

India Union Budget 2006

Implications on Oil & Gas Industry



Senior Management Meet on
'2006 Union Budget Analysis for Oil & Gas Industry'

organised by



Petroleum Federation of India



“India Union Budget 2006 – Implications on Oil & Gas Industry” has been prepared by Oil & Gas Tax Group of PricewaterhouseCoopers Pvt. Ltd., a specialty practice established to serve the unique tax requirements of the oil & gas industry. This publication provides broad view of implications of India Union Budget 2006 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 would strongly recommend readers to seek professional advice before making any decisions.

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Section 1

India Union Budget 2006 - Perspectives

The Union Budget for 2006-07 makes effective use of the macro-economic scenario to find a reasonable balance between enhanced resource commitments to infrastructure and social sector programmes, indirect tax reforms and fiscal consolidation. There is nothing in the budget that will hinder or disturb the current high growth - low inflation configuration and many things that will contribute to sustaining it.

The finance minister has used the healthy micro-economic environment that provides for ambitious revenue targets. Tax reforms have been made and excise duty has been reasonably brought down. Budget has been committed to social sector programmes, and it has been now intended to be more centralised and coordinated. On this aspect, Budget has moved from a project approach to a mission approach.

A couple of factors, though, do reflect negatively on an otherwise very good budget. One, the opportunity to rationalise the duty structure on petroleum products and, in the process, reduce some of the current burden on petroleum companies was not fully exploited. This, of course, could be said

about subsidies in general, but that is a larger issue. Second, while the macro-economic assumptions underlying the budget look quite realistic, there appear to be some imbalances in the revenue targets set for next year.

It has been suggested in certain quarters that drafting up Budget wish-lists is a futile exercise, although one that causes only slight inconvenience, involving, as it does, little more than dusting down last year's and changing the date. Significant measures were expected from this year's budget to help petroleum industry to and on reflection none of them have been met. True to form, there were no surprises, with a continuing emphasis on fiscal and budgetary discipline even though the Budget was made against a backdrop of unprecedented macroeconomic health and stability.

In the past, we have compared Finance Minister to being at a crossroads, needing to choose between a path of traditional reliance on tax revenues and economic growth, and more radical measures. Finance Minister still tarries at the crossroads.

Section 2

Economic Survey 2005-2006 - Comments on Oil & Gas Industry

The Government of India released Economic Survey 2005-06 on the February 27, 2006. The following paragraphs analyse and put in perspective the oil & gas sector related comments in the Survey.

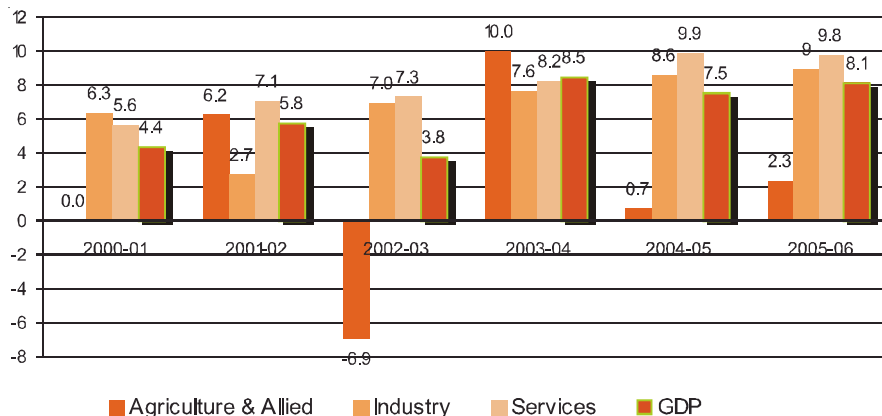
Overview of Growth

Economic Survey 2005-06 considers the current growth of Indian economy as a demonstration of nascent strengths after growing at 8.5 per cent and 7.5 per cent in

the two previous years and places the outlook of the Government of GDP growth in the year 2005-06 at 8.1 per cent at constant prices.

On a positive note, the Survey observes that GDP at constant prices in excess of 8.0 per cent has been achieved by the economy in only five years of recorded history, and two out of these five are in the last three years. The robust growth in the GDP of the country has been achieved as a result of industrial growth, modest inflation despite spiralling

Sectoral Real Growth Rates in GDP (at factor cost)



Note : Figures represent percentage change over previous year.
Source: Economic Survey 2005-06

crude oil prices. Increase in investments, growth in exports and imports, development of infrastructure and fiscal consolidation.

According to the national income data released by the Central Statistical Organisation (CSO) on February 7, 2006, the advance estimate (AE) for growth of GDP at factor cost at constant (1999-2000) prices in 2005-06 at 8.1 per cent was up 0.6 percentage points over the 7.5 per cent growth recorded in 2004-05. The CSO has changed the base year for calculation of national income aggregates at constant prices from 1993-94 to 1999-2000. The revised growth rate with base 1999-2000 is the same as or less than the rate with base 1993-94 for each of the four earlier years ending in 2003-04.

In contrast to the sharp fluctuations in agriculture, industry and services have continued to expand steadily. The Survey notes that since the beginning of the Tenth Plan in 2002-03, with annual growth of 7.0 per cent or more, industry and services have acted as the twin engines propelling overall growth of the economy. Over a somewhat longer horizon, in the six years between 2000-01 and 2005-06 (AE), on average, services with a share of 52.0 per cent of GDP, contributed 65.0 per cent of GDP growth, and increased its share in GDP from 49.8 per cent to 54.1 per cent.

The survey acknowledges that speedy provision of quality infrastructure through appropriate policy stimulus constitutes the first and foremost component of the challenge of positioning the economy on a sustained high-growth trajectory. India's growth prospects are intricately intertwined with the rapid development of physical infrastructure such as power, roads, ports, and airports, and efficient delivery of such services.

Highlights of Oil & Gas Industry

The survey recollects that, with the declared intention of moving towards market-determined pricing for petroleum products, the Government announced the dismantling of the APM with effect from April 1, 2002. For kerosene and LPG, being items of mass consumption, it was decided that subsidies on these will continue on specified flat rate basis. Accordingly, as per the "PDS Kerosene and Domestic LPG Subsidy Scheme, 2002", a flat rate of subsidy per selling unit was approved to be given to public sector Oil Marketing Companies (OMCs). The subsidy was equal to the difference between the cost price and the issue price per selling unit as on March 31, 2002, and was to be phased out in three to five years. The OMCs were to adjust the retail selling prices (RSP) of these products in line with international prices during this period.

