspace over such waters."*

The Act of 1976 empowers the Government of India to exercise jurisdiction in exclusive economic zone in respect of exploration, exploitation, conservation and management of natural resources. The Act also empowers Government of India and enable it to extend the prevailing laws/legislations to the Exclusive Economic Zone.

The Oil Industry (Development) Act, 1974

The Act of 1974 prescribes for the establishment of "Board For The Development Of Oil Industry". The board have a number of powers including the power to provide financial and other kind of assistance to Oil Industry for the purpose of its development. The word other assistances includes providing loans, giving grants.[43]

---

[43] Section 6, The Oil Industry (Development) Act, 1974

Policy Framework Governing The Upstream Sector

The present section deals with various policies governing the petroleum sector in India including the Vision 2025 and New Exploration and Licensing Policy:

Hydrocarbon Vision 2025[44]

The vision of 2025 emphasize on energy security for a longer period of time. The vision clarifies that in order to achieve energy security the focuses on be two factors; Firstly, to increase the in-home or domestic production and secondly by investing in the foreign countries. Through this way only, India will be a self dependent state in terms of energy.

To fulfill these two abovementioned goals it is necessary to amplify the efforts in exploration activities and to determine accurately the area covered by unexplored basins which will amount to increase in domestic availability of Oil and Gas.[45]

New Exploration and Licensing Policy

New Exploration and Licensing Policy i.e. NELP was formulated by the GoI in the year 1997. The main objective was to attract risk investment in the sector from Indian private players and foreign investors. New Exploration and Licensing Policy was adopted in the year 1997 and finally came into force in the year 1999. After the advent of New Exploration and licensing policy the competitive bidding started in Oil and Gas sector for exploration licenses, at it brought the National Oil Companies to at par with the other players i.e. private players for the purpose of obtaining Exploration License. As of now 254 blocks have been awarded for exploration and production under various NELP rounds.

---

[44] Ministry of Petroleum & Natural Gas, *The Hydrocarbon Vision 2025, available at* petroleum.nic.in/docs/reports/**vision**.doc.

[45] World Resources Institute, *Hydrocarbon Vision 2025, available at* http://projects.wri.org/sd-pams-database/india/hydrocarbon-vision-2025.

Following are certain salient features of NELP[46]:

1. Under New Exploration and Licensing policy 100% Foreign Direct Investment is allowed.
2. In the Pre-NELP regime there was mandatory state participation by National Companies along with the carried interest by Indian government but under NELP there is no such requirement or provision.
3. Under NELP the process of awarding blocks is through open international competitive bidding.
4. In the New Exploration and Licensing Policy the national oil companies are at par with other players contrary to earlier regime where the PEL was provided to them on nomination basis.
5. Under the policy the ONGC and OIL are at par with other investors/companies, they get the same fiscal and contract terms as private companies.
6. NELP provides Freedom to the contracting parties for marketing of crude oil and gas in the domestic market of India.
7. Royalty rates are also revised and the present royalty rates for onshore blocks are 12.5% and for offshore blocks it is 10%.
8. In case of deep water blocks royalty to be paid is half in rate for a period of seven years from the date of commercial production.
9. In all the block offered under NELP there will not be any incident of cess i.e. they will be free from cess.
10. Under NELP if a company imports machinery for the purpose of exploration and production, it will be free from import duty.
11. Under NELP there is no provision for any sort of bonus like signature, production or discovery.
12. Under NELP Model Production Contracts are reviewed every time before a round in order to check their conformity with prevailing conditions.
13. NELP prescribes that the Contracts under NELP should be governed by applicable Indian Laws.

---

[46] Ministry of Petroleum & Natural Gas, *New Exploration Licensing Policy, available at* http://petroleum.nic.in/docs/nelp.pdf.

Details of NELP bidding rounds

Parameter	NELP I	NELP II	NELP III	NELP IV	NELP V	NELP VI	NELP VII	NELPVIII	NELPIX
No. of Blocks Offered	48	25	27	24	20	55	57	70	34
No. of Blocks Bid for	28	23	24	21	20	52	45	36	33
No. of Bids Received	45	44	52	44	69	165	181	76	74
No. of blocks awarded	25	23	23	21	20	52	44	34	19
No. of PSCs signed	24	23	23	20	20	52	41	32	19
Area Awarded (Sq.km)	**2,28,472**	**2,63,050**	**2,04,588**	**1,92,810**	**1,13,687**	**3,06,331**	**1,12,988**	**52,603**	**26,428**

[47]

NELP-I

Since its inception 277 PSC's have been signed and 210 are under operation under the NELP regime[48]. Under NELP-I 48 blocks were offered and out of them 27 received bids. RIL emerged as the largest private sector bidder for oil exploration blocks followed by ONGC[49].129 RIL`s bids were for blocks in the Mumbai offshore region, Kerala-Konkan basin, Kutch, North Eastern Coast, and the Krishna Godavari basin. Cairn Energy emerged as the second largest private player putting in bids for three blocks in the Krishna-Godavari basin. The first round was significant on two aspects - first, it marked the consolidated entry of the private sector both domestic and foreign into the area, second the reaction for the blocks showed that the policy had still some way to go before it could attract world oil majors to explore in India.

