FISCAL REGIME IN OIL AND GAS (UPSTREAM) SECTOR

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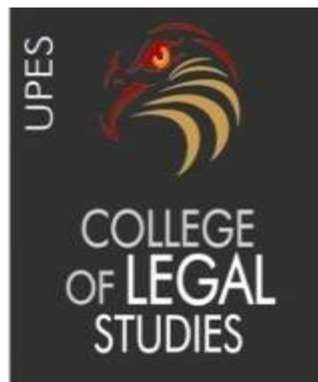
Submitted under the guidance of: Mr. Sujith P. Surendran

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



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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.

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CERTIFICATE

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ABSTRACT

The oil and gas industry is one of such industries that have specific taxation standards. This is as a result of its peculiarity in terms of high capital requirement, earnings violability, regulation, type of business ownership, taxation, non correlation between the account of investment made and returns obtained, the provisions in model contract i.e. PSC with the government and high sensitivity to risk like price risk and foreign exchange risk etc. In India, the ownership of national resources lies constitutionally with the sovereign state. Up to the 1990s, India's oil and gas exploration was dominated by its National Oil Companies (NOCs), first through the granting of exclusive licenses to explore particular areas, and later through equity shares in joint endeavors (in view of an arrangement of royalties consolidated with duties) with private firms. The fiscal regime decides the number of the private domestic and foreign players in a specific part. Before 1997 that is in pre NELP period the financial structure of O&G upstream Industry in India was not a very investor attraction inviting.

However, in 1997 the regime went through a lot of radical changes. With much pressure on the government to change and substitute the then existing fiscal regime enforced the Indian government to implement a investor friendly liberal methodology which prompt the conception of NELP and to take a market driven step which went for making a level playing field for NOCs and private firms and at boosting domestic exploration through private investments. The fiscal terms of the regime were revered within a Production Sharing Contract between the government and exploration firm. The regime was 'dynamic', in that the framework was not front-loaded from the investor's perspective, and income (from the sharing of profits from production between the government and exploration firm) was intended to stream to the government in extent to the volume of income, with profits starting to be shared strictly when firm had recovered their capital expenses of exploration. Be that as it may, a royalty was incorporated to give an early source of government revenue. Therefore, when the NELP was adopted by the government in India, it became imperatives for oil and gas companies in the sector to

prepare financial statements in line with the statement of accounting standards of the PSC.

The worldwide oil and gas industry is reclassifying itself in the midst of indeterminate vitality arrangements and an evolving domain. India, being among them is attempting to align the general business situation. To institutionalize the Indian oil and gas approach system with the global level, throughout the years there have been mass arrangement changes. This article keeping in mind the end goal to increase the consciousness of the exhausting framework likewise examines about the approach and administrative system. It is extremely crucial to comprehend that the strategies and arrangement system, the regulations and their controllers are by and large in charge of strategy being a help or bane to economy. This research plans to explore the wide subject of Fiscal Regime in Indian Upstream Petroleum Sector. The research gives a knowledge into the taxation structure of PRE-NELP and huge changes propagating throughout the years has additionally been highlighted. Moreover, the present research work will examine fundamentally, the current fiscal regime prevalent in Oil and Gas (Upstream) Sector in India, existing issues and to answer the issues and research questions aforementioned. The research, therefore, intends to explore the nature of oil and gas accounting in the country, challenges and solutions.

Keywords: Oil & Gas, Upstream, Fiscal Regime, Foreign Investment, NELP, HELP.

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10. Voice of India vs. Union of India, W.P. (C) No. 8415

ABBREVIATIONS

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1. AOC – Assam Oil Company
2. BB : Billion Barrels
3. BCM : Billion Cubic Meters
4. BP : British Petroleum
5. BOC – Burma Oil Company
6. CAGR : Compound Annual Growth Rate
7. CBM : Coal Bed Methane
8. DGH : Directorate General of Hydrocarbon
9. Edn. : Edition
10. EEZ : Exclusive Economic Zone
11. EIA – Environment Impact Assessment
12. EPC : Engineering, Procurement and Construction
13. E&P : Exploration and Production
14. FDI : Foreign Direct Investment
15. FDP – Field Development Plan
16. FY : Financial Year
17. GAIL : Gas Authority of India Limited
18. GDP : Gross Domestic Product
19. GoI : Government of India

20. HPCL – Hindustan Petroleum Corporation Limited

21. INR : Indian Rupee

22. IOC : Indian Oil Corporation

23. IT Act : Income Tax Act, 1961

24. JVC : Joint Venture Company

25. JVEP : Joint Venture Exploration

26. LNG : Liquefied Natural Gas

27. Ltd. : Limited

28. MAT : Minimum Alternate Tax

29. MBPD : Million Barrels Per Day

30. MMBTU : Million Metric British Thermal Unit

31. MMT : Million Metric Ton

32. MoPNG : Ministry of Petroleum and Natural Gas

33. MOEF – Ministry of Environment and Forest

34. MPSC : Model Production Sharing Contract

35. MRTP – Monopolies and Restricted Trade Practices Act, 1957

36. MWP – Minimum Work Programme

37. NELP : New Exploration and Licensing Policy

38. NM : Nautical Miles

39. NOC : National Oil Company

40. No. : Number

41. OIL : Oil India Limited

42. OISD – Oil Industry Safety Directorate

43. ONGC : Oil and Natural Gas Corporation

44. O&NG – Oil and Natural Gas

45. OALP – Open Acreage Licensing Policy

46. PPP – Public Private Partnership

47. PSC : Production Sharing Contract

48. PSU : Public Sector Undertaking

49. PEL : Petroleum Exploration License

50. PI : Participating Interest

51. RIL : Reliance Industries Limited

52. R & D : Research & Development

53. SC : Supreme Court of India

54. SOE – State Owned Enterprises

55. UOI : Union of India

56. US : United States

57. VAT : Value Added Tax

58. Vs. : Versus

FISCAL REGIME IN UPSTREAM SECTOR IN INDIA

INTRODUCTION

The oil and gas industry is one of such commercial nature industry that have particular tax assessment and fiscal guidelines. This is as a consequence of its eccentricity as far as high capital prerequisite, income violability, regulation, kind of business ownership, tax collection, non-relationship between's the record of speculation made and returns got, the procurements in model contract i.e. PSC with the government and high affectability to hazard like price risk and foreign trade risk and so on. In most countries within the world the possession of natural resources lies unconditionally in the hands of sovereign states, with States acting as custodians. In India, sovereign government is the owner of all the natural resources.[1] In India, "the ownership of national resources lies constitutionally[2] with the sovereign state".

In India, Exploration activity for petroleum and related products can be traced back to the year in 1866 when the Assam Oil Company wished to explore for oil in the state and was successful for the first time atMakum, a small town in Assam. However, until the formation of National Oil Company and Oil and Natural Gas Corporation not much success was achieved by the companies until in 1956 then E&P was only limited to the North part of State.

During 1960's, plenty of "vast" and "averagesized" oilfields with potential reserves were revealed and engaging search lead were obtained to step up prospect explorative activities. Then, during 1970's various exploration fields in offshore basin were made and also during this decade range of average to giant offshore basins were discovered together with the "biggies" like Mumbai High Basin and

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[1] Anupama Sen , *Out of Gas: An Empirical Analysis of the Fiscal regime for Exploration in India* 1999-2010, IAEE (2014), available at www.usaaeen.org , accessed on 08.02.2016

[2] *See generally*, Article 297 of 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.

therefore 1980's can be called as 10 years of fantastic growth in terms of search of potential oil reserves and so, manifested as "*Decade of Prosperity*".

To make the activity in consonance with the Industrial Policy Resolution of 1954[3] the E&P activities of oil and natural gas lied completely with NOCs (like OIL and ONGC) As the policy states, 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 and regulation in terms of the Industries (Development and Regulation) Act and other relevant legislation."[4]

With a highly regarded number of revelations, the enlarging demand supply gap was likewise furthermore extended which pressed our parliamentarians to edge strategies to pull in tremendously required foreign and domestic capital speculations and for this , government declared a few enactments 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* and so forth to strengthen the energy sector in country".

Up to the ninety nineties, India's financial regime for oil and gas exploration was overwhelmed by its Government owned public sector oil Companies (NOCs), first through the allowing of selective licenses to explore specific regions, and later through value offers in joint endeavors (in light of an arrangement of royalties consolidated with taxes) with private firms. The petroleum segment is a vital business for the Indian financial system and has generally been firmly managed, with the E&P activities being fundamentally vested with public sector.

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

[4] *Id*

By the mid 1990s, the production of oil and gas was starting to level and there was expanding urge to change the upstream administration because of a log jam in the rate of reserve aggregation and the absence of investment to put resources into seaward profound water investigation. It was additionally contended that the motivation structures were defective in joint endeavors – NOCs were frequently made obligated for the payment of all royalties, prompting inefficiencies in joint operations.

In 1999, the government declared another regime, the 'New Exploration Licensing Policy' (NELP) went for making level playing field for NOCs and private firms, and at boosting local exploration through private investments. The NELP was declared by the government determination on 10 February 1999 [5] .The foremost statement of the resolution read as:

"In order to attract private investment in [the] oil sector, [the] Government of India had been offering exploration blocks to private companies from time to time. There have so far been nine rounds of exploration bidding and [the] Government of India has entered into contracts for exploration by private companies through Joint venture arrangements. The demand for petroleum is expected to rise rapidly and it is necessary to step up the level of investment in exploration to hasten the pace of reserve accretion, which can serve as a base for higher levels of domestic production".

The financial terms of the regime were cherished within a Production Sharing Contract between and investing firm[6] and the government. The regime was 'dynamic', in that the framework wasn't up-stacked from the prospective investor's perspective, and income (from the sharing of profit oil after cost recovery from the oil production between the State and investing Company) was intended to stream to the government in extent to the flow of income, with benefits starting to be shared strictly when investing company had recuperated their capital expenses of exploration. In any case, a royalty was incorporated to give an early wellspring of government income.

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[5] Available at http://petroleum.nic.in/newgazette/goi1.pdf

[6] Joint ventures and consortiums required each participating company to hold a minimum of 10% of the equity.

"India has a hybrid system of production sharing contract that contain sharing of profit petroleum with the State and has basic elements of royalty[7]*"*. Companies or a group of companies forming a consortium enters into a Contract for production sharing with the Government of India to perform (E&P) activities. Income from exploration and production activity is assessed on a net income basis (i.e., gross revenue minus permissible expenses). Special relaxations are permitted to E&P companies other than the deductions and exemptions permitted under the Indian tax laws for:

- Unprofitable exploration expenses or in case of no discovery in respect of any block awarded or in any area surrendered prior to the commencement of commercial production and discovery; after the commencement of commercial discovery and production; costs incurred, *"whether before or after such commercial production, in respect of drilling or exploration activities or services or in respect of corporal property used in that correlation"*.
- *Reduction of mineral oil in the mining area post-commercial production.*

Notwithstanding being delegated a sensibly "dynamic" financial administration for exploration, the reaction from private financial specialists has not been very exciting. Approximately 250 PSCs have been marked, US$16 billion of speculations conferred, and holds of 700 million metric tones of oil and oil-equi gases collected through nine rounds of leasing exploration grounds under the NELP – be that as it may, activity of exploration has been continuously diminishing, and just three discoveries have been brought into production to this point[8].

There are three segments in oil and gas business or sectors for that matter. They are: Upstream Sector, Midstream Sector and Downstream Sector[9]. E&P activity comes under

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[7] *GLOBAL TAX GUIDE 2015*, EARNST & YOUNG, AVAILABLE AT E&Y.COM, ACCESSEDON 14.03.2016.

[8] *See Generally*, A controversial issue in domestic gas has been the dramatic drop in production since 2011 from India's largest offshore gas block in the eastern offshore 'KG' basin, from which production began in 2009. There is controversy over whether the drop was due to unforeseen technical issues (as alleged by the contractor) or unfavorable fiscal terms and pricing (as alleged by the government). Reserves from the block have since downgraded from 11tcf to between 3-5tcf.

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

the upstream. The upstream sector includes ranges of activity from exploration to production[10] .This dissertation will talk about the "present fiscal structure in Oil and Gas (Upstream) sector of India" and further examine the current framework by comparing it with other countries structure and also to look upon the issues and challenges in the sector.

In this way, there are specific issues which encourages for the need to revise the fiscal structure of the upstream business structure in India, like:

1. The contribution of foreign investors in the upstream sector is lesser than as expected.
2. There is dearth of skills, technology and necessarily required equipments in upstream sector in country. Need for technical advancement.
3. Another being the interest for acquiring Oil and Gas assets abroad which is also a losing ground as pace for governmental decision making process and various official clearances are slow. More governmental interference is a deterrent for the investors[11].
4. Not sufficiently expert taxation and fiscal regime that can deal with the tax incidents of PSC efficiently. Need for a investor friendly regime.

RESEARCH METHODOLOGY

STATEMENT OF PROBLEM

The multifaceted nature of the operations & different stages involved in exploration & production in the upstream oil and gas industry makes the oil and gas taxation more complex in nature. However, India has a hybrid structure of PSCs which contains elements of royalty, as well as sharing of production with the Government. To undertake exploration and production (E&P) activities in India companies need to enter into a PSC

[10] Id

[11] *India's energy security: Key issues impacting the Indian oil and gas sector*, FEDERATION OF INDIAN CHAMBERS OF COMMERCE AND INDUSTRY *available at* http://www.ey.com/Publication/vwLUAssets/Indias_energy_security/$FILE/India-s_energy_security.pdf. accesed on 13.03.2016.

with the Government of India & income from E&P operations is taxable on a net income basis (i.e., gross revenue less allowable expenses). The production sharing contract in India (PSC) requires that oil and gas companies in the upstream sector prepare their financial statement in line with the statement of provisions & terms and condition of the model contract.

However, oil and gas taxation is made increasingly difficult by new challenges and risks such as horizontal drilling, price risk, foreign exchange risk, non production etc. Therefore, this research seeks to investigate oil and gas taxation and it's fiscal regime in the country, practice, challenges and solution.

OBJECTIVE OF STUDY

1. To understand taxation in oil & gas sector in India
2. To determine the nature of oil and gas accounting & taxability
3. To determine the discharges and solutions in oil and gas accounting
4. To determine the nature of oil and gas accounting in India
5. To determine the nature of oil and gas accounting around the world.
6. The research compares the current upstream fiscal systems in other countries
7. What constitute the challenges to the investment I oil & gas sector
8. What are possible solution & suggestions in oil and gas tax regime.

SCOPE AND SIGNIFICANCE OF STUDY

1. It shall provide a detail analysis of the nature of oil and gas taxation and Indian fiscal regime as a framework for further studies.
2. It shall provide a framework to evaluate the challenges in foreign investment oil and gas sector and proper solution.
3. It shall elucidate the nature of oil and gas practice in India.

RESEARCH QUESTIONS

1. Whether the fiscal regime for Indian economy in oil and gas sector is adequate to attract foreign investment.

a. What are the national legislation and contractual framework that governs oil and gas sector (upstream).
b. What are the lacunae in fiscal regime for upstream?
c. What are the suggestions after making an analytical comparison of fiscal regime for upstream in UK, USA, and UAE?