There was sharp increase in international oil prices from late 2003, combined with considerable week-to-week and even day-to-day volatility. Notwithstanding the consequent steep rise in international prices of sensitive petroleum products, oil marketing companies moderated the price increase in petrol and diesel besides maintaining the prices of already subsidized products like domestic LPG and PDS kerosene. Consequently, the OMCs suffered underrecoveries on sale of petrol and diesel. However, as the under recoveries of the OMCs were reaching untenable proportions, in October 2003, Government decided that the OMCs would make up about a third of their under-recoveries on these two products from the surpluses in petrol and diesel, and the balance would be equally shared by the upstream companies and the OMCs. In spite of this subsidy-sharing mechanism, and discounts given by

the refineries to OMCs, the burden of under recoveries continues to rise steeply. The estimated under-recoveries more than doubled from Rs. 9,274 crore in 2003-04 to Rs.20,146 crore in 2004-05, and continue to rise.

The Survey states that the spiraling international petroleum prices not only create a pressure on budgetary resources directly and indirectly through losses of oil PSUs, but also have a debilitating effect on the performance of the industrial sector as a whole. Petroleum is a universal intermediate product. In response to the rising international prices of petroleum products, Government raised the prices of petrol and diesel per litre by a moderate Rs. 2.50 and Rs. 2.00, respectively, with effect from June 21, 2005. As the increase continued to persist, Government was forced to increase the prices of petrol and diesel further by Rs. 3 and Rs. 2 per litre, respectively, with effect from September 7, 2005. The prices of domestic LPG and PDS kerosene were, however, left unchanged. The total subsidy as on Jan., 2006 calculated at international prices for 2005-06 per cylinder of domestic LPG of 14.2 kg and per litre of PDS Kerosene, was estimated at Rs. 170.32 and Rs. 12.96 respectively. In order to compensate the public sector OMCs on account of their mounting under-recoveries, over and above the amount allowed as direct subsidy, budget for 2005-06 provides an additional Rs. 5,750 crore for 'oil bonds'.

The Survey in brief explains the progress made in India on the LNG front and concludes the brief stating that, in June 2005, Sale Purchase Agreement (SPA) for import of 5 MMTPA of LNG from Iran was signed between GAIL/IOC/BPCL and National Iranian Gas Export Co. Ltd. (NIGEC) and

Oil price and global economic prospects

Crude oil prices remain a key input in determination of global economic prospects. A rise in crude oil prices affects the global economy through a variety of channels.

- An initial fall in aggregate demand owing to a transfer of income from oil consumers to oil producers, who tend to have a lower propensity to consume than the former.
- A supply-side effect reflecting higher production costs and lower profit margins.

However, with falling oil intensity over the past three decades, especially in industrial countries, this effect has been weaker.

- A rise in inflation resulting from higher production costs, depending on the response of monetary policy and the extent to which consumers and producers can offset the declines in incomes and profits, respectively.
- A potential impact on activity through lower consumer and investor confidence and reduced willingness to commit to longer-term capital projects.
- A lasting impact on energy demand and supply over time, depending on the duration and extent of price increases.

Source: Economic Survey 2005-06

imports are likely to start by the end of 2009.

With the expected increase in gas availability from various domestic sources and imported LNG, the Survey highlights need for commensurate increase in gas pipeline infrastructure. It states that a gas pipeline policy, envisaging authorization from Government/regulator for all gas transmission pipelines is being worked out and that the Government is in the process of setting up the Petroleum and Natural Gas Regulatory Board which, among other things, will formulate and regulate the pricing mechanism and ensure competitive structure of this sector.

Inflation and Effect of Oil Prices

Inflation, in most parts of the world, showed a rising tendency on account of rising global crude oil prices. The sharp and spiraling increase in international oil prices from late 2003, combined with considerable week-to-week and even day-to-day volatility, posed considerable challenge in the maintenance of macroeconomic stability. Average headline world price of Indian basket of crude petroleum increased by 44.5 per cent, from \$US 37.3 per barrel in April-November 2004 to US\$ 53.9 per barrel in April-November 2005, and was US\$ 58.10 per barrel on February 13, 2005. Nevertheless, the virtuous expansion in the current phase of economic upturn has been maintained without an undue escalation of domestic prices. In India, inflation, measured by a point-to-point increase in the Wholesale Price Index (WPI) declined from 5.7 per cent on April 2, 2005, to a low of 3.3 per cent on August 27, 2005. Despite increasing thereafter, prices have remained at comfortable levels with the WPI inflation at 4.1 per cent on February 4, 2006 vis-à-vis 5.0 per cent on February 5, 2005.

As on February 4, 2006, the fuel group, with an inflation rate of 7.6 per cent, contributed 40.5 per cent to the overall inflation, which was marginally lower than 42.8 per cent a year ago. Much of the inflation in the fuel group is attributable to the 'pass through' effected in June and September 2005, in the form of enhanced retail prices of petrol and diesel, precipitated by the flare-up in global oil prices. While retail prices of kerosene canalised through the public distribution system (PDS), and domestic LPG were kept unchanged for softening the burden on consumers, the incomplete pass through, however, entailed adverse implications both for the finances of domestic oil marketing companies and for the exchequer because of the issue of 'oil bonds' to such companies.

Petroleum Trade

Growth in India's merchandise imports in 2004-05 at 40 per cent in dollar terms was the highest since 1980-81. This surge in growth in 2004-05 was mainly due to the steep rise in price of crude petroleum and other commodities with value of POL imports increasing by 45.1 per cent. While volume growth in import of POL was subdued at 6.4 per cent, largely in response to the price increase, larger imports filled the gap between growing demand and stagnant domestic crude oil production.

Unlike in 2003-04, the surge in POL imports in 2004-05 and 2005-06 (April- November) was dominated by the price impact. The stiffening of global crude oil prices was contributed by a combination of heightened demand, limited spare capacity and geopolitical threats to the existing capacity. Crude oil prices have since moderated and was ruling at US\$ 60.76 per barrel as on February 9, 2006. The surge in crude oil prices has

sharpened the focus on the adverse impact of such volatility on domestic prices and the need to minimize such impact. Given India's relatively high oil intensity and increasing dependence on imported crude oil, efforts are being made to diversify sourcing of such imports away from the geopolitically sensitive regions. Another development has been the decision to build up strategic oil reserves, equivalent of about 15 days requirement, to minimize the impact of crude price volatility in the short term. In a related initiative, India is coordinating with large oil importing countries in Asia, in exploring possibilities for evolving an Asian products market, in place of an Asian premium, which would reduce the premium paid by Asian countries and thus, to some extent help in controlling the country's oil import bill.