---

[47] Director General of Hydrocarbons, *Exploration & Production of Hydrocarbons in India, available at* http://www.dghindia.org/admin/document/topstory/13.pdf.

[48] Director General of Hydrocarbons, *Hydrocarbon Exploration & Production Activities, available at* http://www.dghindia.org/pdf/1DGH%20Annual%20Report%202011-12.pdf.

[49] Reliance acquired 12 blocks while ONGC captured 5 blocks.

NELP IX and NELP X[50]

In the ninth round of NELP 33 blocks were included in the process for exploration. Out of that 33 blocks ONGC bided for 10 blocks for exploration and production. OIL successfully secured 10 blocks and RIL bided for six blocks in toto out of which 2 were deep water block and the other four were in the state of Rajasthan and Gujarat.

As far as the NELP X is concerned, offer is expected to be invite for around 46 blocks inclusive of 17 Onland, 15 Shallow water and 14 deep water blocks. The area covering all these blocks is around 3.14 million square Km and contain 26 sedimentary basins.[51]

---

[50] Nishith Desai Associates, *Oil and Gas Industry in India: Legal, Regulatory and Tax, available at* http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Oil_and_Gas_Industry_in_India.pdf.

[51] *Supra n.8.*

CHAPTER-IV

FISCAL FRAMEWORK FOR OIL AND GAS UPSTREAM SECTOR

Introduction:

Indian taxation system is well developed which clearly demarcates authority to impose tax and collect them in federal structure of India i.e. between Central, State and other local authorities. Indian taxation system empowers the Central government to impose tax on income and in other forms like service tax etc. while the state governments can impose tax on agricultural income.

In the last decade or two the taxation regime of India has undergone drastic changes. During this span of time the then prevailing tax rates in India has been changed in order to bring better fulfillment of tax payment along with making the procedure of payment bit simpler. The process of converting the tax rates into better form is still continue in India. It is noteworthy that majority of the Indian states replaced the prevailing Sales Taxwith VAT after April 1, 2005.

A Prooduction Sharing Contracts (PSC) [52] contains various elements including the element of royalty. Companies enter into a production sharing contract with Government of India in order to undertake exploration and production activities and which also results in sharing of profit with Government of India.

Since a very long time the tax regime of Exploration and Production sector was governed by Income Tax law with primary focus on the major requirement of the sector requirement i.e. to attract risk capital along with better technology in the sector. The investing companies are not only governed by Income Tax law but also the Production

---

[52] The Petroleum Tax Guide, 1999, *available at* http://www.dghindia.org/pdf/PETROLEUM_TAX_GUIDE.pdf.

Sharing Contract.In Reliance industries case[53] decide by the Hon'ble Supreme Court of India, ***"The Hon'ble court held down that in the event of conflict between the provisions of law and the PSC, the provisions of PSC is to be applied."***

Taxation Scenario in Pre NELP and Post NELP Era:

In the Pre-NELP era unlike the present scenario the Government used to offer blocks to joint ventures made between the Government companies and private players for the purpose of exploration and production of Oil fields. In the Pre-NELP era the prevailing fiscal framework was as follow:

1. In the Pre-NELP era the royalty rate was determined on the basis of well head value. It was fixed at @10% of well head value.
2. Section 42 of the Income Tax Act, 1962 used to govern the taxation of exploration and production activities.
3. In the case of unincorporated joint ventures the assessed companies were subject to corporate Income Tax @ 50% of taxable income.
4. The allowable deduction on expenditure on E&P activities was 100%
5. The Government was responsible to pay the stamp duties payable under Production Sharing Contract, if any.

The major differences between earlier rounds of bidding exploration blocks and NELP can be summarized as under[54]:

TERMS	EARLIER ROUNDS	NELP
Royalty/ Cess	In the earlier rounds no royalty or cess from companies. The NOC's	Under the NELP,the is responsible to bear.

[53] Reliance Industries Ltd. V. UOI, Civil appeal no. 5765 of 2014

[54] PetroFed, *Historical Background of Oil Exploration in India, available at* http://petrofed.winwinhosting.net/upload/Part3.pdf.

	used to bear these for companies.	
Participating Interest by National Oil Companies	In the Joint Venture NOC's had to take 25-40% interest and 0-40% otherwise.	Under NELP no provision for such nomination. NOC's are at par with other players.
Carried Interest of NOC's	In joint venture exploration programmes the national oil companies had working interest from the very beginning and in general they used to carry 30% carried interest on a commercial discovery.	Prescribes no carried interest by National Oil Companies.
Level Playing Field for NOC's	National Oil companies didn't have the same level playing field as of private players, the terms available to them were different from private investors.	In the NELP era National Oil Companies are provided with International price on their production and they don't have to pay the customs duty as well.
NOC's to Compete for Acreage	In the Pre-NELP era the National Oil Companies used to get the exploration acreage on nomination basis.	But under the NELP regime the NOC's have to compete with private players.
Incentive for Exploration	No incentives provided during pre-NELP.	In the deep water off shore block companies require to pay the half royalty for initial seven years.