This dissertation will also focus on the proposed suggestion to make fiscal regime for upstream business in India more adequate and investor friendly.

HYPOTHESIS

India lacks investment in upstream sector for which India needs to improvise its taxation regime as the taxation regime is one of the important factors to encourage investment in the country.

METHODOLOGY

In prolongation of the aforesaid objective, the nature of research is purely doctrinal which involve analysis of existing statutory provisions and cases laws as well as analytical methodology is opted to carry out study relying mainly on secondary data which includes journals, articles, commentaries, textbooks, reference books, internet sources, e-books, committee and law commission reports. Citation method used is Bluebook 19th Edition.

The said methodology is preferred, as there are already voluminous literatures and research works available on the particular topic that could come handy in bringing reforms and to analyze the fiscal regime of upstream oil & gas sector in India vis-à-vis investor friendly regime. Further, the objective of this dissertation is to analyze the existing legal framework pertaining to investor and to analyze the challenges faced by the investors in the sector therein.

The approach adopted for this study is a review of the existing literature on fiscal regimes; the focus is on objective presentation of empirical evidence. The methodology involved desktop research which looked into published literature. Based on the evaluation, the paper arrived at possible conclusions and implications for oil fiscal regimes for the country and the world fiscal systems in general. The information gathered

is based on both primary as well secondary researches. Secondary research involved online research, while primary research involves books, articles, journals etc.

LITERATURE REVIEW

1. ***Anupama Sen , Out of Gas: An Empirical Analysis of the Fiscal regime for Exploration in India, 1999-2010(Working paper) (on file with IAEE 2014)***

The paper focuses upon the development in oil & gas sector in last two decades and India's fiscal regime for oil and gas exploration during the period from the liberalization of the upstream fiscal regime (1999) to the bidding round for exploration acreage in the year 2010. The research also focused upon the various tax impositions throughout the country for upstream as well as downstream sector. Researcher has used various methodologies to compare behavior of economical indictors or system functions to analyze the fiscal system. The paper lacked possible solutions & suggestions to improve the system & various incidents of taxes were not covered.

2. ***Babajide, Ogunlade, Aremu, Comparative Analysis of Upstream Petroleum Fiscal Systems of Three Petroleum Exporting Countries: Indonesia, Nigeria and Malaysia, International Journal of Sciences: Basic and Applied Research (IJSBAR)***

The research compares the current upstream fiscal systems of three oil exporting countries: Nigeria, Indonesia and Malaysia. The paper reviewed world's fiscal regimes while benchmarking its impact against key features of importance to the government and oil contractors, individual countries current upstream fiscal regimes. The research covers world fiscal systems in general and trickle down to fiscal systems of three oil exporting countries: Malaysia, Nigeria and Indonesia. It covers history, trends, patterns and fiscal systems of oil and gas industry in general and of the three countries in particular. The research doest cover the information of the respective legislation of the either countries also lacks o providing regulations o indirect taxes in the countries.

3. ***Gokul Chaudhri, Clarity in Fiscal Policy on Mineral Oil and Natural Gas available at http://www.bmradvisors.com/upload/documents.pdf***

The paper deals with the current developments in the fiscal regime of the country petroleum sector d the benefits of the NELP. Paper compares the pre NELP & post NELP era and benefits accruing to the E & P companies out of PSC as a result of NELP. Paper provides information related to legislation & laws related thereto from income tax act and other acts. Paper doesn't deal in details the oil & gas sector and the fiscal regime of the country but focuses more upon the benefits of NELP & tax holidays.

4. ***Deloitte taxation & investment Co., Oil & Gas taxation in India***

The guide very exhaustively deals with all kinds of taxation imposed on the companies involved in E&P activity. It includes all kind of royalties, taxes, cess and all duties which are to imposed for such activities with all the detailed provisions of the related act. The guide doesn't deals with the working and functioning of oil & gas industry and how it works. It doesn't cover the NELP provision or discusses much out PSC regime.

5. ***Emmanuel B. Amponsah, John A. Enahoro, Abdallah Ali-Nakyea, Issues of Taxation in the Oil and Gas Sector in Selected Countries: Lessons for Ghana, International Business and Management Vol. 5, No. 2, 2012***

Study undertakes a review of petroleum taxation in selected countries around the world and seeks to fashion a way for Ghana's infantile petroleum industry. In other words, the study seeks to facilitate a smooth tax regime and policy for Ghana. Study covers fiscal regime of USA, CANADA, UKRAINE, INDONESIA, VENEZUELA, NIGERIA, UAE and GHANA. The study is not extensive study of all the petroleum taxation issues in the selected countries but only focuses upon formulation of uncomplicated oil and gas tax policy for Ghana.

6. ***Ms. Sakshi Parashar, Legal Aspect Of Oil And Gas Sector available at http://www.manupatrafast.com/articles/PopOpenArticle.aspx***

The paper undertakes in detail all the three sectors of the oil and gas industry i.e. upstream, downstream and midstream and its policies and regulations. The paper also discusses their regulators and also deals with topic like FDI, oil pricing and all the legislations. The paper doesn't cover any legal aspect of taxation in oil and gas industry.

7. ***Nishith Desai Associates, Oil and gas industry in India- legal regulatory and tax availale at http://www.nishithdesai.com/fileadmin/user_upload/pdfs***

The paper focuses upon O &G Industry in India at a Glance with a detailed expression of taxation in whole energy sector as per NELP and fiscal regime in India. The paper also focuses on shift from NELP to OALP. Researcher also focused upon various direct and indirect taxes imposed by the government. The paper didn't undertake comparative analysis of the taxation issues in other countries.

8. ***Petroleum prices taxation and subsidies in India(working paper) (on file with IEA)***

The paper looks at the current system of petroleum pricing and the macroeconomic, microeconomic, regional and global effects of this system. The study examines the current pricing mechanism and taxation and subsidy regime on four key petroleum products (petroleum, diesel, domestic kerosene and domestic LPG). In the study, the implications of current arrangements in each of these markets for central and state government revenues and expenditures, for India's macro-economic positioning as well for upstream and downstream sector development are to be examined in detail. The paper undertakes empirical and doctrinal approach to make the report. The paper doesn't focuses upon the taxation issues only but the oil pricing mechanisms and subsidies mechanism.

9. ***Emil M. Sunley, Thomas Baunsgaard and Dominique Simard ,Revenue from the Oil and Gas Sector: Issues and Country Experience , Background paper prepared for the IMF conference on fiscal policy formulation and implementation in oil producing countries, June 5-6, 2002***

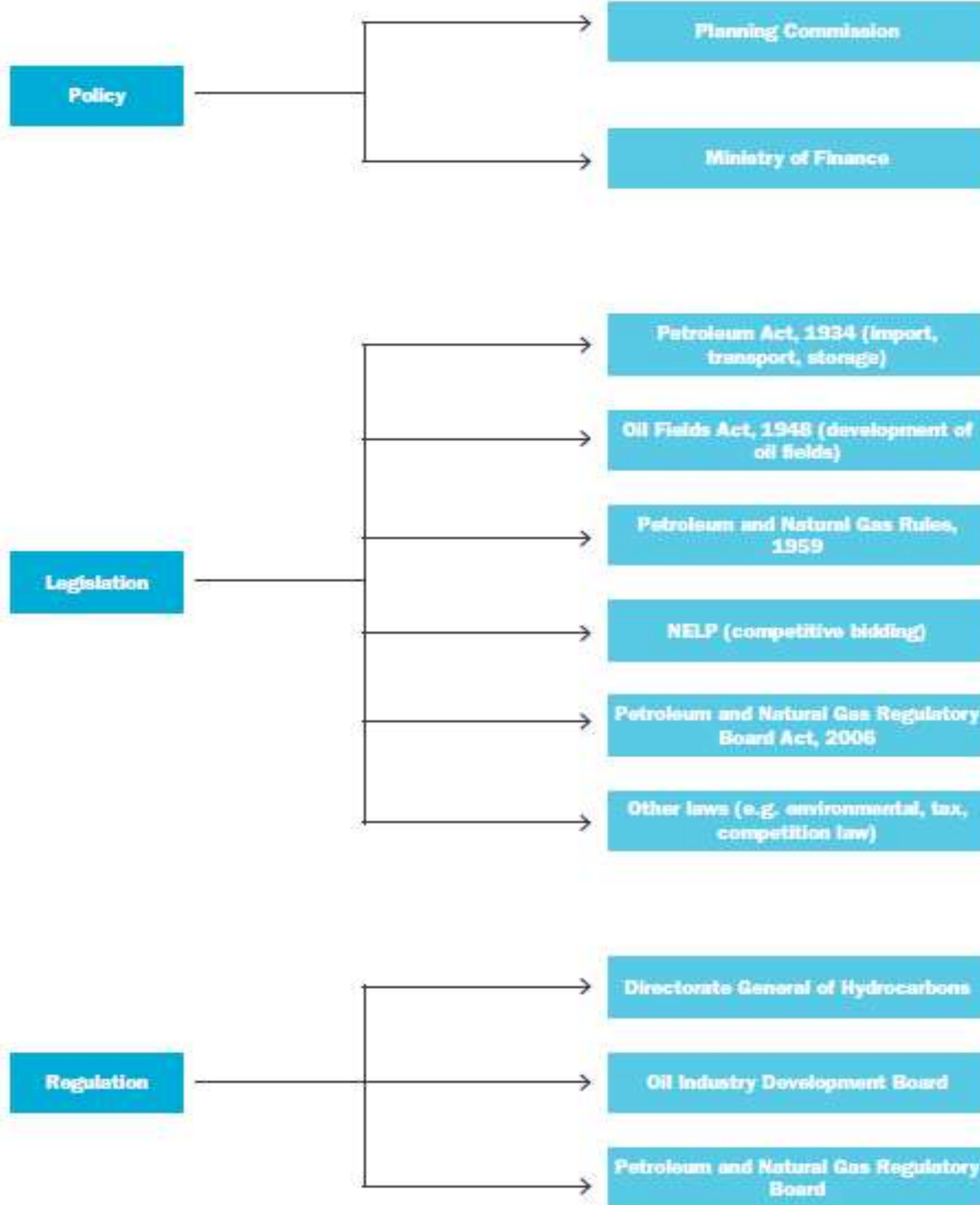
The paper undertakes the importance of stronger and proper fiscal regime for collection of taxes and generation of revenues for the government. The paper doesn't specify any country in particular to examine the fiscal regime and taxation of oil and gas sector.

10. Sheetal Saraswat, Understanding the Tax Regime Governing the Indian Oil Industry, available at *http://lexwarrierin/2012/08/ understandingthetaxregimegoverning the Indian oilindustry.*

The paper undertakes the Indian fiscal regime of upstream sector in oil & gas in detail and also makes possible solutions to resolve the issues. The paper doesn't uses comparative methodology to compare the world fiscal regime. The paper also fails to introduce legislations and provisions of legislations related to the topic.

CHAPTER I

1. OIL AND GAS INDUSTRY IN INDIA AT A GLANCE



[12]

[12] Taken from- Oil &Gas Sector in India, Laws, Regulations and Taxes, available at www.nishithdesaiandassociates.com

1.1. LEGISLATIONS

As expressed over, the legislative powers in admiration of subject matters identifying with developing oilfields, petroleum and petroleum items, mineral oil assets and fluids and substances pronounced by Parliament to be perilously combustible is accommodated in Entry 53 of List I of Schedule 7 to the Constitution[13]. Parliament has solitary and selective power to administer in admiration of subjects specified in List I of Schedule 7 as a result of this constitutional power various laws and policies dealing with oil and gas sector.

Courts in India has reliably maintained the Parliament's legislative power to enact in these matters to the avoidance of States[14]. The impact of these procurements of the Constitution and judgments is that only Parliament has power to pass laws in admiration of Oil and natural gas . The extent of this passage was talked about in significant point of interest in Babubhai Jashbahi in which Gujarat High Court pointed that, "*because of the vital way of minerals, mineral oils and oilfields, these subjects were held inside of the selective area of the Union Govt. Clarifying the extent of the forces identifying with Entry 53, the High Court clarified that these were national resources and that the whole country had a stake in the same".*

The objective and intention behind Entry 53 was, "for Parliament to enact in appreciation of a vital national resource and was not for legislative powers of Parliament in admiration of area or property within the State". Nonetheless, the High Court held that, "*Entry 42 of List III of Schedule 7 (acquisitioning and requisitioning of property) was sufficiently wide to enable Union Govt. acquiring a property having a place with a State Government. Consequently, in appreciation of oilfields, mineral oil assets and petroleum and petroleum items, the Union Govt. has the legislative power or the jurisdiction to regulate and legislate. Where required, the Union government has the power under the*

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[13] Also see Art 297, Natural resources vests with the Union.

[14] *See generally,* Satish Maganlal Vora v. Union of India & Ors. L.P.A. No. 692 of 2000, Babubhai Jashbhai Patel & Ors. v. Union of India & Ors. Special Civil application No. 2912 of 1982.

Constitution to make acquisition of property which is inside of the region of a specific State by goodness of Entry 42 of List III".[15]

Major legislations in the regulation of the oil and natural gas sector includes, -

a. *The Petroleum Act, 1934 ("Petroleum Act") and*
b. *The Petroleum and Natural Gas Rules, 1959 ("Petroleum Rules"), particularly for Exploration and production activities,*
c. *Key policies and regulations includes the Oilfields (Regulation and Development) Act, 1948 ("Oilfields Act"), the Petroleum Rules, and*
d. *The New Exploration & Licensing Policies* and *The Production Sharing Contract*.

Collectively, these acts, policies and rules lay down substantive plus the procedural necessities which are to be complied with by every companies which is engaged in *exploration and production(upstream ,import,production,storage, transport,(midstream) refining (downstream),* or basically any other O&G activity associated with oil and natural gas in India through PSC in upstream and otherwise in downstream or midstream.

1.1.1. OILFIELDS ACT

The essential act for leasing, allotment and licensing of "*petroleum and gas blocks"* is constituted under Oilfields Act.[16] The Oilfields Act grants expansive power to the central government to make rules accommodating the essential "regulation of oilfields" and for the developing the mineral oil assets.[17] Awards of PEL and mining leases[18] is done under this act and Petroleum Rules are also considered while such allotments. Specifically, Petroleum Rules might likewise accommodate matters, for example, who and when applications for mining leases might be made, the terms whereupon such licenses are in all actuality, the most extreme zone and time period for leases and so on. While the Oilfields Act endorses that to be paid only by the holder in whose name lease has been made in admiration of petroleum oil and natural gas, it likewise gives that Union Govt.

[15] State of West Bengal v. Union of India (1964) 1 SCR 371.
[16] The Oilfields (Regulation and Development) Act, 1948 (53 of 1948), available at http://petroleum.nic.in/ordact.pdf (accessed on March 15, 2016)
[17] Ibid
[18] Ibid

might absolved petroleum or normal gas delivered from offshore territories from any eminence. This exception takes into consideration the Union Govt. to support activities in these lesser approached frontiers[19].