The most notable feature was the 91 per cent growth in exports of petroleum products, with a perceptible increase in its share in total exports. It reflected not only the rise in POL prices, but also India's enhanced refining capacity developed with a supportive tariff structure

Petroleum Products' Pricing

In the context of public finance, appropriate pricing of petroleum products assumes significance, particularly with the petroleum marketing sector dominated by public sector oil companies. The movement towards market-determined pricing in hydrocarbon sector has floundered pending the resolution of the issue of subsidy in domestic LPG and PDS kerosene. Kerosene prices have

remained unchanged since April 1, 2002 despite the unprecedented increase in acquisition cost of crude and costs of refining.

Customs and excise on petroleum products constitute about 40 per cent of the total customs/excise collections of the Government. With an equally high sales tax, ranging from 12 per cent to 38 per cent, the tax component of the retail price of petrol and high speed diesel remains high. This has been further compounded by the duty differential across products, including on the basis of end-use, leading to problems of fuel switching and other malpractices. The issue of harmonising state levies on petroleum products is being deliberated by the Empowered Committee of State Finance Ministers on VAT. A Committee on pricing and taxation of petroleum products headed by Dr. C. Rangarajan has recently submitted its recommendations for a new mechanism of pricing that promotes efficiency of the hydrocarbon sector on the one hand, and the concerns of maintaining affordability in prices of cooking fuel for the consumers on the other.

With medium-term prospects of crude prices remaining high, the continuance of incomplete pass-through is not sustainable without serious consequences to the financial health of oil companies and the exchequer. Besides, the perverse incentives for fuel switching and distortions arising from differential tax rates need to be addressed. The management of the lingering oil crisis requires rapid and bold policy responses with a firm resolve.

High and volatile international petroleum prices impart an element of uncertainty in the inflation outlook not only for India but also the world economy. With increasing dependence on imported crude and growing openness, India is no longer insulated from the rest of the world in price developments. This inflation uncertainty, together with the unresolved global macroeconomic imbalances, casts its shadow on the interest rate scenario.

Energy Regulator

Policies and institutions need to be geared up to meet the specific requirements of the infrastructure sectors in India. A well-defined regulatory architecture has to be in place, to increase the comfort level of the different players in the market. Issues of span of control and conflicting domains need to be delineated and fleshed out. For example, an energy regulator, cutting across line ministries, needs to be in harness to tap the synergy of the different sectors.



Section 3

Analysis of Union Budget 2006 - Implications on Oil & Gas Sector

Direct Tax Implications

Corporate tax

- Corporate tax rate for domestic and foreign companies has been left unchanged at 33.66 per cent and 41.82 per cent respectively.
- Minimum alternate tax is proposed to be raised from 8.42 per cent to 11.22 per cent in case of domestic company and 7.85 per cent to 10.46 per cent in case of foreign company. Now MAT applicable, if tax payable is less than 10 per cent of book profits as against 7.5 per cent earlier.
- Tax paid under MAT regime is now allowed to be carried forward for seven years as against 5 years earlier.
- MAT is now payable on long term capital gain earned on sale of listed shares and units of Mutual Fund.
- For determining MAT, depreciation on revalued portion of asset would not be deductible.
- There has been an increase in Security Transaction Taxes by 25 per cent.
- Time limit for setting up a power generation and/or distribution undertaking, in order to claim tax holiday, has been extended from March 31, 2006 to March 31, 2010. This extension is beneficial to oil and Gas company, which are planning to set up independent captive power generation units.
- Time limit for setting up an industrial park in order to claim tax holiday has been extended from March 31, 2006 to March 31, 2009.
- Exemption for aircraft lease rentals under section 10(15A) extended for agreements signed up to March 31, 2007. This would benefit companies providing services of helicopters/ aircraft to the E&P sector.
- Now oil and gas companies need to file return by October 31 in order to be eligible to claim tax holiday under section 10B for export, 80-IA for generation of power, 80-IAB for SEZ, 80-IB for E&P and refining activities and 80-IC for oil companies based in Northeast region.
- If taxes paid in foreign country are eligible for credit in India, then it would not be tax deductible in determining the taxable income.
- Conversion of interest payable into loan will not be treated as actual payment of interest and thus not eligible for deduction.

- Disallowance for expense incurred to earn income exempt from tax, will now be determined as per the prescribed method.
- Contribution by employer to a superannuation fund up to INR 1,00,000 per employee will not be subject to FBT.
- Any expense by way of payment to a person of repute for promoting sale of goods/services shall not be chargeable to FBT.
- Pick up and drop facility provided to the employees shall not be subject to FBT.
- 5 per cent of expenses on tour and travel (including foreign travel) will now be considered as Fringe Benefit as against 20 per cent earlier.
- Tax paid in foreign country and MAT credit will now go to reduce tax liability for determining interest for delay in filing of tax return and default in payment of advance tax.
- Interest for not deducting tax or for delay in deposit thereof to be paid before furnishing of the quarterly withholding tax return.
- Penalty for default in collecting Tax - up to amount failed to be collected
- Penalty for false quoting of TAN to be Rs.10,000.
- The time limit for completing assessment has been reduced from 24 months to 21 months from the end of the relevant assessment year. Thus assessment would need to be made by 31st December instead of 31st March.
- Annual filing of TDS and TCS returns have been done away with.
- Present TDS regime of issuance of withholding tax certificate i.e. Form 16 and Form 16A to continue till financial year 2007-08.
- Tax officer may, having regard to the nature of the transactions, suo moto allot a permanent account number to any person, irrespective of whether or not the person is liable to pay income tax.