From the comparison of both the scenario it's pretty evident that the NELP regime is more investor friendly in terms of fiscal benefits than that of Pre-NELP era. In the earlier time the participation of National Oil Companies were mandatory unlike present scenario where they have to bid like any other company and are at equal place with other investors.

Pre – NELP Production Sharing Contract Regime:

Under the PRE – NELP era the participating companies used to keep in mind their investment recovered and profit after taxes. Because in earlier era the companies used to bid for minimum work programme at each stage of their exploration effort, they used to determine their shares in profit petroleum etc. thus the investment recoverd and other aspects became necessary.

Cost Recovery:

In the earlier time the cost recovery was ring fenced on the basis of production area for exploration, development and production costs. The production cost could only be recovered from the revenue generated in the producing area. But, the exploration and the development costs could be recovered even from the revenue of production area, if the producing area form the part of the area in which such expenses were incurred.

Participating Interest:

In the time prior to NELP NOC's were provided with a choice to take 30% of participating interest in a block at the time of commercial discovery in order to compensate the expenses incurred by them in development and production activities of the field. The national oil companies were also at liberty to acquire 10% working interest in any block.

Time Period:

In the Pre-NELP era the production sharing contracts entered into and between the parties were for a period of 25 years which were further extendable for a period of 5 years for oil and associated gases and extendable upto 35 years where it is the non associated gases. In the case of non associated gases maximum 7 year exploration period is provided.

Relinquishment:

In the Pre-NELP era it was mandatory for the investor to relinquish the 25% and 50% of their contracting area at the end of their first phase of exploration and second phase of exploration consecutively. They were entitle to keep only the producing area along with the area having chances to be a producing area. However, if the government deemed fit that a particular area (not a producing area) require more efforts and can be explored well enough to get the petroleum, government could exempt the contracting party from relinquishment. The first exploration phase was provided with seismic option.

Supplementary Benefits:

1. The first exploration phase was provided with seismic option.
2. The contractors were free from the liability of paying signature or production bonus.
3. Royalty on production was not required.
4. Full exemption from payment of custom duties and other taxes.
5. The Pre NELP provides for a seven year tax holiday.[55]

---

[55] Draft Red Herring Prospectus, *Oil India Limited, available at* http://www.sebi.gov.in/dp/oilindiadraft.pdf.

Current Fiscal Regime in Upstream Sector:

Taxation in upstream sector is a very important concept because in order to increase the participation in the sector the regime should be investor friendly. In order to be an investor friendly regime, it is necessary that the sector should provide the investors with certain perks. Keeping in mind the same the scenario in the upstream sector provides the investors with certain financial benefits like deduction under Income Tax Act, 1961, tax incentives under the PSC and various revised rates on royalty. The present chapter will highlight the efforts of the Indian Government in this regard:

Royalty Regime:

The entitlement of getting the royalty out of Oil and Gas activities is also demarcated between Central and State Government. In the case of offshore drilling Central Government is entitled to get the royalty while in the case of onshore production the concerned state government will have the royalty. The complete power and responsibility of development and regulation of the Oil and Gas field is within the domain of Central Government. The Act of Oil Fields (Regulation and Development), 1948 and the Petroleum and Natural Gas Rules, 1959 deal with the royalty aspect.

The royalty on production from the Oil and Gas fields awarded under production sharing contract is governed by the terms of the respective contract. The receipts in this regard completely depends upon the Oil or Gas produced from that particular field. Production Sharing Contract provides protection to the parties where in case any change to Indian Law results into change in economic benefit of the contracting parties after the date of signing of the contract.

The Royalty percentage prescribed in Production Sharing Contract is as follows[56]-

[56] Ministry of Petroleum & Natural Gas, *Model Production Sharing Contract,* NELP IX, *available at* http://petroleum.nic.in/docs/rti/MPSC%20NELP-IX.pdf.

1. Land Areas:- a. Crude Oil – 12.5%
   b. Natural Gas – 10%
2. Shallow Water Offshore Block:- a. Crude Oil – 10%
   b. Natural Gas – 10%
3. Deep Water Offshore Block:- a. Crude Oil – (5% for seven years and after that 10%)
   b. Natural Gas – (5% for seven years and after that 10%)

Income Tax Regime:

The revenue collected in the form of tax is the backbone of any economy and a major contributor to public revenue. The government imposes tax on general public in order to insure proper funds for public benefit.[57]

As per Hugh Dalton, *"a tax is compulsory contribution imposed by a public authority, irrespective of the exact amount of service rendered to the taxpayer in return, and not imposed as penalty for any legal offence."*[58]

In an order to elucidate upon "Fiscal regime in Oil and Gas (Upstream) Sector in India", this section categorically deals with the general principles of taxation which form the basic foundation for formulating any tax policy.