The impact of the Oilfields Act was talked about finally in Babhubhai Jasbhai, " a case in which two individuals from the Gujarat Legislative Assembly questioned royalty to be paid to the State Government as per the orders issued under the Oilfields Act". The High Court of Gujarat after hearing the contentions dismissing the test on the opinion that, "the Supreme Court could look at question between the Union Govt. furthermore, a State Government under Article 131 of the Constitution". Be that as it may, "the Gujarat High Court likewise analyzed the reason for the Oilfields Act and clarified the area and subject matter of the Oilfields Act as identifying with regulation of matters given under Entry 53. This implies that despite the fact that oilfields are physically arranged inside of a State in India, it is just the Union Govt. that can pass laws in admiration of the same and any question that a State brings up in appreciation of an oilfield, it must do as such with the Central Govt. that too only in the Apex Court[20]".

1.1.2. PETROLEUM ACT

The Petroleum Act manages the import into India, exchanges inside of, capacity, creation, refining and mixing of petroleum. The Petroleum Act being established in 1954 is considered as one of the most established enactment in the oil and gas division. Before this law the standards in regards to the above determined exercises were independent every single state. The Petroleum Act got consistency in this field. The impact of Petroleum Act was clarified in the case of, "Satish Maganlal where the power of Union Govt. to control petroleum items" was followed to "*Section 5 and Section 2(a) of the Petroleum Act"*. For this situation, the Appellant asserted, "an item "created" by him was actually not petrol and therefore couldn't be controlled by Union Govt. In any case, it was set up that the synthetic segment was basically hydrocarbons[21] as expressed under Section 2(a) Petroleum Act which set out definition of hydrocarbon and henceforth, by

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20 *Oil and Gas Industry in India- Legal , regulatory and Taxes, NISHITHDESAIANDASSO., available at www.nishithdesai.com accesed on 11.02.2016*

21 Any mixture of hydrocarbons and any inflammable mixture (liquid, viscous or solid) containing any liquid hydrocarbon.

ethicalness of Section 5, Union Govt. could manage any item that had qualities of petroleum".

The impact of this decision is the prevailing part of Petroleum Act which plays in regulation of exercises in connection to oil and oil related items. Standing out from Oilfields Act, it is clear that while the last manages upstream exercises, Petroleum Act bargains considerably the midstream exercises.

1.1.3. PETROLEUM RULES

The Petroleum Rules give system to concede of "*exploration license and mining lease*." A few of the notable components of the Petroleum Rules are -

- *(i)* *"Prohibition on prospecting and mining except under a license or lease granted under the rules [Rule 4]*
- *(ii)* *(ii) Only Central Government has power to grant licenses or leases in respect of any land vested with it or minerals underlying the ocean within the territorial waters or the continental shelf [Rule 5(i)];*
- *(iii)* *State Government has power to grant license or lease over lands vested with it [Rule 5(ii)];*
- *(iv)* *Person obtaining exploration license obtains exclusive right to a lease for producing (i.e. extracting) oil/gas over any part of area covered in license".*

Petroleum Act and Petroleum Rules are frequently conjured together with the end goal of regulation of and appropriation of oil and oil related items[22].

1.1.4. PETROLEUM AND NATURAL GAS REGULATORY BOARD ACT, 2006

This Act set out of to establish PNGRB ("PNG Act") was advised on April 3, 2006. The PNG Act incorporates the Regulatory Board which directs and regulates the

[22] Supra note 19.

a. refining,
b. handling,
c. stockpiling,
d. transportation,
e. dispersion,
f. marketing and offer of petroleum, petroleum items and
g. regular gas barring generation of crude petroleum and characteristic gas in order to secure the enthusiasm of consumers and
h. elements occupied with particular exercises identifying with petroleum, petroleum items and natural gas,
i. for any other matters coincidental thereto.

The PNGRB Act accommodates a lawful structure for downs tream gas area regulation and also regulates CGD and for proper networking of natural gases .

The Petroleum regulatory Board has certain powers under the PNGRB Act regarding-

a. Section 11 in appreciation of the business sector and the different players in the O&NG market.
b. Functions under Section 12 for dispute resolution between companies in the business occupied and
c. Power to investigate in such matters.

In the case of Voice of India v. Union of India, W.P. (C) No. 8415. Powers of PNGRB was challenged when Board approved for operating gases network[23].

The PNGRB Act and the constituted Board are newly created and it will be at some point in near future before the degree of the law and the power of the PNGRB will be cleared up. Another fascinating aspect of these laws is that in the brawl between particular laws there is no reasonable test for determining the strain as the Apex Court is yet to arbitrate upon any similar question.

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[23] *See generally*, Indraprastha Gas Ltd. v. Petrol and Natural Gas Regualtory Board & Anr. W.P. (C) No. 9022 of 2009.

1.1.5. ENVIRONMENTAL LAW

In production sharing contract, special protection of environment has been concerned by the government and the contractor. Petroleum industry is by nature a very hazardous and polluting industry and causes serious impacts on environment, petroleum operations may cause effects on environment so due regard for safety of environment has been given in particular:

i. To install modern and advances industry tools and standard practices of operation to prevent harm caused to the environment as result of upstream operations
ii. take essential and proper steps for:
    a. Prevention of damage to environment and if it is unavoidable to reduce it to minimum level.
    b. Ensuring compensation for loss of lives or property or to the environment as a result of upstream industrial activity.
iii. To comply with Central governments requirements and to comply all applicable legislations requirement and
iv. In case of non compliance or deviation from the above laws, the contractor has to do good the losses.[24]

An environmental impact assessment for the project site is needed to be performed before starting exploration and production activity as per the norms of "Environmental Impact Assessment Notification, 1994".[25] Consequently, a report consisting of detailed study on drilling and operations to be performed is to be submitted with the MoEF, Union Govt. and additionally EIA report clubbed with public hearing report to be submitted.

MoEF after satisfying that all the compliances and criteria's are met with then permission can be granted for the same. [26]

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[24] Model production sharing Contract,dghindia, available at http://www.dghindia.org/pdf/MODEL%20PRODUCTION%20SHARING%20CONTRACT(MPSC).pdf., accessed on 15.03.2016

[25] *See generally* Section 3 (c) of Environmental Protection Act, 1986.

[26] Environmental Clearance in O&G, IOCL, available at http://www.iocl.com//download/Environmental_Clearance040512.pdf, accessed on 14.03.2016.

1.1.6. COMPETITION LAW

The PNGRB Act engages the Board to "*ensure the enthusiasm of purchasers by cultivating competition and reasonable exchange"* as per Sec. 11. In any case, the issue identifying with out of line exchange hones has additionally come up before the CCI[27]. Not at all like the past enactment, Act of 1957, ("MRTP Act"), has the Competition Act explicitly made the law material to State possessed Enterprises ("SoE"). This issue came up for thought right off the bat in "*Reliance Industries Ltd. v. Indian Oil Corporation Limited and Ors"* at the point when the Competition Commission needed to analyze materialness of Competition Act to State owned enterprise. "The Competition Commission determinedly and unequivocally maintained the appropriateness of the limitations under the Competition Act to PSUs and SOEs in two resulting choices[28]".

Case in point, in O&NG division, the National Oil Company hold around 86 % piece of the share in India's oil Exploration and production market, in natural gas about 77%, 74% in oil refining limit and 86% of promoting infra framework[29]. The NOCs enjoys a superior virtue or have edge over new private segment participants.RIL and SHELL wandered into promoting of oil bigly however needed to close their fuel outlets because of nonattendance of aggressive lack of bias between public and private segment in perspective of the sponsorship (state help) which was an aid for public sector only. Welcoming these substances, legislators in India have put a commitment on Competition Commission to inspect such issues while deciding strength and market dominance in this manner aligning India's opposition law with international practice.

Thus, this has influenced the section/development arrangements of private oil marketing organizations as contending with NOCs is not practical under the current circumstances. Obviously, this directly affects the rate of speculation by private OMCs, and all through the whole oil value chain, and at last on additional remarkable trade segment competition.

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[27] Competition Commission constituted under the Competition Act, 2002 ("Competition Act

[28] Suo moto case No. 03 of 2013 and Case No. 3 of 2012, Maharashtra State Power Generation Company Ltd. V. Mahanadi Coalfields Ltd

[29] Market Study Report "Competition in India's Energy Sector" by TERI and available on the website of the CCI.

1.2.POLICIES

1.2.1. NELP

NELP, New Exploration and Licensing policy, planned by the Union Govt. consisting of Directorate General of Hydrocarbons ("DGH") as the nodal office in 1997-98 to give a level playing field to both open and private area organizations in E&P of hydrocarbons. DGH has been empowered with the obligation of execution of NELP. It is critical to note that NELP is not law without anyone else and is not went in activity of any tenet making powers. Further, in the later past, exchanges identifying with gas-valuing , procurement and acquisition of shares in oil and natural gas organization[30] organizations among others have been tested out in the open interest cases ('PIL'). These are petitions recorded in the High Court of a State or Supreme Court testing official choices of the Union Govt. In spite of the fact that NELPs are presented to test, up to this point, the arrangement of NELP itself has not been tested and in actuality, the Supreme Court has observed this adjustment in approach and its helpful consequences for tackling the capability of the O&NG sector[31].

NELP advances interests in E&P Sector by encouraging apportioning of investigation pieces through global focused offering which is international level competitive bidding. Since 1999, NELP has quickened the pace of exploration of petroleum and natural gas exercises by giving a level playing field to all companies or investors to vie for honor of exploration purpose. National oil Companies, privately owned companies, and foreign organizations contend on equivalent terms and conditions to secure PEL through competitive bidding[32]. To advance E&P exercises specifically, NELP considers FDI up to 100 % in E&P exercises. Over the previous decade, more than 275 blocks[33] allocated in more than nine offering rounds, bringing about revelation of sixty-eight O&NG fields. In additional, the Union Govt. may NELP X, in which 86 blocks will be advertised[34].

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[30] Arun Kumar Agrawal v. Union of India and Ors. (2013) 7 SCC 1.

[31] See for instance Reliance Natural Resources Limited v. Reliance Industries Limited (2010) 7 SCC 1 (paragraphs 81 and 111).

[32] Indian Energy Sector, NELP – New Exploration Licensing Policy, http://www.indianenergysector.com/oil-gas/nelp-new-exploration-licensing-policy.

[34] See, http://articles.economictimes.indiatimes.com/keyword/new-exploration-licensing-policy

One of the advantages of NELP was the seven years of tax exemption for the generation of mineral oil, exception from custom obligation on imports required for the petroleum operations, and also acquiescent cost recuperation up to 100%[35]. In any case, the expense occasion is not accessible in appreciation of O&NG squares recompensed post March 31, 2011. In spite of the fact that prior to Finance Act presented in 2013, there were hypotheses that duty occasions will again be allowed for exploration and production in oil and natural gas obstructs, so as to pull in additional ventures yet not anything was one to influence one progressions.

"*The booming bidder shall enter into a Production Sharing Contract (PSC) with the Union Government for E&P activity. In terms of the PSC, the booming bidder is granted the necessary license under the Oilfield Act*[36] *and (Rules) Petroleum Rules*[37] *for conducting Exploration and production activities, as of more above all as described under the Model Contract*".[38]

The basic components of the NELP regime were as follows :

Royalty

Royalty rates for crude petroleum were set at "12.5% for onshore and 10% for offshore regions". Royalty for natural gas was set at 10%. To support deep water exploration, royalty for these zones was charged at 5% for the initial 7 years of deep water generation.

Cost Recovery

Taken a cost recovery of upto 100% of capital of working expenses preceding imparting of profits from production to the government was took into consideration for the Company. Royalties were additionally fetched recoverable. As far as possible on cost recovery was a biddable parameter in the auction process. Substantial capital expenses could be depreciated on a declining parity premise - quickened depreciation was permitted at 60% for particular resources utilized as a part of field operations. The non

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[35] Confederation of Indian Industry, Indian Hydrocarbon Industry, Policy Framework, http://www.cii.in/PolicyAdvocacyDetails.aspx?enc=fwDi/

[36] Section 6 of Oilfields Act (For details, see http://petroleum.nic.in/ordact.pdf)

[37] Rule 5 of the Petroleum Rules (For details, see http://petroleum.nic.in/pngrules.pdf)

[38] Source: http://petroleum.nic.in/nelp8a2.pdf

specific rate was 15% and extra decline of 20% was permitted real cost of new apparatus or plant in the main year .Few things were not qualified for cost recovery, for case, bank interest on financing, and marketing and transportation costs.

Profit Sharing

Profits arising out of production were to be imparted to the government for the reason of a 'Pre Tax Investment Multiple' (or PTIM - like a R factor scale in the literature on fiscal design). This PTIM was characterized as the proportion of combined income to total capital consumption. In the initial six rounds of the NELP, companies were required to impart a rate of benefits to the government at each of six levels of this venture numerous: 1.5 and beneath, 1.5 to 2, 2 to 2.5, 2.5 to 3, 3 to 3.5 and 3.5 or more. Ordinarily, a higher offer of profits would be shared at higher levels of the speculation numerous, or as the company's production developed in extent to its capital expenditure. A spate of discussions over whether firms were incentivized to gold plate their capital consumptions keeping in mind the end goal to postpone the offering of benefits to the government prompted an adjustment in the PTIM in the seventh NELP round, after which it was constrained to only two dazes, 1.5 and underneath and 3.5 or more, with the reach in the middle of introduced on a straight scale with a positive slant contingent upon the accurate PTIM accomplished in each first year utilizing the formula:

“Z = a + [(b-a)*(X-1.5)/2]”,

where,

Z = “Government share of profits (%)”

a = Government share (%) corresponding to the lowest PTIM or <= 1.500

b = Government share (%) corresponding to the highest PTIM or >= 3.500

X = “PTIM of the contractor (firm or consortium) at the end of the preceding year”

Income Tax

Indian firms paid income tax at 30% and foreign firms at 40%. Also, an extra charge at various rates for domestic and foreign companies was compulsory if the income of the company is above Rs 10 million. Additionally, an educational levy of 3% was likewise material. The effectual corporate duty rates were: for Indian firms with a net income up to and including Rs 10 million – 30.9%, generally 32.45%; for foreign firms with a net income up to and including Rs 10 million – 41.2%, generally 42.02%.