Personal Income tax

- Tax rates remain unchanged
- Investment for 5 year or more in FDRs with scheduled banks eligible for Sec 80C deduction
- Cap on pension funds premium for deduction u/s 80CCC increased from Rs. 10,000 to Rs. 100,000. Aggregate cap on 80C and 80CC continue at Rs. 100,000.
- 1/6 scheme of filing the tax returns abolished

Indirect tax implications

General

- Proposal to introduce GST w.e.f. April 1, 2010.
- CENVAT and Service Tax to converge at 16 per cent.
- End use exemptions to be removed in due course. Notifications to be made available for public debate on the Ministry website shortly.
- E-payments of Excise and Customs Duty to be introduced.
- Departments of Customs and Central Excise to undergo Business Process Re-engineering.
- Introduction of risk management system and electronic data interchange in the Customs Department.
- Advance Rulings extended to determination of taxability under excise/ service tax laws.

Customs Duty

- Median rate of basic customs duty reduced from 15 per cent to 12.5 per cent
- Basic customs duty rates of petroleum products have been reduced. The revised duty rates are as under:

Product	Pre-Budget	Post-Budget
Naphtha	10%	5%
Petroleum coke	10%	5%
Goods falling under Heading 27.10, 27.12, 27.13 and 27.15	15%	10%
Catalysts	10%	7.5%

- ACD of 4% introduced across the board on most imports. However, petroleum crude, kerosene for PDS, LPG for domestic household consumers, petrol, diesel, coal, coke and petroleum gases and fuels falling under Chapter 27 of the CTA have all been exempted from the ACD of 4%.
- Pipeline projects for transportation of crude oil, petroleum products and natural gas have been notified as Project Imports under Heading 98.01 of the CTA.

CENVAT

Status on petroleum products:

Product	Pre-Budget	Post-Budget
Crude Oil	Cess at the rate of Rs 1800 per tonne under the OIDA	Cess at the rate of Rs 2500 per tonne under the OIDA
	NCCD at the rate of Rs 50 per tonne	NCCD at the rate of Rs 50 per tonne

Product	Pre-Budget			Post-Budget	
	BED	SED	AED Rs./ltr	SAED Rs./ltr	
Petrol	8% + Rs. 5 per Ltr	NIL	2.00	6.00	No change
High Speed Diesel	8% + Rs.1.25 per ltr	-	2.00	-	No change
Light Diesel Oil	16% + Rs. 2.50 per ltr	-	-	-	No change
Kerosene (PDS)	NIL	-	-	-	No change
LPG (Domestic)	NIL	-	-	-	No change

Service Tax

- Service tax rate increased from 10 per cent to 12 per cent.
- Service tax inter alia extended to the following new services:
 - Transport of goods in container through rail;
 - Ship management services;
 - Public relations services;
 - Business support services;
 - Sponsorship services
- Scope of the following services has been expanded:
 - Management consultancy to specifically include consultancy in different areas of management;
 - Erection, commissioning or installation service, to include erection, commissioning or installation of structures, whether or not pre-fabricated;
 - Consulting engineer service, to include engineering consultancy services provided by any firm or body corporate;

-
- Exemption from service tax in relation to general insurance for business where premium is booked outside India has been withdrawn.
 - Exemption from service tax granted on financial leasing services, including equipment leasing and hire-purchase, on 90% of the amount representing interest i.e. the difference between the aggregate of the installments payable over the lease tenure and the principal amount.
 - Exemption from service tax has been extended to all taxable services provided by Reserve Bank of India.
 - Section 66A to levy service tax under reverse charge method on taxable services provided from outside India to a recipient in India.
 - New section 67 introduced to provide for determination of the value of taxable services- mechanism for determination of non monetary consideration, including book adjustments, to be laid down.

Central Sales Tax

- Empowered Committee of State Finance Ministers and the Central Government to reach a consensus on phase out of CST
- LPG for domestic use to be notified as declared goods and hence chargeable to Value Added Tax at a maximum of 4%.

Score Sheet -Industry expectation's realization in Budget 2006

Direct Taxes

E&P companies to choose period of seven years of tax holiday	No
Deduction for infructuous or abortive exploration expenses u/s 42	No
Introduction of specific provisions in the Income Tax Act regarding 'Farm-in costs'	No
Allowance of deduction to E&P companies for Site Restoration Fund	No
Infrastructure Status to E&P under Section 80IA	No
Grant of infrastructure status to cross country pipelines for crude/ gas / petroleum products and LNG re-gasification terminals	No
Extending depreciation benefits available to pollution control equipment to capital investments made by refineries for producing fuels with stringent emission norms	No
Depreciation on LPG Cylinders	No
Recognise discounts given by PSU upstream companies to PSU downstream refiners/marketing companies	No

Indirect Taxes

Concessional rates of customs duty on goods required for oil and gas projects	Yes, Pipeline projects included in the category of Project Imports
Declared Goods status to Natural Gas under the Central Sales Tax Act, 1956	No
Reintroduction of irrecoverable taxes compensation scheme to cover under recoveries of CST, octroi, entry tax etc.	No
Excise duty on crude oil and petroleum products to be made specific or based on tariff values	No
Withdrawal of National Calamity Contingent Duty on Crude Oil	No
Withdrawal of end-used based exemptions applicable to Industrial Units	No
Captive consumption benefit for LSHS/ Fuel Oil etc used as Fuel Oil	No
Removal of anomaly in classification of lubricating oils	No
Exemption to services provided to Oil & Gas exploration sector	No
Exemption from payment of service tax on LPG (Domestic) and SKO (PDS) operations	No

Section 4

Pre-Budget Expectations by Oil & Gas Industry

Direct Tax

Upstream

E&P companies to be allowed to choose period of seven years of tax holiday

Tax holiday u/s 80-IB(9) is available to E&P companies for seven consecutive assessment years starting from the year in which commercial production commences. During these initial seven years, companies have large expenditure to set off and hence actual benefit of tax holiday may not flow to them. It was expected that E&P companies would be allowed to choose a period of seven years tax holiday from initial fifteen years.

Deduction for infructuous or abortive exploration expenses u/s 42

Under section 42 of the Income Tax Act, the deduction for infructuous or abortive exploration expenses is not allowed till the surrender of the area, though the same is required to be charged off in the books of accounts as per accounting practices. As a result, oil companies are unable to avail deduction of expenses incurred on abortive exploration in the year when expenditure was incurred. It was expected that the condition of 'surrender' of area is deleted from Section 42(1)(a).