The great economist and writer of "***The Wealth of Nations***" Adam Smith also renowned as the father of modern political economy prescribed certain basic principles require to

[57] Gaurav Akrani, *What is Tax?, available at* http://kalyan-city.blogspot.com/2010/12/what-is-tax-definition-adam-smith.html.

[58] Eshetu Kitata, *Assessment of Profit Business Tax Collection and its Administration; the Case of Boset Woreda, available at* http://www.academia.edu/7676451/Research_Paper_June_16_2014.

build a good taxation system. These basic principles are also known as “Canons of Taxation

The celebrated cannons prescribed by Adam Smith are[59]

1. **Canon of Equity**

The Canon of Equity focuses on giving monetary and social equity to the individuals of the society. As indicated by this rule, the government should be paid by the individuals relying upon their capacity to pay. The canon provides that the taxes payment to the government payable by the high or rich class should be higher because they can enjoy and earn the money only under the security provided by the state and state bodies like police etc. In the canon of equity Adam Smith contended that the taxes levied upon individuals should be relative to wages earned by them, i.e., nationals of a country should pay the taxes to the extent of income which they can enjoy safely under the protection of state.

2. **Canon of Certainty**

As indicated by Adam Smith in the canon of certainty that whenever an individual is subjected to any tax, the same should be sure and certain, and should not be discretionary. The tax paying citizen should know the amount, time and way of paying the tax in advance.

Every tax levied upon and payable by citizens should comply with the canon of certainity. In a good taxation structure along with the tax paying individuals the government also knows about the amount of tax it is going to receive from taxation.

3. **Canon of Convenience**

[59] Stephen Smith, *Introduction to key concepts in economics of taxation*, *available at* http://www.ucl.ac.uk/~uctpa15/Econ7008_slides1.pdf.

Through the Canon of Convenience Adam Smith conveyed that while taxing an individual, his convenience for the same should be the concern of the government. The way of tax payment and the time of tax payment should not create any trouble to the payer. As while taxing a farmer the harvesting season should be keep in mind. The compliance of Canon of Convenience will increase the tax income.

4. **Canon of Economy**

The Canon of Economy focuses on the economic viability of the tax collection process. It emphasize that the expenditure incurred in the process of tax collection should always be less than the collected tax. If the cost of collection is high or the the tax so collected is difficult to administer then inspite of benefitting the economy, it will hamper the economy.

Prerequisites of a Good Taxation System:

For a good taxation system fulfillment of canons of taxation is must. But , along with the canons of taxation the government should also focus on certain other principles, like;

1. Tax collection should be for the purpose of benefitting the public services.
2. The tax paying individual should asked to pay the taxes in accordance with his ability to pay the same and the ability should be decided with keeping in mind, his overall income and property under his ownership.
3. There should not be any discrimination in imposing tax on individuals or organizations.

The Indian Income Tax Act[60] provides special provision for taxability of upstream companies. Section 42[61] of the Act lays down as:-

---

[60]The Income Tax Act, 1961.

[61]*Id.*

"[(1)] For the purpose of computing the profits or gains of any business consisting of the prospecting for or extraction or production of mineral oils in relation to which the Central Government has entered into an agreement with any person for the association or participation [of the Central Government or any person authorised by it in such business] (which agreement has been laid on the Table of each House of Parliament), there shall be made in lieu of, or in addition to, the allowances admissible under this Act, such allowances as are specified in the agreement in relation—

(a) to expenditure by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee ;

(b) after the beginning of commercial production, to expenditure incurred by the assessee, whether before or after such commercial production, in respect of drilling or exploration activities or services or in respect of physical assets used in that connection, except assets on which allowance for depreciation is admissible under section 32 : [***]

[Provided that in relation to any agreement entered into after the 31st day of March, 1981, this clause shall have effect subject to the modification that the words and figures "except assets on which allowance for depreciation is admissible under section 32" had been omitted; and]

(c) to the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding year or years as may be specified in the agreement; and such allowances shall be computed and made in the manner specified in the agreement, the other provisions of this Act being deemed for this purpose to have been modified to the extent necessary to give effect to the terms of the agreement.

[(2) Where the business of the assessee consisting of the prospecting for or extraction or production of petroleum and natural gas is transferred wholly or partly or any interest in such business is transferred in accordance with the agreement referred to in sub-section (1), subject to the provisions of the said agreement and where the proceeds of the transfer (so far as they consist of capital sums)—

(a) are less than the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of transfer, shall be allowed in respect of the previous year in which such business or interest, as the case may be, is transferred;

(b) exceed the amount of the expenditure incurred remaining unallowed, so much of the excess as does not exceed the difference between the expenditure incurred in connection with the business or to obtain interest therein and the amount of such expenditure remaining unallowed, shall be chargeable to income-tax as profits and gains of the business in the previous year in which the business or interest therein, whether wholly or partly, had been transferred :

Provided that in a case where the provisions of this clause do not apply, the deduction to be allowed for expenditure incurred remaining unallowed shall be arrived at by substracting the proceeds of transfer (so far as they consist of capital sums) from the expenditure remaining unallowed.