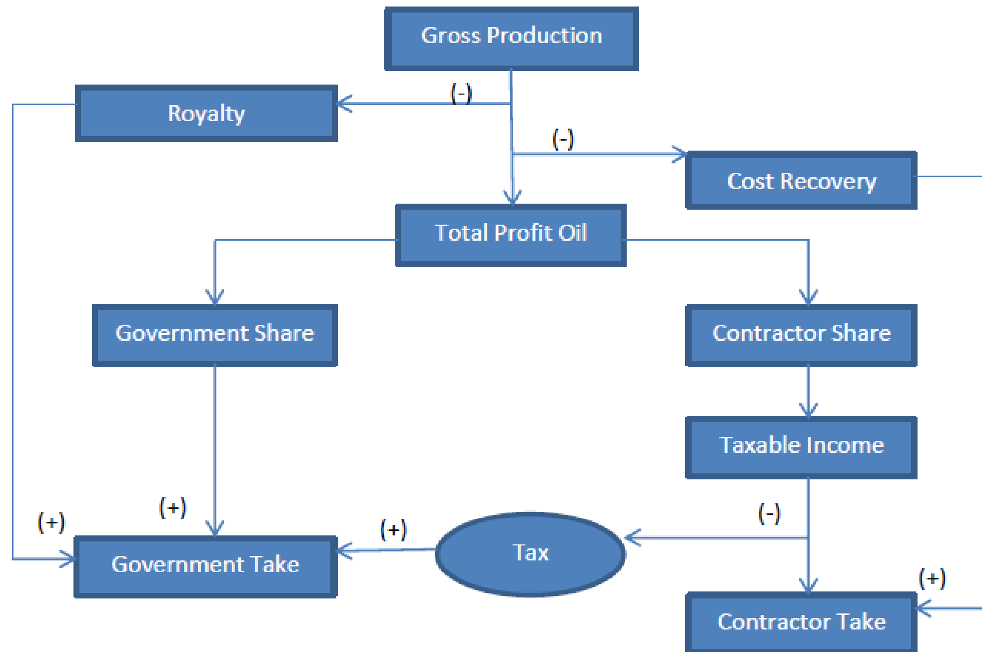
Other Taxes

i.) Minimum Alternate Tax (MAT)

If tax paid on income was less than 18.5% of its book profit, then MAT was applicable on firm. Effective rate of 19.06% is levied for MAT. For the purposes of scrutiny book profit can be considered as gross revenue (cost recovery plus profit share) minus royalty, operating costs, intangible capital costs and the decline of tangible capital costs. The MAT could be offset against income tax for a time of 10 years.

All the more for the most part, firms were not required to pay mark, discovery, or production bonuses. A seven years of tax-free income period was granted from the start of production, yet this has been pulled back in 2011. Fiscal security was ensured amid the agreement period and contracts were subjected to the Conciliation and Arbitration Act (1996). Companies, including the National Oil Companies, were to be paid international costs for crude petroleum. Firms were likewise given the contractual 'flexibility to showcase' their production inside of the local (Indian) market, despite the fact that this procurement has been disputable and gas is still subject to apportioning policies. There was no 'ring-fencing' of blocks, so the consumption from one block could be balanced against that of another block.

Figure 1 underneath gives a schematic of the Indian financial regime:



Source: Dharmadji et al (2002)

Following are certain salient features of NELP[39]-

a. FDI up to 100% is permissible.
b. There was compulsory State participation through the National Companies along in the Pre-NELP regime on condition and with the approved interest by the Indian government, save for under NELP there is no such condition or provision.
c. In the "New Exploration and Licensing Policy" the NOCs are kept at equal footage with different private players in opposition to prior regime where the PEL was given to them on selection basis.
d. Under NELP blocks are awarded through international open competitive bidding.
e. Under the NELP approach the ONGC and OILtd. are at equal footage with different private players in market , they get the same monetary and contract terms as privately owned businesses.

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

f. Under NELP regime there is no restriction to the contracting parties for crude oil marketing and gas marketing in the India's domestic market.
g. Revised royalty rates under NELP are investor friendly, "the present royalty rates are 12.5% for onshore blocks and 10% for offshore blocks".
h. Applicable rate of royalty is "half in rate for a time of seven years from the date of commercial production in case of deep water blocks".
i. In the entire block presented under NELP there won't be any confrontation of cess i.e. they will be without charge from cess.
j. As per NELP, no import duty is to be imposed on any apparatus or installation if it has been imported with the purpose of E&P activity.
k. Under NELP, prerequisite for any sort of bonus like signature, production or discovery is not present.
l. Under NELP, review of model production contract is done every year before every round of bidding to check their whether they are in conformity with the current scenario.
m. Governing laws under NELP shall be Indian laws.

1.2.2. HYDROCARBON VISION 2025[40]

The vision of 2025 stress on vitality energy security for a more extended timeframe. The vision illuminates that to accomplish energy security the spotlights on be two elements; Firstly, to expand the domestic (self sufficient) generation and furthermore by putting resources into the outside nations. Through along these lines just, India will be a self ward state as far as energy resources are concerned.

To satisfy these two aforementioned objectives it is important to, "open up the endeavors in exploration exercises and to decide precisely the territory secured by unexplored bowls which will sum to increment in domestic accessibility of Oil and Gas[41]".

[40] Ministry of Petroleum & Natural Gas, *The Hydrocarbon Vision 2025, available at* petroleum.nic.in/docs/reports/vision.doc.
[41] World Resources Institute, *Hydrocarbon Vision 2025, available at* http:///projects.wri.org/sd-pamsdatabase/ India/hydrocarbon-vision-2025.

1.3. UPSTREAM REGULATORY BODIES

The Govt. of India (GoI) is entrusted by the Constitution of India, 1950 "*to make laws concerning regulation and development of oil fields and mineral oil assets, and petroleum and petroleum item".*

In advancement of these power gave by List 1 to the Union of India, the Indina government has planned various petroleum laws and arrangements to control diverse exercises in the division. The MoPNG[42] is responsible in connection to the area as every one of the power, functions and obligations to manage the division is vested inside of it.

1.3.1. MINISTRY OF PETROLEUM AND NATURAL GAS

Duties of MoPNG include:

1. Managing exploration and production activity in the sector.
2. Managing and ensuring good refining, marketing and distribution of petroleum and products and products.
3. Regulation of export, import and safeguarding of petroleum and related products vests with the MoPNG. In addition to petroleum products liquefied LNG also comes under its purview.

The MoPNG regulates the alloction of gas alongside its production from NOCs by its requests with force got from acts, at the exceptionally same time it regulates the gas by the procurements of Production Sharing Contract (PSC). Various associations falls under the locale of MoPNG counting about fourteen open division endeavors (ex. GAIL) and different elements like "*Petroleum Planning and analysis cell*"(PPAC) and the Director General of Hydrocarbon[43].

1.3.2. DIRECTOR GENERAL OF HYDROCARBON

Indian government has implemented several policies and regulators over a period of time to regulate oil and gas sector more efficiently. One of several measures adapted is an

[42] *See Generally*, Ministry of Petroleum and natural Gas, Government of India.

[43] Anne-Sophie Corbeau, *Natural Gas in India, available at* https://www.iea.org/publications/freepublications//publication/natural_gas_india_2010.pdf. accesed on 11.01.2016.

administrative body that has been set up as a watch dog administrator for the upstream sector, and has been successful since its implementation. The Directorate General of Hydrocarbons also known as the DGH was set up under the executive control of the Ministry of Oil and Natural Gas. Established in the year 1993, it acts as an upstream advice-giving and technological controller body which seeks to promote effective administration of domestic oil and gas resources at the same time trying to maintain and preserve the environment, safeguard and maintain the safety standards and itstechnical and economic aspects. To carry out the functions more efficiently and to grant extensive powers DGH was made an statutory agency and an authority to exercise powers under the Act of 1948[44] in the year.

The DGH has been granted with various statutory and much extensive powers under the Act of 1948[45] with an outlook to promote NELP and to administer the PSC with much more efficacy[46].

1.4.TAXATION REGIME REGULATION IN UPSTREAM IN INDIA

The Income Tax Act of 1961 contains procurements to regulate the tax assessment situation of upstream segment[47]. It has a wide system of tax assessment expense settlements with more than 90 nations over the globe including even those to keep away from twofold tax assessment. Amid the period of financial changes or reforms i.e. the time of precedent 10-12 years, important changes are confronted by the Indian tax collection framework. Amid this time period the overall assessment rates were amended after analyzing comparatively with different countries all together to get proficient regime and to be sure with the time the tax collection administration of India has been improved and incite enhanced consistence[48].

In India a customized tax assessment administration wins to manage the relationship between non residents service providers and upstream incidents as a result of E&P activities in India. Further, the system in India allows the investor in for 100% expense

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

[45] *Ibid.*

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

[47] The Income Tax Act, 1961.

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

relaxation or a period of tax exemption for a time of seven years as for benefits earned from the production and development of petrol as Article 17 gives:-

"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 segment is among the center commercial enterprises of India which incorporates raw petroleum, natural gas, coal, power, and so forth. Hence, it's part in the economy is of most extreme significance and it causes varieties and impact vital choices in the economy[49]. Among all countries, when it comes to the consumption of energy, India remains at fourth biggest position[50]. According to the numbers and graphs of 2013, India have demonstrated reserves of 5.7 billion barrel[51].

1.5.DOMESTIC OIL PRODUCTION AND IMPORTS IN INDIA

To the extent that the demand of oil supply is concerned it is expected to be expanding with the annual growth rate of 3.3% and per day demand to be 4.0 million barrels by 2016 within 8 years, from the FY 2008. There is ever-growing demand of the imported crude oil and the same is expected not to decrease anytime in near future. With the well built inflation in the demand and fastest growing economy which will result into better transportation and production, which will result in further increase of the demand of crude oil. Figure below evidently mentions the rate of import in year 2014 and our home production. There is expected growth in domestic production and a slight decrease in the import rates[52].

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

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

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

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

In FY 2014-

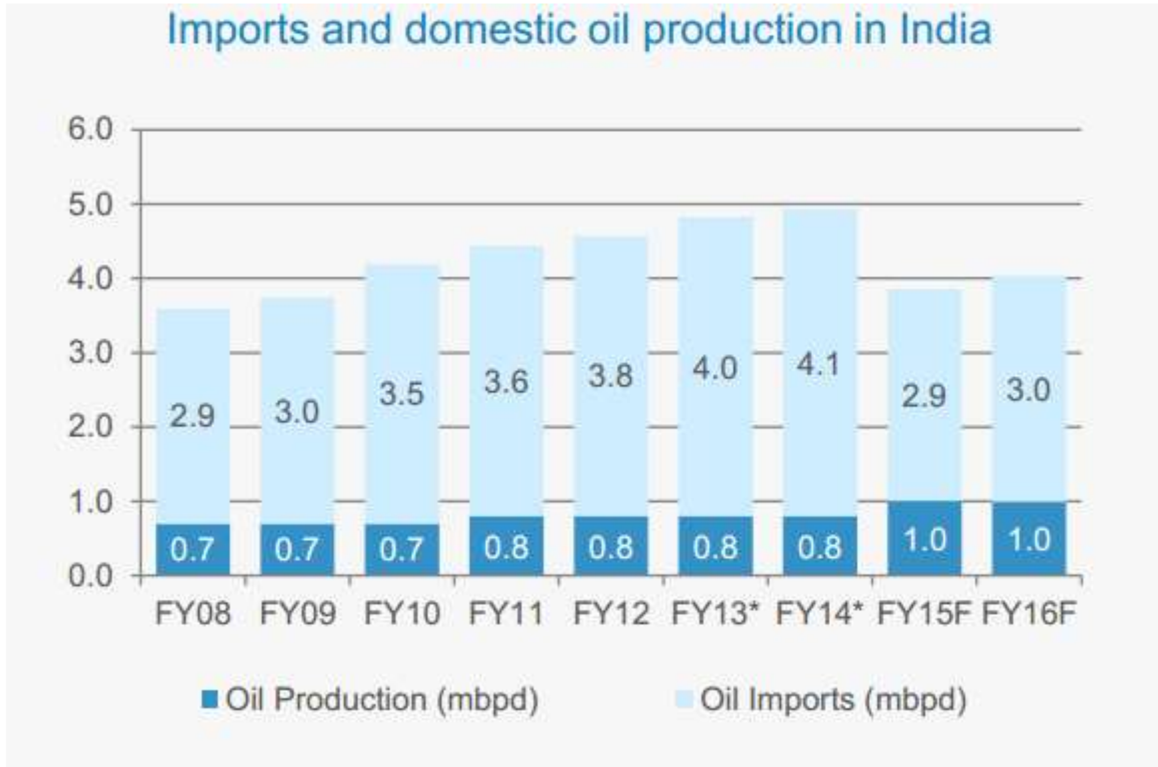
Import dependency – 80%

Domestic basket- 20%

Expected in FY 2016

Import dependency- 75%

Domestic basket- 25%



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1.6.REVENUE GENERATION FROM OIL & GAS SECTOR

OIL and GAS sector in India, in the terms of revenue generators, is the leading contributor to the State and Central funds[54]. Contribution of the sector is 15% in the Indian GDP[55]. "India being fourth biggest oil consumer in the world also is a net exporter of fuel products[56]. It is 4th biggest consuming country with the per day consumption of 3.1.million barrels after Japan, the USA and China[57]". Transport sector in India is the biggest oil consuming sector. Dependency of our country majorly lies with import to

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[53] *Id.*

[54] 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.

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

[56] Supra note 58

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

satisfy their domestic demands as the consumption is relatively vey higher than the production in country,

The production and exploration of Oil and Gas advantages the concerned country from various perspectives. It add benefit to the treasuries of country in different way including the benefit to the administration through expense and different incomes, build the job in the country, benefits through the sale of petroleum and related items and so on. It is verifiable truth that the accessibility of hydrocarbon assets is not high but rather because of consistent endeavors of Indian government towards oil and gas segment in the last 20-25 years furnished it with 9,650 crores amid the year 2009-2010 as non-tax income source from the organizations occupied with E&P. It is essential that the non-tax commitment comprising of, royalty, share in profit petroleum and other exploration fees of the industry was 9,423 crore amid the year 2008-2009[58].

India is having affluent hydrocarbons assets and it generally interests many investors across the nation over every one of the countries to put money into the business. The rich assets and the arrangements of the business have pulled in the FDI to country to great extent. It can be very much infirmed from the record that, "it pulled in foreign investment (FDI) worth US$ 3, 332.78 million amid April 2000 to December 2011, and according to Department of Industrial Policy and Promotion (DIPP) further US$ 196 million were put resources into the part amid April-December 2011-2012[59]".

1.7.PETROLEUM LICENSING SYSTEMS

In fiscal regime where Sate owns the rights over all natural resources and mineral rights vets with the government, State can choose either of licensing system form the two, first being Contractual System and the other is Concessionary system.