Introduction of specific provisions in the Income Tax Act regarding 'Farm-in costs'

Long standing demand of the E&P sector is introduction of specific provisions in the Income-Tax Act regarding treatment of 'Farm-in costs'. Tax treatment of such payments remain unclear and gives rise to dispute between the industry and the tax department. It discourages acquisitions in E&P sector since the magnitudes of tax costs are high and can result into transactions proposals becoming uneconomical. 'Farm-in' is a transaction unique to the E&P sector and thus it was expected that specific provisions be introduced for 'Farm-in' costs.

Allowance of deduction to E&P companies for Site Restoration Expenses

E&P companies are allowed deduction in respect of Site Restoration expenses under section 33ABA, only if the amount is deposited in a special bank account opened for this purpose. The same results in unnecessary blocking up of funds, which may otherwise be mobilized by the industry for drilling operations in India. The companies in E&P sector as well as financial services market have matured and present more efficient alternatives to ensure adequate provisions

and accumulation for meeting abandonment cost without having to deposit in specified sinking fund. It was therefore expected that the requirement of deposit of funds in Site Restoration Scheme is done away with and the deduction allowed to E&P companies for provision of site restoration/abandonment expenses made on scientific basis.

Infrastructure Status to E&P under Section 80IA

Investors in industrial undertakings in sectors like power, telecommunication, roads, ports, etc. and other infrastructure facilities have been granted tax benefits under the provisions of Section 10(23G). These benefits are mainly in the form of exemptions from income-tax on investment income from infrastructure sector. Petroleum Industry is not covered under the definition of "Infrastructure Facility". Grant of infrastructure status to E&P industry has been a long outstanding demand, for the role it can play in attracting investors to this capital intensive industry.

Midstream

Grant of infrastructure status to cross country pipelines for crude/ gas / petroleum products and LNG re-gasification terminals

The need for an optimal system of petroleum product transportation is being felt over the years. Therefore, creation of infrastructure like LNG regassification terminal and network of pipelines is critical to growth of industry as well as the country's economic growth. Pipelines have several distinct advantages over other modes of transport in terms of safety, eco friendliness, transportation losses etc. It was, therefore, expected that pipelines is also classified as 'infrastruc-

ture facility' and granted the benefit of tax holiday under section 80-IA and under Section 10(23G).

Downstream

Extending depreciation benefits available to pollution control equipment to capital investments made by refineries for producing fuels with stringent emission norms

Refineries are making substantial capital investments for producing fuels with stringent emission standards in order to reduce pollution. It was expected that such capital investment, being pollution control measure, be treated at par with depreciation benefits available to other pollution control equipments.

Depreciation on LPG Cylinders

Depreciation on LPG cylinders has been consecutively reduced from 100% to 80% to 60% in the earlier budgets. Reducing depreciation rate only indirectly increases their burden, particularly when 100% depreciation has been allowed for several years without any restriction. It is suggested that 100% depreciation may be restored.

For all activities

Recognize discounts given by PSU upstream companies i.e. ONGC, OIL and GAIL to PSU downstream refiners/marketing companies as their contribution under burden sharing mechanism instituted by the Government, under income tax and should be allowed as deduction.

Indirect Tax

Customs Duty

Correction of the inverted duty structures in the petroleum industry

At present the customs duty on crude oil is 5 per cent while the customs duty on petroleum products such as Superior Kerosene Oil (SKO), Naphtha for fertilizer use and for Liquefied Petroleum Gas (LPG) is "Nil". The inverted duty structure leads to a higher tax on intermediaries as compared to the finished product and also results in a negative tariff differential. The expectation from the budget was, therefore, a reduction in the customs duty leviable on crude oil from 5 per cent to Nil and rationalization of the duties on the other products.

Concessional rates of customs duty on goods required for oil and gas projects such as

New Refineries/Refinery Expansions and Green Fuel Projects mandated under 'Auto Fuel Policy', product and gas pipelines, environmental/ pollution control projects, developing CNG/ auto LPG infrastructure and pilot projects for producing hydrogen/ GTL: A reduction in the customs duty on materials required to build hydrocarbon infrastructure would help in improving rate of returns and therefore, will put the projects on fast track. At the same time, a reduction in the customs duty on capital goods would reduce the project cost while increasing the overall productivity in the sector. The budget was, therefore, expected to address the above issue by providing concessional rates of customs duty on goods and material required for oil & gas projects.

Excise Duty

Excise duty on crude oil and petroleum products to be made specific or based on tariff values

In order to avoid unnecessary litigation it was, therefore, expected that the excise duty on petroleum products be made either specific or based on tariff values. This move would serve to cushion the consumers from any volatility in the global market and also prove to be a revenue neutral measure as far as the exchequer is concerned.

Withdrawal of National Calamity Contingent Duty

National Calamity Contingent Duty (NCCD) of excise @ of Rs.50 per metric tonne on indigenous crude oil and simultaneously an additional duty of customs @ Rs.50 per metric tone on imported crude oil was introduced w.e.f. 1.3.2003. This duty was to be valid for one year i.e. up to 29.2.2004 so as to replenish the national calamity contingent fund but has been retained for 2 years increasing input costs of refineries and reducing overall refinery protection. It was expected that, the duty may be discontinued effective 1.3.2006. In the alternative, Cenvat credit may be allowed against payment of excise duty on finished petroleum products manufactured from crude.

Withdrawal of end-used based exemptions applicable to Industrial Units

Petroleum products supplied for specific end uses are eligible for full exemption from duty e.g. Naphtha for fertilizer and LSHS for generation of electricity, products supplied for on-board consumption for Indian Navy Vessels 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 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; 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 cannot be effected from the refineries, due to logistic & infrastructural problems. It was expected that the Budget would simplify the process by issuing the notification exempting the goods based on end-use be withdrawn instead the beneficiaries be given duty subsidy by the Government.

Captive consumption benefit for LSHS/ Fuel Oil etc used as Fuel Oil

Inputs procured from outside the refinery on payment of duty, when used as fuel in the refinery, qualify for Cenvat credit notwithstanding that part of the finished product is cleared under exemption. However, the refineries are denied the benefit of such Cenvat credit on products manufactured within the refinery and captively used as fuel. It was, therefore, expected that exemption should be provided to inputs manufactured in the refinery and used captively as fuel within the same refinery for manufacture of finished products which are cleared under exemption.

Classification of lubricating oils

An anomaly exists in the classification of lubricating oils under the Central Excise Act. This anomaly needs to be removed to avail of the reduction for the goods under MRP based assessment as per Notification No. 13/2002 - CE (NT) dated March 1, 2002 issued under Section 4A of the Central Excise Act, 1944.