Explanation.—Where the business or interest in such business is transferred in a previous year in which such business carried on by the assessee is no longer in existence, the provisions of this clause shall apply as if the business is in existence in that previous year;

(c) are not less than the amount of the expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed in respect of the previous year

in which the business or interest in such business is transferred or in respect of any subsequent year or years:

[Provided that where in a scheme of amalgamation or demerger, the amalgamating or the demerged company sells or otherwise transfers the business to the amalgamated or the resulting company (being an Indian company), the provisions of this sub-section—

(i) shall not apply in the case of the amalgamating or the demerged company; and

(ii) shall, as far as may be, apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the latter had not transferred the business or interest in the business.]]

[Explanation.—For the purposes of this section, "mineral oil" includes petroleum and natural gas.]"

Thus, from section 42 of the Income Tax Act it is clear that the following expenditures are allowable:

- Section 42 allows the expenditures incurred in the form of in fructuous or abortive exploration. And
- The expenses incurred for exploration, services or assets for abovementioned activities.
- Depletion of mineral oil in the mining area post commercial production

Article 17[62] of the Model PSC provides for the following specific allowances in computing the taxable income of the E&P companies:

- Exploration and drilling expenditure, both capital and revenue in nature, is 100% tax deductible

[62] *Supra n.6.*

- Expenditure incurred on development and production activities (other than drilling expenditure) is allowed as per the provisions of the Income Tax Act (“the Act”)
- All exploration and drilling expenditure is allowed to be aggregated till year of commencement of commercial production. Alternatively such expenditure may be amortized equally over a 10-year period from start of commercial production.

Production Sharing Contract Regime:

India has a hybrid system of PSCs containing elements of royalty as well as sharing of production with the Government. E&P companies (contractors) that are awarded the exploration blocks enter into a PSC with the Government for undertaking the E&P of mineral oil. The PSC sets forth the rights and duties of the contractor. The PSC regime is based on production value.

Cost Petroleum or Cost Oil[63]

Cost petroleum is the portion of the total value of crude oil and natural gas produced (and saved) that is allocated toward recovery of costs. The costs that are eligible for cost recovery are:

- Exploration costs incurred before and after the commencement of commercial production
- Development costs incurred before and after the commencement of commercial production
- Production costs
- Royalties

[63]Earnst and Young, *Global oil and gas tax guide* (2013), *available at* http://www.ey.com/Publication/vwLUAssets/2013_global_oil_and_gas_tax_guide/$FILE/EY_Oil_and_Gas_2013.pdf.

The unrecovered portion of the costs can be carried forward to subsequent years until full cost recovery is achieved.

Profit Petroleum or Profit Oil

Benefit petroleum implies the aggregate estimation of unrefined petroleum and regular gas delivered and spared, as decreased by expense petroleum. The benefit petroleum offer of the Government is biddable by the builder. The squares are sold by the Government. The offers from organizations are assessed taking into account different parameters including the offer of benefit rate offered by the organizations. The law has no tops on consumption recuperation. The rate of recuperation of cost acquired in any year is according to the offers put together by the organizations. Further, no inspire is accessible on recuperated expenses.

The costs that are not eligible for cost recovery[64] are as follows:

- Costs incurred before the effective date[65] including costs of preparation, signature or ratification of the PSC.
- Expenses in relation to any financial transaction to negotiate obtain or secure funds for petroleum operation. For example, interest, commission, brokerage, fees and exchange losses.
- Marketing or transportation costs.
- Expenditure incurred in obtaining, furnishing and maintaining guarantees under the contract.
- Attorney's fees and other costs of arbitration proceedings.
- Fines, interests and penalties imposed by courts.
- Donations and contributions.
- Expenditure on creating partnership or joint venture arrangement.
- Amounts paid for non-fulfilment of contractual obligations.

---

[64]Without prejudice to their allow-ability under domestic tax laws.
[65]Effective date means the date when the contract is executed by the parties or the date from which the license is made effective, whichever is later.

- Costs incurred as a result of misconduct or negligence of the contractor
- Costs for financing and disposal of inventory.

The PSC provides protection in case changes in Indian law result in a material change to the economic benefits accruing to the parties after the date of execution of the contract.

Domestic Tax Laws

The contractor under NELP is obliged to pay exhausted under Indian Income Tax Act . The expansive procurements under local expense laws are highlighted as underneath:

Corporate tax rates

Domestic companies are subject to tax at a rate of 30% and foreign companies at a rate of 40%. In addition, a surcharge (7.5% on tax for a domestic company and 2.5% on tax for a foreign company) must be paid if income is in excess of INR 10 million. An education levy of 3% also applies. The effective corporate tax rates are as follows:

Minimum Alternate Tax

Local organizations are liable to assessment at a rate of 30% and remote organizations at a rate of 40%. What's more, an additional charge (7.5% on duty for a household organization and 2.5% on assessment for a remote organization) must be paid if pay is in overabundance of INR 10 million. A training duty of 3% additionally applies. The successful corporate expense rates are as per the following:

Ring-Fencing

No ring-fencing applies from an expense point of view; hence, it is conceivable to counterbalance the investigation expenses of one piece against the salary emerging from another square.