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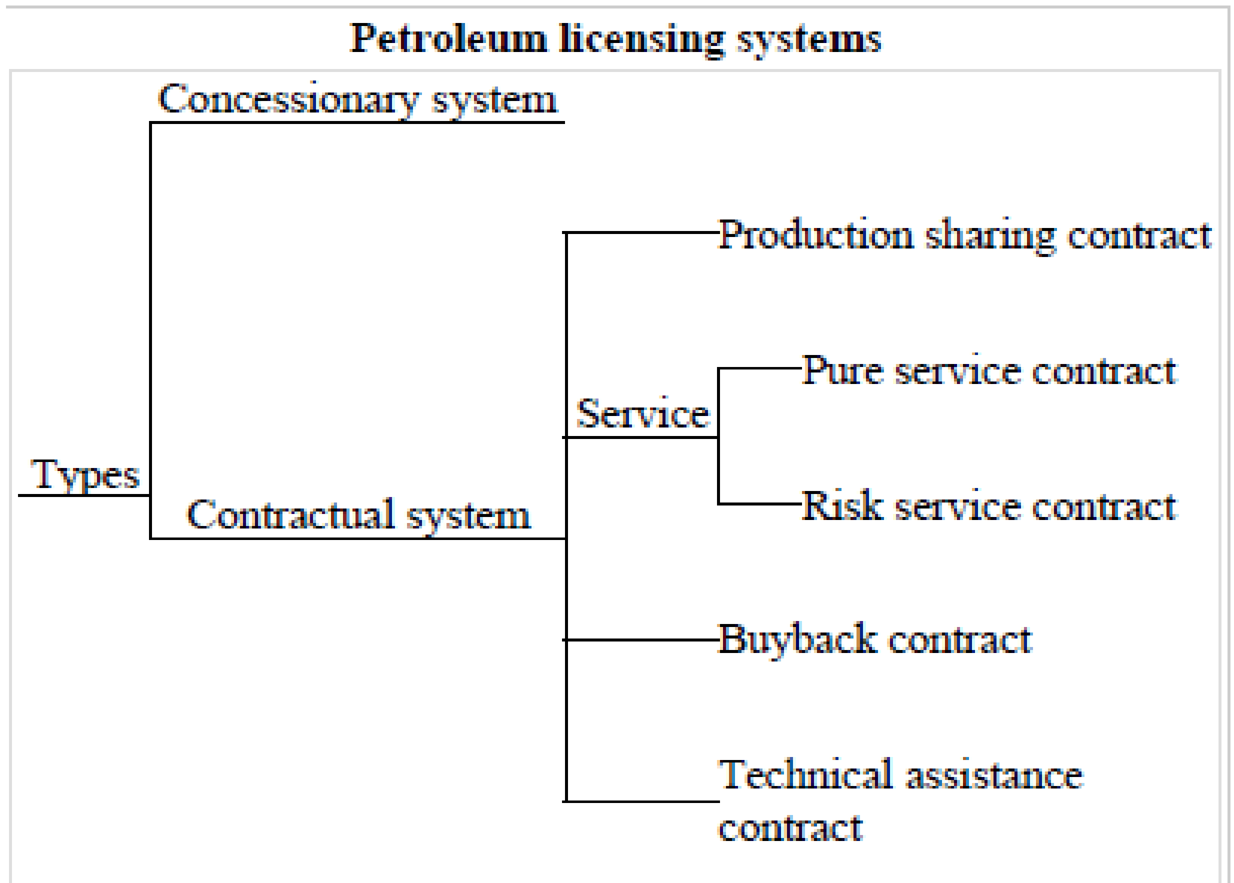
[58] Jyoti Mukul, *Govt. Non-tax Revenue from Oil Sector over Rs. 9,650 Cr.* BUSINESS STANDARD, Apr. 20, 2010, *available at* http://www.businesso.standard.com//article/economy-policygovt-non-tax-revenuefrom-oil-sector-over-rs-9-650-cr-11004200001.html.

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



Concessionary systems

The basic rule of the concessionary permit framework is that the state exchanges its responsibility for in the subsoil to an entity, frequently an association of companies or the joint ventures. The organization gets exclusive rights to perform extraction activities in a predefined area. On the off chance that more than one company are appointed license, the State will give a joint working agreement (JOA) which expresses every entity's value share. They together form a consortium to carry out E&P activity, in which one is appointed as the Operator. One of the organizations is regularly doled out the administrator part, which complete the real work in the interest of the group.

Contractual systems

In contractual frameworks, the state holds its possession to hydrocarbon assets. A business enterprise and the contractor company is being locked in to extract petroleum as per some agreement. The nations utilizing this sort of frameworks regularly have their

(SoE) State owned Enterprise and oil organization which represents the state interests. As of concessionary frameworks, more than one oil organization can make associations in the permit. Most utilized variations of agreement are:

Production sharing contracts

A contractual regime where the contractor receives his payment in the form of petroleum which is of two kinds- profit petroleum and cost petroleum also in terms of crude explored from the area.

Service contracts

In service contracts there is an agreed amount of fixed compensation, and contractors are paid in cash for the services they provide, on the other hand in risk service contracts the contractor links his compensation to the subjects of the projects and undertakes to accepts to bear all the risks associated with the projects.

Buyback contracts

Under this kind of regime, the government allots a block to a company or group of companies for exploration and production of oil and gas for a period of 10 years at no costs or fees on an agreement that the government shall after expiry of period of 10 years buy back the land and all the natural resources belonging to that particular block and the State will retain the ownership over the land. This type of contract is used in Iran[60].

Technical assistance contracts

As per this type of contract, government enters into an agreement with companies or group of companies for a development project over any previously allotted blocks or any oil field which is already in production to increase the efficiency of production of the oil field and for other purposes like infrastructural development.

[60] Abbas Ghandi, C.Y.Cynthia Lin (December 8, 2011), *Do Iran's BuyBackService Contracts Lead to OptimalProduction.*

CHAPTER-II

2. FISCAL FRAMEWORK IN INDIA

Taxation system of India is well established and it clearly defines the role of Central, State and other local authorities in imposing tax and collecting them in Indian federal structure. In Indian taxation system, "while the SG at state level are empowered to impose tax on agricultural income, the Central government can levy tax on income and in indirect forms such as service tax etc".

The taxation regime of India has experienced drastic changes in the last two decade. To make payment procedure of tax simple and at the same time to check the completion of tax payment, the existing tax rates have been changed many times and the procedure to make the tax rates in better form is still an ongoing process in India. For example, after April 1, 2005 greater part of the Indian states switched to the Value Added Tax- VAT from Sales tax.

A Production Sharing Contracts (PSC)[61] contains various elements including the element of royalty. To carry out Exploration and Production activities, "companies enter into a Production sharing contract with Government of India that also results in sharing of profit with the Government". With major focus on the key requirement of the sector i.e. to attract risk capital along with improved technical expertise, the tax regime of Exploration and Production sector since a very long time is administered by Income Tax law. Companies which are investing are not only governed by Income Tax law but also by the Production Sharing Contract .In Reliance Industries case [62] 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."**

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

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

2.1. TAXATION SET-UP IN PRE NELP AND POST NELP ERA

Dissimilar to the current scenario, during the Pre-NELP era, oil field blocks to carry out Exploration and Production were offered only to joint ventures between the National Oil Companies (NOC) and private players by the Government. In the Pre-NELP era the prevailing fiscal framework was as:

a. The royalty rate was determined on the basis of value of crude at well head. It was fixed at 10% of well head value.
b. Section 42 of the Income Tax Act, 1962 administered the taxation of Exploration and Production activities.
c. In the case of independent joint ventures the concerned companies were subjected to corporate Income Tax at 50 percent of taxable income.
d. The permissible deduction on expenditure on Exploration and Production activities was 100%.
e. The Government was responsible to pay the stamp duties payable under PSC, if any.

The important differences between "earlier rounds of bidding exploration blocks and NELP" are as under[63]:

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[63] *Historical Background of Oil Exploration in India,*PETROFED*, available at* http://petrofed.winwinhosting.net/uploadp//Part3.pdf. accessed on 11.01.2016

AREA	PRE-NELP	NELP
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.

After comparing both the scenarios it can be stated that the NELP regime is more investor welcoming in terms of fiscal benefits accrued to invetors than that of Pre-NELP regime. Unlike the current licensing policy where the National Oil Companies have to bid along with other company and are at equal place with other investors, during the Pre-NELP era, their participation in the bidding process was mandatory.

2.1.1. PRE – NELP REGIME

Since during the Pre–NELP era, "the participating companies had to bid for Minimum work program at each stage of the exploration program, other aspects like shares in profit petroleum and the investment recovered became necessary".

Cost Recovery:

The cost recovery of Exploration, Development and Production costs during the Pre–NELP era was ring fenced on the basis of production area, i.e. "the production cost of oil and related products couldn't be recovered from the revenue generated in any other producing area but the only area where production has been made from that expense". But if the producing area forms the part of the area in which exploration and the development was carried out, cost expenses could be recovered even from the revenue of production area.

Participating Interest:

In the Pre-NELP era, "in order to compensate the expenses incurred by National Oil Companies in Development and Production activities of the field, they were provided with an option to take 30% of participating interest in a block at the time of commercial discovery". The NOCs were also at liberty to acquire 10% working interest in any block.

Time Period:

During the Pre-NELP era for Oil and associated gases the oil companies entered into a Production Sharing Contracts for a period of 25 years that was further extendable for a period of 5 years and for non-associated gases upto 35 years in case for which the maximum 7 year exploration period was provided.

Relinquishment:

It was mandatory for the Oil Company to give up the 25% and 50% of the awarded area at the end of their 1st and 2nd of exploration consecutively. The investors were entitled to keep only the producing area along with the area having chances to be a producing area. However, if the government felt that a particular area (not a producing area) require more efforts and can be explored well enough to get the hydrocarbon, government could exempt the contracting party could be exempted from relinquishment. The first exploration phase had an option to carry out seismic exploration.

Supplementary Benefit

1. The first exploration phase was provided with an option to carry out seismic exploration.

2. The contractors were exempted from paying signature or production bonus.

3. Full exemption from Royalty on production

4. Payment of custom duties and other taxes was not required..

5. A 7 year tax holiday[64] was provided during the Pre NELP

2.1.2. PRESENT SCENARIO OF FISCAL REGIME IN UPSTREAM SECTOR

Taxation regime in upstream sector is a very important concept and should be investor friendly in order to promote the participation in this sector and to promote it in a way to make it investor friendly it should have essential features that grants special perks to the investors. Considering these facts the various deductions like deduction under Income Tax Act, 1961, tax incentives under the Production Sharing Contracts and various revised rates on royalty. The present chapter will highlight the efforts of the Indian Government in this regard:

Royalty Regime:.

The Act of Oil Fields (Regulation and Development), 1948 and the Petroleum and Natural Gas Rules, 1959 deal with the issues related to royalty. The complete regulatory power and responsibility of Development of the Oil and Gas field is within the domain of Central Government. The royalty entitlement out of Oil and Gas activities is usually divided between State government and Central government depending upon cases. In the

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

case of offshore drilling, royalty goes to Central Government while the concerned state government will have the royalty in the case of onshore production.

Terms of the respective contract governs, the Royalty on production from the Oil fields awarded under PSCs and it totally depends upon the Oil or Gas produced from that particular field. After the date of signing of the contract In case any new provisions are announced in Indian Laws that result into change in economic benefit of the contracting parties, PSCs provides protection to the parties from those changes.

The Royalty percentages followed in Production Sharing Contract are as follows[65]

A. Onshore Fields (Land Areas):-
    a. Crude Oil – 12.5%
    b. Natural Gas – 10%
B. Shallow Water Offshore Block:-
    a. Crude Oil – 10%
    b. Natural Gas – 10%
C. 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

The revenue collected by government in the form of tax is the backbone of any economy and a major contributor to its income. The tax is imposed on general public to ensure appropriate funds for public welfare.[66]

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."*[67]

The great economist and writer of **The Wealth of Nations** *Adam Smith who is also known as The Father of modern political economy, recommended certain basic principles*

[65] Global Tax Guide, 2015 E&Y. See also Indian government tax guide for oil and gas, 1999

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

[67] TEXTBOOK ON DIRECT TAXES, TAXMANN, VINOD SINGHANIA AND MONICA SINGHANIA, Editon 2014

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

In order to explain the "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 celebrated cannons prescribed by Adam Smith are[68]

1. Canon of Equity
2. Canon of Certainty
3. Canon of Convenience
4. Canon of Economy

The Indian Income Tax Act[69] provides special provision for taxability of upstream companies. Section 42[70] of the Act lays down as:-

[(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

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

[69] The Income Tax Act, 1961.

[70] Id

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 subtracting 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:

- "Expenditures incurred in the form of in fructuous or abortive exploration".
- "The expenses on exploration, services or assets for above mentioned activities".
- "Depletion of hydrocarbon in the drilling area post commercial production".

"Article 17 of the Model Production Sharing Contract" includes the following specific allowances in calculating the taxable income of the Exploration and Production companies:

- Exploration and drilling expenditure, both capital and revenue in nature, is 100% tax deductible. Expenditure incurred on Development and Production operation (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. On the other hand from start of commercial production such expenditure may be paid back equally over a 10-year period.

2.2.PRODUCTION SHARING CONTRACT REGIME

India has a hybrid system of PSCs containing elements of royalty as well as sharing of production with the Government. Companies (contractors) which are awarded the exploration blocks enter into a Production Sharing Contract with the Government for undertaking the Exploration and Production of mineral oil. The PSC decides the rights and duties of the contractor and is based on production value and profit shairng.

Cost Petroleum or Cost Oil[71]

Cost petroleum is the portion of the total value of hydrocarbon produced (and saved) that is allocated toward recovery of costs. The expenses that can be included in cost recovery are:

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

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

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Profit Petroleum or Profit Oil

After recovering the cost of exploration and production operation and taken bythe contractor , whatever amount of natural gas and crude oil is left is known as "profit petroleum", whixh is shared between the government and the investor or contractor. This share is bided by the contractor as it is the share of government in natural resource as a result of blocks allotted to the contractor for exploration and production. Government has set various criteria's for the evaluation of bids by the companies which also includes share of petroleum offered or percentage of profit offered by the companies to the government. There is no restriction declared by any statute for the recovery of expenditure of exploration and production, all of the cost is recoverable on condition that onlyt that part of expenditure is recoverable on particular year which has been mentioned

[71]*Global oil and gas tax guide* (2015),Earnest & Young, accessed on 11.02.2016

by the company during bidding. There is no upper limit in cost recovery. Costs that are expressly excluded from the cost recovery are below mentioned[72]:

1. Any cost incurred before the effective date of production sharing contract with the government. Ex- Costs of documentation , or ratification,
2. Any cost incurred for any financial transaction related to petroleum, operations and securing fund for petroleum operations,
3. Any transportation or promotion costs,
4. Costs involved for maintaining documents and guarantees under the contract,
5. Any expenditure on arbitral proceedings and fees paid to lawyers,
6. Any imposition by Courts,
7. Any charity, contributions or donation,
8. Any costs on mergers, demergers or forming any arrangements,
9. Any costs meant to fulfill any obligation of contractor under contract,
10. Any expenditure as a result of fault of the contractor.

After the date of execution of the contract in case of any new provisions are announced in Indian Laws that result into change in economic benefit of the contracting parties, PSCs provides protection to the parties from those changes.

Domestic Tax Laws:

The contractors under NELP are obliged to pay taxes under Indian Income Tax Act. Highlighted are the expansive procurements under local expense laws:

Corporate tax rates

Domestic companies are subjected to a tax rate of 30% and foreign companies at a rate of 40%. If the income is in excess of INR 10 million, additionally a surcharge (7.5% on tax for a domestic company and 2.5% on tax for a foreign company) must be paid along with an education levy of 3%.

Minimum Alternate Tax

If tax paid on income was less than 18.5% of its book profit, then MAT was applicable on firm. Effective rate of 19.06% is levied for MAT. For the purposes of scrutiny book

[72] *Without prejudice to their allowability under domestic tax laws*

profit can be considered as gross revenue (cost recovery plus profit share) minus royalty, operating costs, intangible capital costs and the decline of tangible capital costs. The MAT could be offset against income tax for a time of 10 years.