Service Tax

Exemption to services provided to Oil & Gas exploration sector

Ambiguity exists on applicability of service tax in view of particular wordings of the relevant definitions of 'site formation and clearance, excavation and earth moving and demolition services'. Difficulties are apprehended at the field level, significant costs are incurred by the E&P Sector in carrying out these activities and disputes between service recipients, service providers are significantly increasing and service costs to E&P companies are growing. While Government's intention not to burden the cost of Oil & Gas E&P Projects with Customs, Excise and other duties has been partially implemented by issuing appropriate exemption notifications under Customs and Excise laws, corresponding exemption notification, exempting services rendered to exploration and production activities from levy of service tax has still not been made. It has been a long standing request of Oil & Gas exploration industry to extend the benefit of exemption from service tax on services used in exploration and production activity.

Exempt payment of Service Tax on LPG (Domestic) and SKO (PDS) operations

As the oil marketing companies have been incurring under-recoveries in the last fiscal, the problem has been compounded with the applicability of service tax. Service Tax is currently leviable on the activities of LPG/SKO business viz. Packaging Services, transport of goods through pipeline, transport of LPG/SKO via Road and storage and warehousing Charges. Keeping with the policy of nil taxation on subsidised products, it was suggested that the above activities are exempted from service tax.

Central Sales Tax

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

Natural Gas and regassified LNG have emerged as important sources of energy for various industries like power, fertilizers etc. Post introduction of VAT effective April 2005, natural gas has been classified under revenue neutral rate of 12.5%. Some states have kept natural gas out of VAT and are levying sales tax at the rate of 20%. In the case, natural gas is transferred after purchase on inter-state basis, full tax credit is not available. Since natural gas is a key input, due to this high and multiple point sales tax structure, the consumers are adversely affected particularly in the fertilizer and power sectors. Suitable relief in sales tax will not only ensure that cost of gas to the end consumer is kept low but will also facilitate development of a National Gas Grid in the country. This provision stipulates that sales tax on these declared goods cannot be more than 4%. In order to provide a level playing field amongst different primary energy sources, natural gas including re-gasified

LNG should be declared as 'goods of special importance in Inter-State trade or commerce' u/s 14 of the Central Sales Tax Act.

Reintroduction of irrecoverable taxes compensation's scheme to cover under recoveries of CST, octroi, entry tax etc.

Refineries as well as Oil Marketing Companies selling petroleum products on interstate basis to other Oil Companies are not able to recover Central Sales Tax for inter-state sales. This is because prices of petroleum products such as MS, HSD, SKO and LPG are fixed and hence CST cannot be passed on by Oil Marketing Companies to the consumers of the consuming states. This results in a huge under-recovery to stand-alone refineries as well as to composite oil companies. Even in the context of implementation of Value Added Tax (VAT), there is uncertainty on abolition of CST on petroleum products, as major petroleum products are kept outside VAT.

Value Added Tax

Applicability of VAT to Petroleum products

Petroleum products have been excluded by most of the States from levy of VAT, Sales tax and VAT rates are very high and vary based on end use, further rates are also not uniform across the States. This leads to high tax rates which are an impediment to orderly growth and input tax credits not granted. It has created ambiguous and non-uniform sales tax regime which results in increased transaction costs. It was expected that Budget will provide roadmap for applicability of classical VAT across the value chain for all petroleum products and will reduce the rates of tax to a maximum of 20%, as per the VAT Scheme. This will allow real economic value of fuels to be reflected in their prices.

Section 5

Recent Significant Policy Changes and Initiatives for Oil & Gas Industry

Sixth Round of New Exploration Licensing Policy (NELP VI)

Government of India (GoI) has invited offers for 55 blocks comprising of 24 deepwater, 6 shallow-water and 25 onland blocks covering a sedimentary area of about 3.55 lakh sq km under NELP VI on February 24, 2006. GoI has made changes to the terms of earlier NELP rounds, based on consultations with various stakeholders including E&P companies and industry bodies, significant among which are:

1. Blocks have been categorized on the basis of geological perceptions and bid evaluation criteria customized accordingly
2. To discourage speculative bidding on the basis of aggressive work programs, more emphasis has been placed on the fiscal parameters
3. Weightage has been given to technical capability of designated operator only unlike that of consortia in earlier round.
4. The relinquishment norms have been simplified and the exploration program is now divided into two phases rather than earlier three phases.

Policy on Gas Pricing

Prior to 1987, gas prices were fixed by ONGC/OIL. The price is being fixed by Government w.e.f. 30.1.1987. The price of APM gas of ONGC and OIL was last revised effective 1.7.2005. The salient features of the revised pricing order effective 1.7.2005 are as follows:

1. ONGC and OIL produced about 55 MMSCMD APM gas from nominated fields. The determination of producer price for this gas will be referred to the Tariff Commission. Till the Commission submits its recommendation and a decision is taken thereon, the consumer price of APM gas will be increased from Rs.2,850/MCM to a fixed price of Rs. 3,200/MCM on adhoc basis.
2. It has been decided that all available APM gas would be supplied to only the power and fertilizer sector consumers against their existing allocations along with the specific end users committed under Court orders and small scale consumers having allocations upto 0.05 MMSCMD at the revised price of Rs. 3,200/MCM. This price is linked to a calorific value of 10,000 Kcal/cubic metre.

However, the gas price for transport sector (CNG), Agra-Ferozabad small industries and other small scale consumers having allocations upto 0.05 MMSCMD would be progressively increased over the next 3 to 5 years to reflect the market price.

3. The gas supplies through GAIL network to non-APM consumers will be at the price at which GAIL buys from JV producers at landfall point, subject to a ceiling of ex-Dahej RLNG price of \$US 3.86/mmbtu for the current year i.e. 2005-06. For the North-East region, Rs.3,200/MCM will be considered as the market price during 2005-06.
4. The price of gas for the North-Eastern region will be pegged at 60% of the revised price for general consumers. Thus, the consumer price for the North-East region will increase from the existing price of Rs.1,700 to Rs.1,920/MCM.
5. Subject to the determination of producer price, based on the recommendations of the Tariff Commission, any additional gas as well as future production of gas from new fields to be developed in future by ONGC/OIL will be sold at market-related price in the context of NELP provisions.