Treatment of Exploration and Development Costs

All exploration and production expenses are 100% duty deductible. Such expenses are accumulated till the year of initiation of business generation. They can be either completely guaranteed in the year of business creation or they can be amortized equity over a time of 10 years from the date of first business generation. Improvement costs (other than penetrating consumption) are suitable under the typical procurements under the household charge[66].

Capital Allowances:

Accelerated depreciation

Depreciation is computed utilizing the declining-equalization strategy and is permitted on a class of benefits. For field operations completed by mineral oil concerns, the deterioration rate is 60% for indicated resources while the nonexclusive rate of devaluation on the composed down premise is 15% (dominant part of the advantages fall inside the bland rate). Further, extra deterioration of 20% is accessible on the real cost of new hardware or plant in the first year.

Incentives:

Tax holiday

---

[66] Sheetal Saraswat, *Understanding the Tax Regime Governing the Indian Oil Industry, available at,* http://www.petroleum.nic.in/pngstat.pdf visited on 17April 2014.

A seven-year tax occasion equivalent to 100% of taxable benefits is accessible for an endeavor occupied with the matter of business creation of mineral oil or characteristic gas or refining of mineral oil.

Carry forward losses

Business misfortunes can be carted forward and set away against business pay for eight back to back years, gave the wage tax come back to the year of misfortune is documented on time. For nearly held companies, a 51% congruity of proprietorship test must additionally be fulfilled.

Research & Development

Use on logical exploration caused with the end goal of the business is tax deductible.

Withholding Taxes

The following withholding tax rates apply to payments made to domestic and foreign companies in India:

Table 1

NATURE OF INCOME	RATE (%)
Domestic Company	Foreign Company*

DIVIDENDS*	0%	0%
INTEREST	20%	20%***
FEES FOR PROFESSIONAL OR TECHNICAL FEES	10%	10%
NON-RESIDENT CONTRACTOR		Maximum 40%***
BRANCH REMITTANCE	0%	0%

TAX		

For countries with which India has entered into a tax treaty, the withholding tax rate is the lower of the treaty rate and the rate under the domestic tax lows on outbound payments.

* The rates are to be further enhanced by the surcharge and education levy (cess).

** Dividends paid by domestic companies are exempt from tax in the hands of the recipient. Domestic companies are required to pay Dividend distribution tax (DDT) at 16.61% on dividends paid by them.

*** This rate applies to interest from foreign currency loans. Other interest is subject to tax rate at the rate of 40% (plus applicable surcharge and education cess).

**** Subject to treaty benefits. If a permanent establishment is constituted in India, the lower withholding tax rate depends on profitability.

Comparative Analysis

India is a developing country and in a developing country the fiscal scenario of crucial economic sector like oil and gas sector plays a vital role for the purpose of development. Indeed, the fiscal scenario of Indian oil and gas sector efficient enough to attract risk capital and better technology in the sector but in few other Asian countries like Malasiya, Indonesia etc. (also governed by Production Sharing Agreement/ Contract) the fiscal scenario is a bit different. This present part of the dissertation deals with fiscal scenario of Indonesia and Malasiya and comparison of Indian fiscal scenario with both the countries.

Production Sharing System and Fiscal Scenario of Malaysia:[67]

- In Malaysian Production Sharing Contract the royalty i.e. the first revenue to the government is 10%.
- The Malaysian PSC's limits the cost recovery up to 50% only.
- The profit oil get split in the ratio of 60%/40%, where the government gets the larger part of the share.
- Like other countries, Malaysia is also having provision for tax on profit oil. It is limited to 20% which gets added to the part of government.

From the overview of fiscal scenario prevailing in Malaysia, it is quite clear that the terms are inclined towards the government. The royalty payable is 10%, the cost recovery is limited to 50% unlike the other countries where it is unlimited and even the government is getting big part of the profit petroleum. But, even after all these factors; most of the international investors are interested in investing into Malaysian Oil and Gas sector. Reasons are:

- Geological potential of Malaysia.
- Political stability in Malaysia.
- Technological advancement in Malaysia. (Article)

[67] Malaysia production sharing agreement

Thus, because of the abovementioned factors a lot of companies would love to invest in Malaysia even though the fiscal regime over there is toughest in South- East Asia.

Production Sharing System and Fiscal Scenario of Indonesia:[68]

- In Indonesian Production Sharing Contract there is no provision for payment of royalty.
- In Indonesian PSC cost recovery is limited to 80%.
- The profit oil gets split in the ratio of 72%/28%, where the government gets the larger part of the share.
- Indonesia is having provision for tax on profit oil. It is limited to 48% which gets added to the part of government.