Domestic companies - 30%

Foreign Companies- 40%

(An educational cess of 3% additionally)

Ring-Fencing

Ring fencing of any contract area is the mechanism to limit the utilization of costs incurred in one area to be offset against revenue of other contract area. There is an exception to rule fencing that, to allow unrecovered costs from an oil field block or contract are which is not in operation or has been abandoned to carryover to a contract are or block which is active in operation. This acts as tool for non discrimination next side to exploration hence prevents RRT.

From an expense point of view no ring-fencing is applied hence, it is likely that investigation expenses of one block against the revenue emerging from another block can be counterbalanced.

Treatment of Exploration and Development Costs

"All E&P expenses are 100% duty deductible. Such expenses are mounted up till the year of initiation of commercial production. They can be either completely guaranteed in the year of commercial production or they can be paid off over a time of 10 years from the date of production. Improvement costs (other than drilling cost) are suitable under the typical procurements under the household charge"[73].

Accelerated depreciation

It is offered for nay investment done by the company in the business. On the other hand, there are two substantial issues involved, "One is that it becomes impossible to determine the ration in which crude is commercially produces, and the another is the value of deposit of resources is always larger than the invested amount".

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[73] Sheetal Saraswat, *Understanding the Tax Regime Governing the Indian Oil Industry, available at,*http://www.petroleum.nic.in/pngstat//pdf

Depreciation is calculated using the declining-balance method and is allowed on a class of assets. For field operations carried out by mineral oil concerns, the depreciation rate is 60% for specified assets *while* the generic rate of depreciation on the written-down basis is 15% (majority of the assets fall within the generic rate). Further, additional depreciation of 20% is available on the actual cost of new machinery or plant*7* in the first year.[74]

INCENTIVES:

Tax holiday –

Tax holiday of 7 years is granted to companies engaged in oil and gas exploration and production business. Tax exemption f 100% is allowed on initial period of 7 years on production of petroleum and natural gas. Exemption commences from the date of first commercial production.

Carry forward losses

Business losses in oil and gas sector can be set off and carry forwarded from any business to 8 back to back financial years. For domestic companies 51% test of ownership test has to comply with.

Withholding taxes

“*Tax would have to be withheld at the applicable rate on all payments made to a non-resident, which are taxable in India. The obligation to withhold tax applies to both residents and non-residents. Failure to withhold tax could result in tax, interest and penal consequences.”*

[74] Global Tax Guide, E&Y , 2015

Nature of income	Rate (%)[8]	
	Domestic company	Foreign* company
Dividends**	0%	0%
Interest	10%	5%/20%***
Fees for professional or technical fees	10%	10%****
Royalty	10%	10%****
Nonresident contractor		Maximum 40%*****
Branch remittance tax	0%	

2.3.FOREIGN INVESTMENT OPPORTUNITIES AND MARKET STATUS

Major economic and energy security concerns for India are to make pace with the international competitive market and to foreign investment opportunities in Oil and Gas sector. In order to facilitate the influx of foreign capital and promote businesses to invest in India, in 1991, the Union Govt. instituted various policies[75] including the de-licensing and deregulation of various petroleum products, freedom to form joint venture companies, more simplified procedure to obtain industrial licenses, and most importantly the allowance of 100 percent FDI in most of the parts of business. As per the 2013 report of Commerce andIndustry'sMinistry consolidated FDI policy, 100% FDI is allowed in following segments[76]

a) The automatic route for E&P,
b) Infrastructure related to marketing of O&NG,
c) petroleum product and natural gas pipelines,
d) Liquefied natural gas regasification infrastructure,

[75] Ministry of Petroleum and Natural Gas, Introduction, http://petroleum.nic.in/app//intr.htm
[76] Oil and Gas Industry in India (June 2013), India Brand Equity Foundation, http://www.ibef.org//industry/oil-gasindia.aspx

e) Petroleum refining in the private sector (all subject to the existing sector policy and regulatory framework)[77], market study and formulation".

"*Allowing 100 percent FDI under an Automatic Route means the Foreign companies do not need to obtain prior authorization to invest from either the Union Government or the RBI (however, certain documents must still be filed with the RBI). For proposals on FDI that do not qualify under the Automatic Route, a government body, the Foreign Investment Promotion Board (FIPB) offers a single window clearance[78]. Under this policy, government approval[79] route, up to 49% FDI is permitted in petroleum refining by PSUs without any disinvestment or dilution of domestic equity in the existing PSUs. From 2000-11, India's Oil and Gas sector attracted FDI worth US$ 3,152 million. The Oil and Gas industry is currently dominated by the Union Govt. PSUs. In PSUs, 51% or more of the paid up share capital is owned by Union Govt. or the various state governments*[80]"[81]

Leading PSUs in the Indian Oil and Gas industry include:

a) ONGC (74% State owned)
b) OIL (98.1% State owned)
c) IOCL (89% State owned)
d) Gas Authority of India (57% State owned)
e) BPCL (66% State owned)
f) HPCL (51% State owned)

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[77] Ministry of Commerce and Industry, Consolidated FDI Policy (Effective 05 Apr 2013), available at http://www.dipp.nic.in/English/Policies//FDI_Circular_01_2013.pdf
[78] *Id*
[79] Register in India, Approval Route of Government, http://www.registerinindia.com//approval-route-ofgovernment.html
[80] Public Sector Undertakings in India, http://www.india.gov.in/spotlight//public-sector-undertakings-india
[81] India's Oil ans Gas Sector, legal, regulations and taxes, NISHITHDESAIANDASSOCIATES< available at www.nishithdesai.com, accessed on 11.12.2015

The Indian government has announced various policy initiatives in order to attract foreign investment in oil & gas sector. The key initiatives include:

- Indian oil & gas fields are open for investment by domestic private & foreign entrepreneurs under the framework of NELP.
- FDI is permitted up to 100% in discovered small & medium sized fields through competitive bidding.
- Delicensing of refinery industry.
- The refining sector is open to the joint sector (public private partnership) as well as to the private sector for new refineries. In case of private Indian company, FDI is permitted upto 100%.
- For petroleum products & pipeline sector, FDI is permitted upto 100% through automatic route.
- FDI upto 100% permitted for natural gas/LNG pipeline with prior government approval.
- FDI upto 49% under the government route is permitted for petroleum refining by the public sector undertakings without any disinvestment or dilution of domestic equity in the existing public sector undertakings.
- Subject to the policy laid down by the government, marketing of transportation fuels (like MS, HSD & ATF) can be permitted to a company investing or proposing to invest atleast ₹ 20 bn in exploration, refining, pipelines or terminals in the oil & gas sector of India.
- FDI is permitted upto 100% on automatic route in infrastructure related to marketing and marketing of petroleum products.
- FDI upto 100% is permitted for purpose of market study and formulation, and for investment/financing.

[82]

2.4.OPEN ACREAGE LICENSING POLICY

Since 2009, there are speculations that Open Acreage Licensing Policy that encourages open licensing for exploration and production rights will come into force replacing the existing NELP regime. Since 1999 there have been nine NELP rounds. NELP has been criticized for its failure to attract widespread participation by Global Oil and Gas companies, in particular NELP VIII and IX. NELP-VIII had announced 70 blocks and got 76 bids for 36 of the 70 blocks on offer. As a result of that, the Union Govt. has begun working on OALP.

As a prerequisite of transition to OALP, Directorate General of Hydrocarbons has started working on a National Data Repository (NDR) that aims at gathering all the available geo-scientific data available in India under one roof. The major objective of the NDR is to make a repository of reliable exploration and production data for India with provisions for seamless access and on-line data management. Unlike NELP, OALP would enable bidders to bid for blocks on offer at any time of the year. The regulator will assess the bid made by this operator, call in any competing bids and, finally, decide whether to grant it or not. OALP permits every company to study and specialize in certain geographies if

[82] Available at https://www.dnb.co.in/IndiasEnergySector2012/KeyRegu.asp

they so wish, making the entire country open for E&P. Right now, companies are limited to what the DGH puts. Canada and the UK are among the countries that offer acreage for E&P on an open basis.

2.5.CHAPTER SUMMARY

To summarize, salient features of Indian fiscal regime in O&G sector are:

TAX POLICY

- India's Fiscal terms are labeled as one of the best in the world.
- "For past 10 years, India attracts foreign private participation through NELP, which was implemented in 1997 for more active participation.
- Monetary incentives in New Exploration policy is result of hydro carbon vision 2025.

HYDRO CARBON VISION 2025

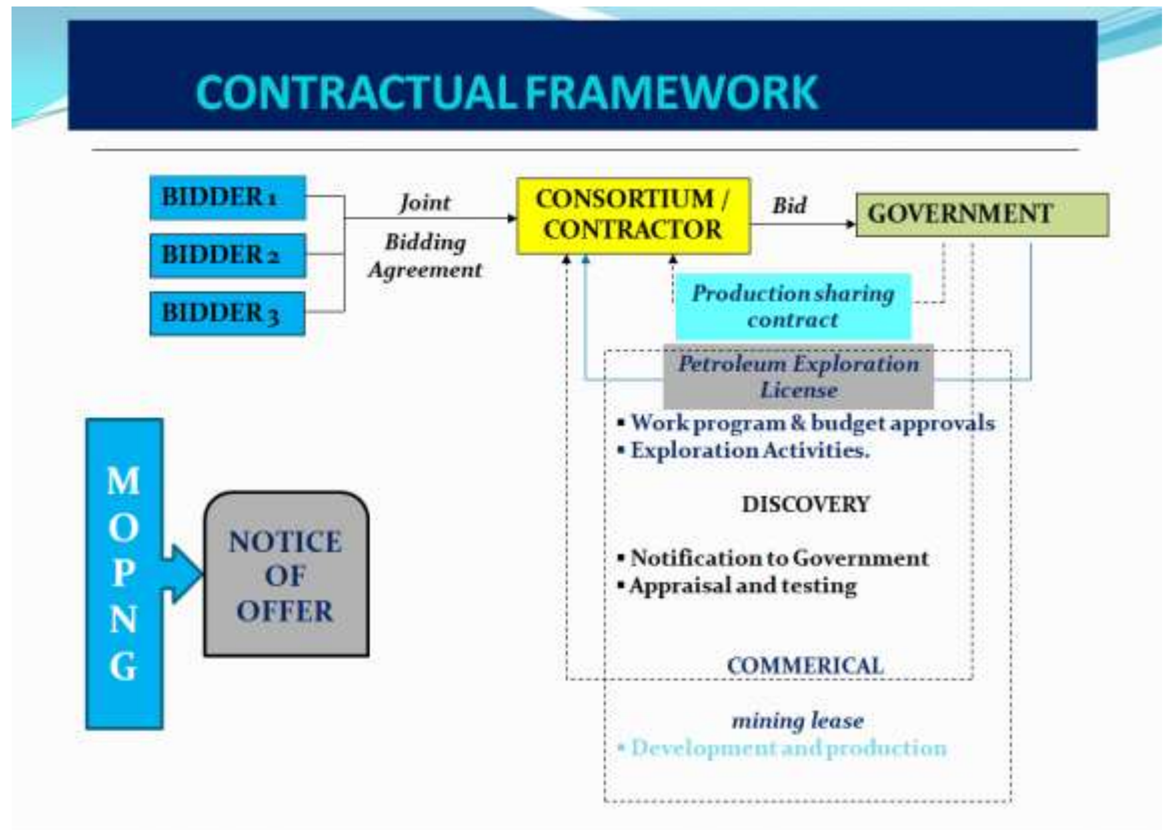
- Group comprising Finance, Petroleum and External affairs Ministers presented Hydrocarbon Vision 2025 to the Prime Minister- The Vision document lays down the framework which would guide the policies relating to the hydrocarbon sector for the next 25 years
- The report recommended the government to put in place a comprehensive policy to include total deregulation of overseas E&P business and provide internationally competitive fiscal terms to attract major oil and gas companies.
- The fiscal incentives of the Government in New exploration licensing policy (NELP) are manifestation of recommendations of Hydrocarbon Vision 2025.

BUSINESS MODEL

- The below mentioned flowchart depicts the business model of upstream in India. Contractual framework is such where the company investing money enters into a PSC with the government and as result government provides exclusive right to the contractor for exploration and production. Government doesn't invest in the business and its is the obligation of contractor to explore the field and commence

the production. Government only gets the share in the production of oil after company recovers all the expenditure incurred in operation. Company and government determine their share by a set out formula given in PSC.

- Government only acts as regulator of the business and creates a level playing field for the competition. Government also makes policies for the environment safeguards and acts as watchdog of all activities.



HIGH CONTRIBUTION TO EXCHEQUER

- Contributions of the sector in the form of taxes, profit in share, royalty etc… is a major source of revenue for the government
- Government seeks to maintain a balance between return to exchequer and incentives for investment.

FISCAL SCENARIO UNDER NELP

- Tax holiday for first 7 years(Not applicable now)
- Exemption on customs duty for equipments etc… imported for use in petroleum operations
- Cost recovery up to 100% etc…
- Deduction up to 100% during exploration phase and deduction allowed as per income tax act during development phase

ARTICLE 17

- "Companies involved in petroleum operations also subjected to all fiscal legislations or laws unless they are exempted by any other law wholly or partly or by this contract".
- Section 42 is a special provision for taxation of Exploration and Production Companies. "Section 42 directs the assessee to Article 17 of Production sharing agreement i.e., it provides that the taxable profits of a person who has entered in to an agreement with the government for its participation in business of prospecting, exploration or production of mineral oil will be determined in accordance with the special provisions contained in the agreement between the government and such person."
- Article 17 - "Any other allowance which are not specified herein, shall be treated in accordance with the provisions of income tax act 1961."

ALLOWABLE DEDUCTION

- Article 17 of PSC
- "So far exploration and drilling expenditure 100% deduction is allowed".
- Expenditure incurred during development operations is allowed as per income tax act 1961.
- Deduction allowable only on expenditure incurred on petroleum operations
- Section 40 A and 44 c.

- 100% deduction is allowable on unsuccessful exploration cost for income tax purposes.

AMORTIZE

- All such allowable expenditure in respect of exploration and drilling is required to be totalled till the commencement of commercial production.
- Such expenditure may be amortize over a 10 year period.(For calculating income tax purpose) from the date of first commercial production
- The expenditure incurred in respect of development operations and production operations will be allowable as per the provisions of the income tax act.

CORPORATE TAX

- “Section 80 IB (9) provides for 7 year income tax holiday from the commencement of commercial production.”
- Applicability of this rule is subject to the date of commencement of commercial production, if only it is after 1st April 1997
- “But even during tax holiday period the E & P companies have to pay Minimum alternate tax at the rate of 19% on profits and gains.”

ROYALTY

- “Royalty varies from 10-15%”.
- “For on land-Crude oil-12.5%, Natural Gas-10% to state Government”.
- “For off shore-10%-for both crude oil and natural Gas.”
- “Deep water blocks-5% for both crude oil and natural gas for first seven years of commercial production and thereafter 10%(Special concessions for deep water blocks)”
- “Royalty to be paid on well head value.”

CUSTOMS DUTY

- Custom duty is exempted on petroleum machineries imported by the contractor and its sub contractors “as per article 17.5 of the production sharing agreement.”