Bio Diesel Purchase Policy

MoPNG, Gol has introduced Bio diesel purchase policy on October 9, 2005. Highlights of Bio diesel purchase policy are:

1. With effect from January 1, 2006, the public sector oil marketing companies shall purchase, through its select purchase centers, bio diesel (B100), which meet the fuel quality standard prescribed in the Bureau of Industrial standard (BIS)

specification formulated vide PCD3 (2242) C-dated 26 July 2004, and as may be notified and modified from time to time. The oil marketing companies shall make available the comprehensive industry guideline "Operations, Quality and Safety manual on Bio-Diesel – HSD B100 and HSD B05max" for information and guidance to bio-diesel industry.

2. The purchase centres have been identified in consultation with oil marketing companies, viz. Indian Oil Corporation (IOC), Bharat Petroleum Corporation Limited (BPC) and Hindustan Petroleum Corporation Limited (HPC). On the basis of availability of minimum testing facilities for B100 and for blending in HSD to the extent of five percent. Depending upon response, felt need, and preparedness in testing and accepting bio-diesel, more purchase centres would be identified subsequently.
3. The oil marketing companies shall buy bio diesel (B100) which meets the prescribed BIS standard, at a uniform price, as may be decided by the oil marketing companies from time to time, depending upon marketing conditions. Such uniform price shall be inclusive of any taxes and duties and transportation cost for delivery of bio diesel at purchase centre. The uniform price once fixed shall be in operation for six months, at the end of which it would be reviewed. The initial purchase price of bio diesel by the oil marketing companies will be Rs 25 per litre. The registered authorized bio-diesel manufacturers shall be required to deliver B100 at the notified purchase centres in calibrated tank trucks of capacity not less than 10 KL. In case the suppliers envisage any deviation, they should inform the concerned oil company and supply as per mutual convenience.

Rationalization of the policy on Foreign Direct Investment

On January 24, 2006, Gol, with a view to facilitating the easier inflow of FDI into India, has decided that instead of having to seek FIPB approval, FDI upto 100% would now be allowed under the automatic route for:

1. Laying of natural gas/LNG pipelines;
2. Market study and formulation and investment/financing in the petroleum sector.

The Union Cabinet has also raised the FDI caps/ceiling to 100 per cent under the automatic route in case of investment in creation of infrastructure related to marketing in petroleum sector.

In the Pipeline

Petroleum and Natural Gas Regulatory Board Bill

The Government proposes to set up a Petroleum and Natural Gas Regulatory Board to regulate the refining, processing, storage, transportation, distribution, marketing and sale of petroleum and petroleum products (excluding production of crude oil and Natural Gas). One of the basic objectives of this Bill is to provide for a regulatory mechanism which would facilitate uninterrupted and adequate supply of petroleum, natural gas and petroleum products in all parts of the country, including remote areas, at fair price, promote competitive markets and access to monopolistic infrastructure in the nature of common carrier on non-discriminatory basis by all entities. Provisions have been made in this Bill to ensure redressal of grievances and protection of

consumer interest. Once this bill is enacted, all downstream operations shall be regulated by this statute.

Draft Policy for Development of Gas Pipelines Network

The Central Government has circulated a Draft Policy for Development of Gas Pipelines Network for public comments. The Draft Policy aims at promoting investment in gas pipelines, providing inter-connectivity between regions, consumers & producers and for providing framework for future growth of the gas sector. The Government proposes to adopt the Draft Pipeline Policy for laying natural gas pipelines in the interim period until a statutory provision is made (through enactment of the Petroleum and Natural Gas Regulatory Board Bill).

Under the Draft Policy, all gas pipelines except captive transmission gas pipelines laid for exclusive use of a large consumer will be built on the common carrier principle and their capacity will be expanded or an additional pipeline will be laid if so desired by the Regulator to meet the requirements of new players. The Draft Policy provides for the appointment of a Regulator for regulating transmission, distribution, supply and storage system for natural gas and LNG and to promote development of the sector. Some of key functions of the Regulator shall be:

- Authorize laying of network of pipelines, through which transportation of all gas will be done.
- Oversee access to the gas pipeline on non-discriminatory, common carrier principle with level playing field for all users.
- Approve the ceiling tariff rates for gas transmission in all cases where gas is

transported on the common carrier principle and a tariff has not been finalized by the users with the owners of the pipeline.

- Approve tariff for the transmission pipeline and/or for the distribution pipelines so as to provide a reasonable rate of return.
- Ensure grid connectivity by issuing appropriate directions for operations of any pipeline network.
- Resolve issues relating to the operation of the pipeline on a nondiscriminatory basis or the tariff of the pipeline.

To promote and develop the gas sector, there may be a National Advisory Council consisting of stake holders of the gas grid system to give advice on such matters to the Government and the Regulator.

Other significant developments

Draft report on Integrated Energy Policy

Government, in order to meet the challenge of the country's rising energy needs and providing adequate energy of desired quality in various forms to users in a sustainable manner at reasonable costs, set up an expert committee under the Chairmanship of Dr. Kirit S. Parikh to prepare an integrated energy policy.

The draft report of the committee was released on December 21, 2005 for seeking comments from public.

Rangarajan Committee Report on Pricing and Taxation of Petroleum Products

The Government on 26th October 2005 had set up a committee to look into the various aspects of pricing and taxation of petroleum products with a view to stabilizing/rationalizing their prices, keeping in view the financial position of the oil companies, conserving petroleum products, and establishing a transparent mechanism for autonomous adjustment of prices by the oil companies.

Committee has submitted its report to MoPNG on February 17, 2006. The recommendations made in the report can be divided broadly into three groups.

1. The first set of recommendations relating to pricing of petrol and diesel are following:
 - i) shift to a trade parity pricing formula to operate as an indicative ceiling price for determining refinery gate as well as retail prices;
 - ii) Government to keep at arms length from price determination and to allow flexibility to oil companies to fix the retail price under the proposed formula; and
 - iii) reduce effective protection by lowering the customs duty on petrol and diesel to 7.5%. This set of recommendations should be implemented as an integrated package as selective implementation will create more distortions.