The fiscal scenario of Indonesia is inclined towards the contracting party i.e. companies as there is no provision for royalty in their fiscal regime.

From the understanding of fiscal regime of Malaysia, Indonesia and India it can be concluded that the fiscal regime prevailing in India is very balancing as it provides the government with decent revenue and competent enough to attract the private(including foreign) investors along with technology require. As in India[69];

- Royalty rates are 12.5% for the onland areas and 10% for offshore areas. Royalty to be charged at half the prevailing rate for deep water areas beyond 400 m bathymetry for the first 7 years after commencement of commercial production.
- Cost recovery up to 100%.
- Share of government in profit oil is biddable.
- 100% Foreign Direct Investment is allowed.
- Companies to be exempted from payments of import duty on goods imported for petroleum operations.

[68] http://pubs.sciepub.com/jfa/2/2/2/index.html
[69] MPSC

India's PSAs levy higher taxes than the average Asian PSA, and the minimum area that has to be relinquished at the end of the first exploration period tends to be proportionally larger. However, taxation is not necessarily a disincentive. While royalty payments are based on gross production regardless of the profitability of the field, taxes are paid on the foreign oil company's share of profit oil and thereby take profitability into account. For several other contract variables the country offers relatively better terms than the rest of the region.[70]

The Indian PSC is comparatively different from general Asian PSAs as generally in other Asian PSCs:[71]

1. Duration of Contract- 24 years
2. Relinquishment- 20 years
3. Royalty- 5.5%
4. Cost Oil- Maximum-60%
5. Profit Oil- Min.28-Max.55
6. Taxation- 41%
7. Signature Bonus- US$ 1.8m
8. Production Bonus- US$ 5m

Thus, the regime in other Asian PSAs is different from that of India

---

[70] http://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/WPM25-ProductionSharingAgreementsAnEconomicAnalysis-KBindemann-1999.pdf

[71] *Id.*

Issues and Challenges

Due to strong regulatory framework and provisions of fiscal incentives, participation of private companies until NELP VII was strong. On the other hand, consequent changes acquainted have driven with uncertainity and perplexity among industry players. The accompanying are a percentage of the duty and administrative issues affecting the business:

1. Deduction for unsuccessful investigation costs:

Segment 42 of the Income Tax Act, 1961 gives that the reasoning to unsuccessful investigation costs is permitted just in appreciation of a region surrendered preceding the start of business creation. Thus, finding of costs because of fruitless investigation is not accessible in the year when consumption was caused and is allowed just on surrender of region. Such necessities of surrendering the range for profiting reasoning for unsuccessful consumption impel investigation organizations to surrender the zone without completely investigating the same, which is not in light of a legitimate concern for the business or of the nation.

2. No derivation for use caused on boring and investigation exercises by an Indian organization with abroad creation square:

Segment 42 of the Act gives reasoning to use acquired on penetrating and investigation exercises did in India. In like manner, an Indian organization with an abroad investigation square is not qualified for any comparable expense treatment.

3. No assessment occasion for creation of regular gas:

Assessment occasion under area 80IB(9) of the Act is accessible to endeavors occupied with the business generation of mineral oil and regular gas in squares authorized under Coal Bed Methane IV. In like manner, no finding is accessible for generation of regular gas in pieces authorized under other NELP and CBM rounds of offering.

4. No alternative for guaranteeing duty occasion under segment 80IB(9) of the Act:

Assessment occasion under area 80IB(9) is accessible to an endeavor, which is occupied with the business generation or refining of mineral oil for a long time including introductory appraisal year. In any case, in the starting years there is barely any benefit to exploit the duty occasion since undertaking bring about impressive consumption to set off and consequently, real advantage of expense occasion does not stream to them.

5. No exclusion of oil and gas benefits from Minimum Alternative Tax (MAT):

The profit allowed by method for duty occasion is part of the way counterbalanced since no absolution has been conceded from toll of MAT.

5. Reimbursement of cost saddled under area 44BB of the Act (for administration suppliers):

<u>As section 44B provides:</u>

“[Special provision for computing profits and gains of shipping business in the case of non-residents.

44B. (1) Notwithstanding anything to the contrary contained in sections 28 to 43A, in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to seven and a half per cent of the aggregate of the amounts specified in sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession" .

(2) The amounts referred to in sub-section (1) shall be the following, namely :—

(i) the amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.]

[58]*[Explanation.—For the purposes of this sub-section, the amount referred to in clause (i) or clause (ii) shall include the amount paid or payable or received or deemed to be received, as the case may be, by way of demurrage charges or handling charges or any other amount of similar nature.]”*

1. Treatment of Tax Credit:

An important issue for tax payers is treatment of tax credit. Many companies, those who are functioning or operating in more than 1 country are generally subjected to the income tax scenario of the producing company**.** Thus, there are higher chances that in the absence of a good enough taxation regime in the producing country the concerned company will be subject to higher amount of tax payment in the home country. Some

specialized mineral taxes may be deemed to differ in nature from a standard corporate tax and, therefore, could face difficulties in qualifying for a tax credit.[72]

2. The treatment of various items is left to interpretation of the PSC:

The production sharing contract lays down the provisions regarding tax treatment of certain items in oil and gas operations**.** all these treatments are supposed to be read with the provisions enshrined in Income Tax Act, 1961 but sometimes in certain cases controversy arises due to lack of reference in the Act. Sometimes production sharing contract itself become complex and difficulty arises in determining allowable cost.