- "Government has the right to inspect the records and documents [17.6] and the physical items for which the exemption is provided".
- Items not used immediately become liable for payment of custom duty
- **"Essentiality certificate** - For getting exemption the company has to get certificate from DGH and submit to relevant authorities.(To show that the imported goods are required for such operations)."
- Sell import items - Items which are no longer required can be sold in India by contractor or subcontractors but subject to article 27 along with applicable laws, regulations etc…
- Section 44BB Special provision for taxation of oil field service providers

OTHER CHARGES

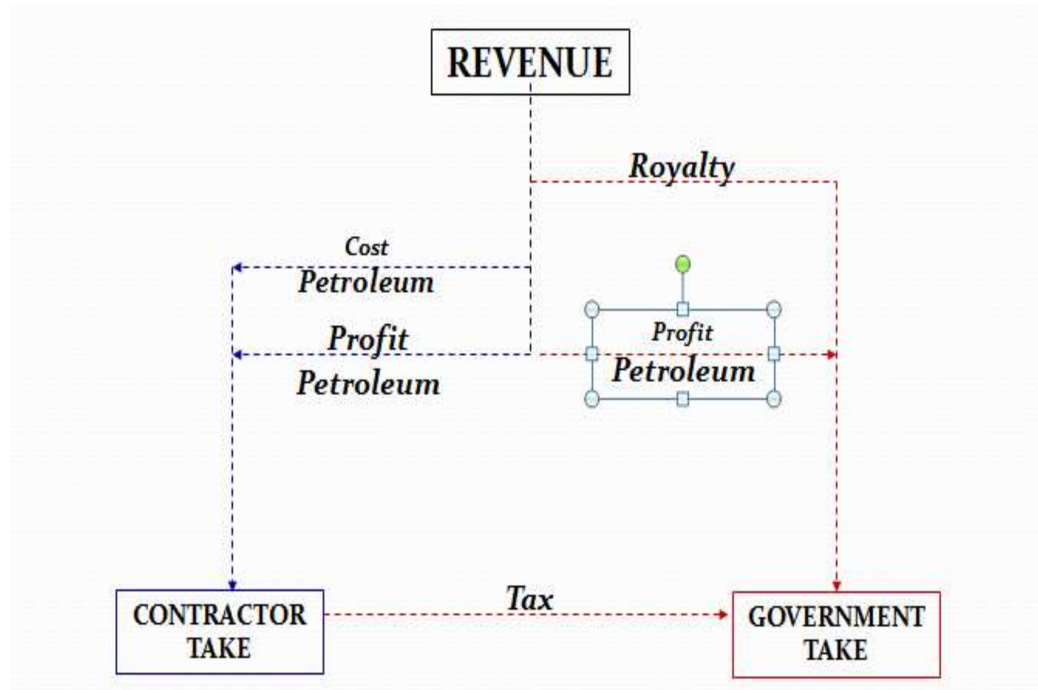
- Apart from the tax, royalty the contractor would be paying license charges and rental fees.
- **ECONOMIC BENEFIT** If there is a change in the economic benefits of the parties then the parties shall consult promptly in good faith to make necessary revisions and adjustments to the contract (Article 17)
- Provided that the expected economic benefits to the parties shall not be reduced as a result of the operation of this article.

ISSUES:

- 100% tax holiday on profits & gains is not absolute
- No tax holiday for Crude oil &Natural Gas by ex finance minister in parliament through explanatory memorandum has created confusions in the minds of the investors.
- Because of that 2008 auction has been postponed many times
- On July 6th 2009 Finance minister clarify the matter and informed the house that tax exemption applies to natural gas also.
- Now tax holiday is not available for the companies which has signed production sharing contract after march 2011.

- Elimination of Minimum alternate tax (MAT)
- Companies insist for 10 year tax holiday.

REVENUE MODEL IN PSC



CHAPTER III

3. COMPARATIVE ANALYSIS OF TAXATION REGIME & ISSUE IN O&G SECTOR AROUND THE WORLD

3.1. THE UNITED STATES OF AMERICA

The U.S. income acts set forth a calculation for use in deciding depreciation derivations on equipment utilized as a part of U.S. domestic petroleum production and a different calculation for computing depreciations on equipment utilized for production outside the U.S. [83] This infers a U.S. petroleum organization that does both local and global operations should hold fast to three tax laws; in particular,

- The foreign nation's income tax laws,
- U.S. income tax laws on local operations, and
- U.S. income tax laws representing global operations.

These, seemingly, will undoubtedly raise a great deal of tax assessment issues for the organization being referred to.

Another oil and gas tax assessment issue worth saying is that, an oil company drilling in the United States is obligated for determining its taxable income as per United States tax laws and paying any fitting taxes the administration of United States. In the same course, a United States petroleum organization drilling oil in Ghana can fit in with both the tax laws of Ghana and also those of United States, the home soil. These prerequisites ought to be recognized by applying both domestic as well as international regulations. There might be tax credits in the nation of origin and in addition tax arrangements between the two nations to bypass twofold tax collection on the same benefits. These statutory necessities are further made complex when an oil company works locally and globally. Notwithstanding, this practice prerequisite is not a disconnected case; it for all intents and purposes applies to all oil producing companies and oil producing nations in most part of the world.

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[83] Wright and Gallun, 2008

3.2.CANADA

In Canada, the lands are possessed by the states, so the royalties in a way are rental installments for the profits received from extracting the oil. Hence, the state royalty payments are a tax or expense to oil companies for utilizing state's property. However, since the administration of an oil producing region is in charge of the royalty issues and could impose taxes like the corporate income tax to gain income, there is the propensity to view royalties as a component of the fiscal administration to earn revenue. Appropriately, the hydrocarbons businesses' rental charges should be deducted from taxes and royalties to quantify the fiscal impact. This is unreasonable to do without evaluating the exact rental charge for utilization of state's property[84].

In addition, dissimilar to the rental payments received from oil and gas ventures, royalties might misrepresent financial decisions. As an alternate option, comprehensive tax and royalty effective tax rates can be assessed to ensure comparability; for example, between Alberta and Texas. It is worth bringing the attention that royalties in the Exploration and Development stage are "negative" on condition that such costs are deductible from the Royalty base, which, in a few circumstances, will be the situation. Each oil and gas producing state makes provision to deduct reserve Royalties from income. For examples are that Ontario is the only state that utilizes resource allowance related to mining of the asset, in Saskatchewan and Nova Scotia assessments on capital are being staged off, and for British Columbia and Saskatchewan taxes on capital gains are considered alongside retail sales taxes.

3.3.THE UNITED ARAB EMIRATES

The United Arab Emirates (UAE) is the largest oil producing nation in the Arabian Gulf. In 1967, Abu Dhabi became a member of the Organization of the Petroleum Exporting Countries (OPEC) and the Federation took over this membership in 1974. Since 1970, the federation has also been a member of the Organization of Arab Petroleum Exporting

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[84] Mintz, 2010 Mintz, J. (2010). *Measuring Effective Tax Rates for Oil and Gas in Canada*. University of Calgary: School of Public Policy Technical Papers. Retrieved from http://policyschool. ucalgary.ca/sites/-default/files/research/mintztech-taxoilgas.pdf

Countries (OAPEC). The UAE has huge hydrocarbon treasury, and is a secure production ability. Oil and Gas are the foundation of the Federation's economy. In 1962, production started from the offshore regions, followed by onshore fields in 1963. Since then the Oil and Gas sector progressed at a commendable speed. In 1963, the Emirate of Abu Dhabi started exporting crude and soon became a foremost oil exporter worldwide.

With majority of Oil reserves (around 90% of the Federation's hydrocarbon store), Abu Dhabi is the leading oil producer out of the seven Emirates making up the Federation. Abu Dhabi's oil reserves are estimated to be around 92.26 billion barrels whereas Dubai, Sharjah and Ràs Al Khaymah have estimated 4.0 billion barrels, 1.5 billion, and 0.1 billion respectively[85].

In UAE there is neither federal petroleum legislation nor a federal petroleum policy under which grants for E&D certificates are fixed beforehand. As per the UAE Constitution, oil and gas matters are left to the control of the individual member Emirates. Each of the oil producing Emirates has a Petroleum Department, the head of which is Abu Dhabi. Since 1988, the Supreme Petroleum Council of the Emirate of Abu Dhabi has replaced the Petroleum Department in Abu Dhabi. The council grants permits for exploration, petroleum concessions, finalizes different oil agreements, regulates the hydrocarbon policy of each Emirate, and carries out the various functions of public authority in the Oil and gas sector. Being the largest and most profitable oil producing Emirate, having fair relationships with multinational oil companies, Abu Dhabi is most suited to focus on its legal taxation framework for oil and gas resources as representative of the Federation.

In 1966, the flat three rupees per ton royalty was substituted by a 12.5% royalty by the Government of Abu Dhabi and the two concessionaires, Abu Dhabi Petroleum Company (ADPC) and Abu Dhabi Marine Areas (ADMA). Also, both the companies agreed to adhere to the Income Tax Law of 1965 hence paying an income tax at the rate of 50%, which was increased to 55% in 1971. This tax regime was maintained until, in 1974, the OPEC formula was brought into effect.

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[85] Heritage (2010). *2012 Index of Economic Freedom: United Arab Emirates*. Retrieved from http://www.heritage.org/index/ default

The Deminex Agreement[86], is a representation of the most recent model of concession agreement Abu Dhabi has adopted. Article 3 of this agreement, entitled Ownership of Natural Gas, instructs that "*all natural gas that may be discovered or produced in the concession area in association with crude oil or independently shall be subject to the provisions of Law No. 4/1976*". Law No. 4/1976 established the sole ownership of Abu Dhabi Emirate over all its "*associated as well as non-associated gas*".

Article 10 is related to bonus payments: "$2 million an initial bonus, another $2 million after the commercial discovery, $5 million following when crude oil exports reach an average of 100,000 barrels per day, and finally $10 million subsequent to exports of 200,000 barrels per day".

Article 13 that deals with the royalty payments includes, "a progressive or moving scale royalty concept where each year the oil company needs to pay the Government a royalty (fully expensed) equal to 12.5% of the produced crude oil posted price. If the production during the year reaches an average rate of 100,000 barrels per day, the company shall pay a royalty of 16%. Moreover, at an average rate of production of 200,000 barrels per day, the royalty will go up to 20%".

Article 17 focuses on taxation that adopts, "a progressive income tax where the oil producing company shall pay a 55% basic income tax. But, the tax rates go up to 65% if the crude oil production during a year reaches an average of 100,000 barrels per day. In case the production reaches an average of 200,000 barrels per day, the company shall pay an income tax at the rate of 85%".

For assessment and payment of income tax, the oil producing companies need to abide by the requirements of the Abu Dhabi Income Tax Decree 1965, as amended, complemented by the provisions of Article 17 of the (Petroleum) Agreement. Additionally, according to the Agreement in Article 18, after the taxation to which the concessionaire is subjected to have been determined, no other or higher taxes, duties, charges or fees can be imposed upon the company. Besides, Article 44 states that Government, in all rights and obligations has option to acquire a participating interest of up to sixty percent (60%), at any time after the discovery of oil in commercial quantities by a company.

[86] Concluded on May 3, 1981

Hydrocarbons provide for nearly 80% of total government earnings of the United Arab Emirates (UAE), in spite of all these extremely rigid provisions on taxation. In 2008-2009, the country suffered heavily by falling oil prices, highlighting the danger of over-dependence on earnings from petroleum taxes.

3.4.NIGERIA

Nigeria is a major oil producer of Africa with the largest gas reserves. According to the Energy Information Service estimations, in 2008, the country had an average crude oil production level of 1.94 million barrels per day where the actual production was a total of 2.17 million barrels of oil per day out of which 1.9 million was exported. The oil industry acting as the core hub of the economy contributes between 90% and 95% of Nigeria's export income, approximately 80% of government revenue and over 90% of its foreign exchange revenues.

The law that presently administers the Oil and Gas production in Nigeria is the Petroleum Profit Tax Act (PPTA), enacted in 1959 (NAPIMS, 2012). In accordance to the PPTA, petroleum operations are taxed at the rate of 85% by Nigeria's Federal Inland Revenue Service (FIRS) (Nigeria-law, 2012). However, for companies which have not completely recovered their capitalized preproduction expenditure, the tax rate is 65.5%. Apart from this, it is obligatory for all the companies listed in Nigeria to pay Education Tax at 2% of chargeable profits as contribution to the Education Tax Fund[87] (Nigeria-law, 2012).

"According to the Section 2 of the PPTA petroleum operations (upstream) that are taxable are defined as follows":

i. *Exploration,*
ii. *Appraisal,*
iii. *Drilling/Mining,*
iv. *Production/Recovery*
v. *Transportation by pipelines,*
vi. *Sale of chargeable oil, and*
vii. *All other operations incidental to any of the above.*

[87] Education Tax Act No. 7 of 1993

"Downstream processes which include marketing and refining operations are not subject to the PPTA but they have to comply with the Companies Income Tax Act (CITA)".

Nigeria's present regulations that were affected by the new PPTA includes:

i. The Petroleum Profit Tax Act 1959;
ii. The Petroleum Act 1969;
iii. The Petroleum Technology Development Act 1973;
iv. The Associated Gas Re-injection Act 1979;
v. The Petroleum Equalization Fund Act 1989;
vi. The Oil Pipelines Act 1990;
vii. The Nigerian National Petroleum Corporation Act 1997;
viii. The Petroleum Products Pricing Regulatory Agency Act 2003. [88]

At its bill stage, Legall (n.d.) quoted Tolu Aderemi[89], as saying that the PPTA would provide a "more robust, accountable and transparent oil and gas industry" and that it would serve to "consolidate a plethora of laws, statutes and regulations which regulate the Nigerian oil and gas industry" as well as "reform, review and streamline existing legislation, in order to deliver a fair, economic return for Nigeria as well as for investors." Again, one Dr. Mgbeoji is supposed to have fully agreed that Nigeria's new oil and gas legislation would include numerous ideas for improving the sector, but he contended that "the bottom line is whether these ideas will be implemented with courage and honesty".

All provisions on institutional reform, environmental concerns, and on reduction of institutional burdens need to be applied for a very effective implementation of Nigeria's new legislation on oil and gas so as to sustain existing companies and attract new ones. However, clumsy bureaucracy, misunderstanding and slowdowns in approval processes are caused by too many regulatory bodies with overlapping functions, and it should be looked upon[90].

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[88] Legall, n.d

[89] a solicitor at Perchstone & Graeys, Lagos

[90] *Petroleum Fiscal Systems in Nigeria*. NATIONAL PETROLEUM INVESTMENT MANAGEMENT SERVICES (NAPIMS) (2012). Retrieved from http://www.napims.com/fiscal.html

According to the reports Federal Inland Revenue Service collected Nigeria's half-year[91] oil tax revenue that was 2/3 of a total of N2.43 trillion; that is, N1.60 trillion. Whereas N838.58 billion was the collections of non-oil taxes for the same duration, most likely highest the Nigeria has achieved this since the discovery of Oil[92].