-
2. The second set of recommendations relate to pricing of domestic LPG and PDS kerosene, viz:
 - (i) restrict subsidized kerosene to Below Poverty Line (BPL) families only;
 - (ii) raise the price of domestic LPG by Rs. 75/cylinder;
 - (iii) discontinue the practice of asking ONGC/GAIL/OIL to provide upstream assistance, but instead collecting their contribution by raising the OIDB cess from the present level of Rs. 1,800/MT to Rs. 4,800/MT; and
 - (iv) Government meeting the balance cost of subsidy from the budget. The 'PDS Kerosene and Domestic LPG Scheme 2002' will have to be suitably amended for this purpose. This set of recommendations should also be implemented as an integrated package as partial implementation will not yield sustainable results.
 3. The third set of recommendations relate to restructuring excise duties from the present mix of specific and ad-valorem to a pure specific levy and calibrating the levies at Rs. 5.00/litre of diesel and Rs. 14.75/litre of petrol.



Section 6

Commodity Balance of Petroleum and Petroleum Products

As per MoPNG, domestic crude oil production in the period April - December 2005 declined by 6 per cent when compared with the corresponding period for 2004.

Refinery Production was marginally higher in April - December 2005 as compared to that in corresponding period of April - December 2004.

The domestic natural gas production rose from 23.86 MMT in April - December 2004 to 24.10 MMT in 2005 for the corresponding period, thus registering a growth of 1 per cent.

Particulars	Unit	April to Dec 2005	April to Dec 2004	% Variation
Domestic Crude Production	MMT	24.04	25.56	-5.90
Domestic Gas Production	BCM	24.10	23.86	0.98
Refinery Production	MMT	95.34	94.95	0.41
Refinery Capacity Utilisation	Percent	99.40	98.90	0.51

Source: MoPNG

Commodity Balance of Petroleum and Petroleum Products

(Million Tonnes)

Item	1950-51+	1960-61+	1970-71+	1980-81	1990-91	2000-01	2001-02	2002-3	2003-04	2004-05	2005-06* (Apr.-Nov.)
I. Crude Oil	2	3	4	5	6	7	8	9	10	11	12
1. Refinery throughput	0.3	6.6	18.4	25.8	51.8	103.4	107.3	112.6	121.8	127.1	83.8
2. Domestic production	0.3	0.5	6.8	10.5	33.0	32.4	32.0	33.0	33.4	34.0	21.4
(a) On-shore	0.3	0.5	6.8	5.5	11.8	11.8	11.9	11.5	11.5	11.6	7.6
(b) Off-shore	-	-	-	5.0	21.2	20.6	20.1	21.5	21.9	22.4	13.8
3. Imports	N.A.	6.0	11.7	16.2	20.7	74.1	78.7	82.0	90.4	95.9	63.4
4. Exports	-	-	-	-	-	-	-	-	-	-	-
5. Net imports (3-4)	N.A.	6.0	11.7	16.2	20.7	74.1	78.7	82.0	90.4	95.9	63.4
II. Petroleum Products											
1. Domestic consumption@	3.3	7.7	17.9	30.9	55.0	100.1	100.4	104.1	107.8	111.6	69.3
of which											
(a) Naphtha \$	-	-	0.9	2.3	3.4	11.7	11.7	11.9	11.9	14.0	7.0
(b) Kerosene	0.9	2.0	3.3	4.2	8.4	11.3	10.4	10.4	10.2	9.4	6.2
(c) High speed diesel oil	0.2	1.2	3.8	10.3	21.1	37.9	36.5	36.6	37.1	39.7	26.0
(e) Fuel oils	0.9	1.7	4.7	7.5	9.0	12.7	13.0	12.7	12.9	13.6	8.2
2. Domestic consumption\$\$	0.2	5.7	17.1	24.1	48.6	95.6	100.00	104.1	113.5	118.2	76.0
of which											
(a) Naphtha \$	N.A.	-	1.2	2.1	4.9	9.9	9.2	9.7	11.3	14.3	9.3
(b) Kerosene	N.A.	0.9	2.9	2.4	5.5	8.7	9.7	10.0	10.2	9.3	5.9
(c) High speed diesel oil	N.A.	1.1	3.8	7.4	17.2	39.0	39.8	40.2	43.3	45.9	30.4
(e) Fuel oils	N.A.	1.6	4.1	6.1	9.4	11.4	12.2	12.2	13.4	14.8	9.4
3. Imports	3.1	2.5	1.1	7.3	8.7	9.3	7.0	6.7	7.9	8.8	7.3
4. Exports@@	N.A.	N.A.	0.3	Neg.	2.7	8.4	10.1	10.3	14.6	18.2	12.5
5. Net Imports (3-4)	N.A.	N.A.	0.8	7.3	6.0	0.9	-3.1	-3.6	-6.7	-9.4	-5.4

*Provisional

+On a calendar year basis.

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

@@Including supplies of POL products to Nepal till 1997-98.

N.A. :Not available.

Neg. :Negative

\$:Includes NGL consumption from 1995-96 onwards.

\$\$:Excludes LPG production from fractionators.

Source : Ministry of Petroleum and Natural Gas.

Abbreviations

ACD	Additional Customs Duty
AED	Additional Excise Duty
APM	Administered Pricing Mechanism
ASEAN	Association of South-East Asian Nations
BCM	Billion Cubic Metre
BED	Basic Excise Duty
C&F	Cost and Freight
CTA	Customs Tariff Act, 1975
DFRC	Duty Free Replenishment Certificate
ECB	External Commercial Borrowing
EPCG	Export Promotion Capital Goods
FBT	Fringe Benefit Tax
GDP	Gross Domestic Product
GDR	Global Depository Receipt
GoM	Group of Ministers
GST	Goods and Services Tax
GTL	Gas to Liquid
INR	Indian Rupees
JV	Joint Venture
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
LSHS	Low Sulphur Heavy Stock
MAT	Minimum Alternate Tax
MMT	Million Tonne
MMTPA	Million Metric Tonne per Annum
MoPNG	Ministry of Petroleum & Natural Gas
MRP	Maximum Retail Price
MS	Motor Spirit
NCCD	National Calamity Contingent Duty
NCMP	National Common Minimum Programme
NELP	New Exploration Licensing Policy
NGL	Natural Gas Liquid
OIDA	Oil Industry Development Act, 1974
OVL	ONGC Videsh Ltd.
PDS	Public Distribution Scheme
PSE	Public Sector Enterprises
POL	Petroleum Oil & Lubricants
SAED	Special Additional Excise Duty
SED	Special Excise Duty
SEZ	Special Economic Zone
TRAI	Telecom Regulatory Authority of India
USD	United States Dollar
VAT	Value Added Tax
WPI	Wholesale Price Index

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