3. No specific income tax regime for taxation of EPC contracts:

This indicates that it is essential to undertake adequate planning to face tax risks effectively.

4. 'Farm-in' transaction:

Farm-in' is an exchange in which a homestead in gathering gets an interest in an agreement from the other party known as ranch out gathering or existing gathering to the agreement in lieu of a thought which may be installment of a part or the ranch out party's whole impart of expenses relating to the agreement. Homestead in exchanges are totally distinctive to Exploration and Production as Oil is existed in the where it counts of a specific country or nation in this way fall under the locale of that nation and accordingly, property of that specific nation. Along these lines 'ranch in' is an exchange wherein the homestead in organization gets an offer in licenses and rights subsequently which are originally allowed to the organization farming out of a square.

---

[72] Hemali Deepak Thakkar, *Oil and Gas Sector: Industry Overview and Taxation Provisions, available at* http://www.caalley.com/art/art11_0825.html.

The industry has put in a few endeavors to look for illumination on the duty treatment of ranch in expenses. Nonetheless, there is very little direction accessible, causing to lead towards a debate between the industry and the assessment division. The income powers don't permit the case of the ranch in expenses either as income consumption or as devaluation. The income powers dismiss the case of homestead in expenses as income consumption under Section 37 on the ground that the said segment of the Income Tax Act is not appropriate to E&P organizations to claim the reasoning of use. Additionally, the income powers don't acknowledge the case under Section 42 by contending that the investigation costs are really to be incurred by the homestead out gathering. While disallowing the case of devaluation, the income powers don't consider that the investigation rights allowed by the Government are in the way of permit, and that the same ought to be perceived as an intangible resource qualified for deterioration under area 32 of the Act. Taxability of homestead in/ranch out exchanges require fitting thoughtfulness regarding guarantee evasion of further assessment issues of any kind.

It is additionally essential to note that according to the procurements of the Production Sharing Contracts (PSCs) marked by the Government with the different oil investigation organizations, the whole consumption incurred on drilling and investigation exercises is to be borne by the oil investigation organization. In the occasion the endeavors of the oil investigation organization are unsuccessful, the whole use would be a misfortune incurred by the said organization. Be that as it may, if the oil investigation organization strikes oil in the investigation obstruct, a certain part of the benefits earned by the oil investigation organization from the generation and offer of the oil from the square must be imparted to the Government. This would be a win-win circumstance for the Government since it won't just prompt a superior abuse of the unfathomable unexplored capability of our exploratory basins; yet will likewise give extra incomes to the Government in the type of offer of benefits from the oil stores found in these pieces. In such a case, the procurement ought to make the

endeavor qualified to claim a higher weighted reasoning of the real costs incurred in appreciation of drilling and investigation exercises.

11. Depletion allowance:

The depletion allowance is similar to the depreciation allowance afforded other firms for their investments. However, there are substantial differences. One is that it is difficult to estimate what proportion of a mineral deposit has been exhausted. Another is that the value of the deposit is often substantially larger than the amount invested. The search for a deposit entails.

CONCLUSION

The oil and gas segment in India is sufficiently produced and it is normal that in the following 15-20 years its commitment to India's vitality division will be incredible. A preservationist appraisal of 7 every penny development in the Indian economy is required to pretty nearly twofold India's every capita vitality utilization through the following 20 years . Oil and Gas area in India is the key gadget/supporter to Indian GDP as it satisfy a critical interest of the nation and vitality request and financial development are quite often interlinked

To remain with the increment popular, the administration has permitted 100 every penny Foreign Direct Investment in the division and empowered some substantial associations, for example, in the middle of BP and Reliance Industries (US$ 7.2 billion arrangement). So as to support private division interest help the improvement of the part so as to build up the financial situation of the nation, the legislature presents approaches, for example, the New Exploration and Licensing Policy.The cooperation of the private segment will bring more money related and innovative assets to the area, which will help the area in its development.

In worldwide oil industry, monetary terms acknowledged by a nation mirrors its arranging quality and experience of the nation, geographical prospects, and the reputation of its past oil ventures. All these elements specifically impact the extent of the income accumulation of the administration.

With wide scope of instruments accessible in the segment, we can say that Indian arrangement creators have outlined a financial administration for oil area that draw in ventures and additionally secure sensible income for the legislature. In spite of these capabilities, there is pressing need to blueprint some alluring highlights to focus in the

financial administration for the Indian petroleum division from the point of view of multinational oil organizations.