In 2012 Salau stated that since the NNPC had not discussed with any of the oil companies who are major investors in the revolution plan as well as delivering the gas needed for the projects incorporated in the program, the implementation of the country's $10 billion (N1.5 trillion) gas monetization scheme master plan is in danger of failing. Creating more doubts regarding the viability of the project, the companies were evidently kept out of the critical planning stage of the important exercise. "The project which is to expedite the nation's industrial rebirth by constructing two world-standard petrochemical plants, two plants for fertilizer production as well as five fertilizer blending plants, one methanol plant, and one distribution plant for liquefied petroleum gas (LPG) is also to fully commercialize and salvage Nigeria's Power Holding Company whose debt is estimated to be increasing at about N1.5 billion every month. In fact, this scheme is expected to have a gargantuan impact on the Nigerian economy; it is projected that, between 2012 and 2014, the fertilizer and petrochemical projects would attract more than $10 billion (N1.5 trillion) foreign direct investment (FDI)[93]".

Managing Director of Seplat Petroleum Company Limited, one of the operating companies in Nigeria, mentioned that, both the multinational and local oil and gas companies are not satisfied with the current pricing mechanism, the dreadful state of infrastructure, and discouraging regulatory framework. "Moreover, the companies allege that where the oil and gas will come from, the practicality and the components of the project have not yet been communicated by the NNPC which appears not to be serious about the project though the project is to take off in 2012. Again, although Mr. Avuru

[91] January to June, 2012

[92] Okwe (2012), Okwe, M. (2012, July 24). Taxes Fetch N2.43tr. *The Guardian* (p. 6). Guardian Newspapers (Nigeria) Limited. Retrieved from www.ngrguardiannews.com.

[93] Emmanuel B. Amponsah[a], John A. Enahoro[b]; Abdallah Ali-Nakyea, *Issues of Taxation in the Oil and Gas Sector in Selected Countries: Lessons for Ghana*

lauded the objectives of the scheme, he disapproved of the implementation and methodology[94]". He is further quoted as saying that "the current gas pricing would not encourage returns on investment while the tax is increasing. What we have in the new PIB is the royalty (...down to two percent) but tax has gone up to 80 percent although they might claim there was some rebate which is just 60 cent/thousand, for the first one tcf that you produced. What it means is that at $2 gas price, effectively the tax rate has gone up from 30 percent to 65 percent, even after giving you the rebate"[95].

The exceptional reduction in % collections from taxes in Oil as against non-oil taxes in the first half of 2012 indicates that Nigeria should not essentially rely on its petroleum revenue forever. This is not a healthy signal unless there are indications that the other sectors of the nation's economy are growing. In order to encourage and attract the much needed local and foreign investments in other potential sectors of the economy, the nation needs to do well to streamline all contentious taxation issues[96]. The country cannot afford to "completely" depend on the hydrocarbon sector and at the same time scare investment in the sector through unusual and extreme taxation regimes and relegating of major stakeholders, as it is being speculated.

[94] (Salau, 2012),
[95] *Ibid*
[96] Nigeria-Law (2012). *Guide to Business in Nigeria*. Retrieved from http ://www.nigeria-law.org/ BusinessInNigeriaTaxation.htm

CHAPTER IV

4. ISSUES AND CHALLENGES IN INDIAN TAXATION REGIME IN OIL & GAS SECTOR

Even with an excellent currently applicable production-sharing contract (PSC) regime and having potential oil reserves, Indian O&G block auctioning and bidding have not engrossed the big investors in the industry ,say, the Exxons and the Chevrons[97]. The reason, according experts of industry, is the vagueness in policy execution and administration intrusion.

For the reason that there was a solid administrative system and procurements of monetary motivating forces, investment of privately owned businesses until NELP VII was solid. Then again, resulting changes in the regime and policies have motivated with vulnerability and confusion among private industry company.

4.1.ISSUES IN GENERAL

The following are considered to be issues affecting the business:

1**. Cost Recovery of unsuccessful exploration area**

As per Section 42 of the Income Tax Act, 1961 which gives an interpretation that an unsuccessful exploration or an exploration that does not lead to commercial production of oil and gas is permitted only with the approval that the block relinquished before the commercial production. Hence the cost recovery for unsuccessful exploration and non discovery can only be accessible in year next to the relinquishment of the area not in the year expenditure occurred. So, to accrue maximum benefit out of the surrendered land's cost of exploration, company sometimes relinquish the land without exploring and discovering the block for the production which goes against the India's concern for oil and gas business.

2. No assessment in the case of production of Natural gas:

Tax assessment under section 80IB(9) of IT Act, 1961 is only available in case only when it happens with the commercial production of crude petroleum and natural gas in areas

[97] Richa Mishra, *oil & gas policy*, available at http://www.frontline.in/other/data-card/oil-gas-policy/article5702002.ece

allotted under CBM policies. In the same way, no discovery is accessible for the production and discovery of natural gas in areas allotted under “new exploration licensing policy” and “Coal bed methane rounds of open bidding”.

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

Tax holiday or exemption under 80IB (9) is only available under this section in condition that there is commercial production of petroleum and petroleum products has been done in initial year of appraisal(for feasibility study). In any case, this hardly brings any profit to the company as initial years are cost recovery period and this holiday can hardly be availed during this time, as a consequent this exemption doesn’t flow to the companies.

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

O&G sector is also burdened with the Minimum alternate tax which has to be paid in the event when the tax paid is less than 18.5% of book profit of the company. There is no relaxation to companies on MAT, which acts as burden for the company in profit making. This way all the relaxation given earlier become counterbalanced and lesser remains with the company.

5. **Recompense of cost saddled under Section 44BB of the Act (specifically for Public sector retailer):**

As section 44B provides:

“[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."]

6. Treatment of Tax Credit:

This is a very important issue for the companies engaged in oil and gas business. Most of the companies in oil and gas sector in India are foreign companies, so there are higher chances of double taxation, one in home country and the other in the country where E&P activities are going on. Companies which are operating in more than one country are generally subjected to tax scenario of the producing country. In absence of tax treaties between the two countries, company shall be charged at the home country for the same income accrued at the producing country[98].

Some countries offer a very different taxation regime for petrol products and therefore could face difficulties in getting tax credit.

7. Interpretation Of PSC:

Generally, the production sharing contract in India contains all the provision related to taxation and their allowable deductions and exemption in upstream sector. All these provisions of PSC shall be read with Income tax Act, 1961 and interpreted in the lights of provisions in the Act. Sometimes difficulty arises in case of interpreting the act and provisions to PSC and also because of lack of position of the provision of PSC in the act.

Sometimes interpretation of PSC becomes difficult and complex to determine exemption relaxation and the allowable expenditure.

8. EPC contracts faces lack of a proper regime:

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[98] Hemali Deepak Thakkar, *Oil and Gas Sector: Industry Overview and Taxation Provisions, available at* http://www.caalley.com//art/art110825.html.

Engineering procurement and construction contract are the subcontract enered into by the Exploration company for performing any engineering construction in the offshore or inshore areas, also known as technical assistance in work contract. Thwre are several riks involved with EPC contract and any smaller income accrued as EPC is taxable. Also India has no specific regime for EPC contracts income assessment.

This reflects that it is vital to undertake adequate tax regime and planning for EPC contract.

9. 'Farm-in' transaction:

Farm out as defined under text book on oil and gas as, **"***A farm-out is an agreement whereby a third party agrees to acquire from one or more of the existing licensees an interest in a production license, and in the operating agreement relating to it, for a consideration which, in oil industry practice, will normally consist of the carrying out of a specified work obligation, known as the earning in obligation, used in the drilling of one or more wells*[99]"

In simple terms, Farm out is the creation of interest of part or all of an oil, natural gas or mineral interest to a third party by the producing company.

In India, as quoted by E&Y Tax Guide, "No specific provision applies for the tax treatment of farm-in consideration, and its treatment is determined on the basis of general taxation principles and the provisions of the PSC. However, special provisions determine the taxability of farm-out transactions in certain situations.[100]"

10. Depletion allowance:

The depletion payment is much similar to that of depreciation allowance allowed on machinery and other installments. It is offered for nay investment done by the company in the business. On the other hand, there are two substantial issues involved, " One is that it becomes impossible to determine the ration in which crude is commercially produces, and the another is the value of deposit of resources is always larger thantheinvested amount".

[99] TEXTBOOK ON OIL AND GAS, DAINTITH & WILLOUGHBY - UNTIED KINGDOM OIL AND GAS LAW (SECOND EDITION)
[100] GLOBAL TAX GUIDE, E&Y, 2015 AVAILABLE AT E&Y.COM ACCESSED ON 17.03.2016

Depreciation is calculated using the declining-balance method and is allowed on a class of assets. For field operations carried out by mineral oil concerns, the depreciation rate is 60% for specified assets*6* while the generic rate of depreciation on the written-down basis is 15% (majority of the assets fall within the generic rate). Further, additional depreciation of 20% is available on the actual cost of new machinery or plant*7* in the first year.[101]

In addition, oil and gas industry need to address many issues to make industry more investor friendly and market adaptive approach. The major issues/challenges for the upstream Indian oil & gas industry are:

i. Amidst unstable international prices to ensure unremitting oil and gas supplies.

ii. To manage demand supply gap of petroleum and related products.

iii. To uphold the international market as a exporter of petroleum and related products.

iv. Balanced price mechanism in view of out of control global prices.

v. Formation of market competition in distribution and retail trade.

vi. Improving the management of subsidies in LPG, kerosene, petrol & diesel.

vii. Upgrading in energy efficiency and conservation of environment.

viii. To work in upstream sector as there is dearth of statutory framework in the upstream industry

ix. International or cross borders gas pipelines is facing improbability

4.2.REVENUE ISSUES

There are various tax and non tax instruments sources of collecting revenues that government can utilize in the oil and gas sector. Most of the countries use profit sharing and production based method of collecting economic rent as the government share or through some other instruments like PSC. Government also takes equity interests in the

[101] Global Tax guide 2015, E&Y accessed on 14.03.2016

business and participates more directly in the business, in some countries. Policymakers will likewise need to choose the treatment of indirect taxes, for example, VAT and traditions obligations.

Numerous monetary instruments might be expected to make an interest between the State and the investors (oil and gas companies) over the life of the contract. Royalties, for example, in the Production based instruments acts as guarantee and ensures the shares of government by way of an agreement and also that government receives a minimum rent for its natural mineral resources . Instruments like Production sharing contract or any other profit sharing agreement no doubt gives an upper side to the profit in business which is profitable or a discovery has been made but at the same time it becomes a loss business for the government when the business turns out to be not profitable and as result the government will get no revenues.

Other than profit based or production based agreements or instruments, there are various other payments like bonuses or rental and of different sorts. Bonuses guarantee some in advance income for the government and encourages O&G companies to all the E&P activities more quickly. They are normally suitable just in profoundly imminent zones where there is good market competition present among financial investors for petroleum operation rights. Another important instrument can be Annual rental payments typically though not an important source of revenue for the government but are designed in a way to encourage companies for relinquishment of their rights and create contract regions.

In numerous nations with petroleum assets, incomes from various instruments collect to various gatherings; for instance, royalty installments might be made to neighborhood units of government, landowners or the petroleum service.

4.2.1. TAX/ROYALTY REGIMES

This is the most common way of taxing oil and gas and it involves a combination of royalty and taxes. A tax/royalty regime generally includes 3 levies:

(1) the regular income tax that is applicable to all companies,
(2) a royalty which secures a minimum work payment to the government
(3) a resource rent tax to capture a larger share of the profits of the most profitable projects.

Income Tax

Same as for the other companies, Income tax in oil and gas sector is no different. It is levied as ion the any other registered company. That the tax rate for oil and Gas Company to be higher than that of normal company's general rate. Government uses this way to collect resource rent from the investors in block for the natural resources.

In general practice, most countries provides an incentive for the exploration and production activities in form of allowing to recover all the expenses incurred in the activity as cost recovery in accelerated way over few years. Recovery of cost in accelerated manner reduces the risk of investor and also distributes the debt of investors over the years hereby bringing forward the payback for the investor. It also deduces the interest costs and also deduces tax rates facilitating the project finance. Some countries have more specific lure offers in a manner to encourage exploration. .

Royalties

In simple royalty regimes, revenue is received as the developer announces the production in an oil field, it being easier to administer than many other instrument, these instrument are considered to be favorite and attractive to any government.

Additionally, it also ensures that the government receives minimum payable rent for the natural resources they extracted .Royalties are typically collected either specifically through amount or the volume of oil and gas extracted or through "*ad valorem levies*" which is based on the value of which gas and oil are extracted. Countries like Chile, Ecuador, Norway and Thailand have introduced a new concept of adding profit element in royalties which depends upon the level of oil produced or another mechanism of nominal return, in Counties like Peru and Kazakhstan, such as R factor.

Generally royalties raise the marginal cost of oil production and extraction, but can also act as a deterrent for the investor if charged at a higher rate. It may lead to non development of oil field by the investor even in case of discovery of marginal oil reserves and may show the way for the early desertion of oil wells that are producing at good rate. Investors partly oppose to the use of royalty regime,(even in areas of rich potential reserve) as it is charged at a higher rate and also that such payments only acts as deduction in accessing the total income at the end of year for assessment in home

country and are not allowed to be taken as foreign tax credit next to the own's country income tax assessment.

In the cases of royalty regime, the issue that is faced by the policymakers is to establish an effective mechanism for the assessment and valuation of the explored and extracted oil and gas to be used as base for collection of royalties and other levies. Ad valorem royalties are generally levied on the price of export or on selling price, after netting back certain costs. Observable price is also an issue to be considered. It is pertinent to note here that if a quoted market price is being used it should be such adjusted so as to reflect the difference in quality of the crude oil and gas, and also while establishing well head value, other costs and transportation costs should always be net back.

As per Article 9 of the Tax Guide[102], Royalty defined as "*PSC Participants shall pay royalty at 10% for crude oil & natural gas in offshore areas. For onshore areas the royalty shall be at 12.5% for crude oil and at 10% for natural gas. Provided, however, the royalty will be charged at half the rate applicable to normal off-shore area i.e., at 5% for deep water areas beyond 400 m bathymetry for the first 7 years, commencing with the year in which Commercial Production is commenced".*

"The valuation of Petroleum for the purpose of calculating royalty shall be as per the provisions of the Oilfields (Regulation and Development) Act, 1948 and the Petroleum and Natural Gas Rules, 1959. The royalty amount due for any month shall be paid to the Central Government/ State Government latest by the last day of the succeeding month in accordance with the provisions of The Petroleum and Natural Gas Rules, 1959".

Resource Rent Tax

RRT is an innovative endeavor with dual objective to furnish the government with a proper offer of share as the rent and to make the expense framework less distortive and in the favor of the investors. For instance in Australia and Papua New Guinea is forced just if the gathered income from the undertaking or the cash flow is sure. The net negative cash flow (in the early years of a venture) is amassed at a loan interest rate that, in principle, is equivalent to the organization's opportunity cost of capital (risk adjustment).

[102] Petroleum Tax Guide, 1999.

Once the company has earned the hurdled rate of interest, resource rent tax take the share that means if any business venture is less profitable, governments share will reduce automatically and will be at loss for the government in RRT making government flow of revenue back loaded. To combat this effect or to reduce the chances of loss, RRT is generally clubbed together with standard profit tax and royalties to provide minimum revenue to the government. Any project can be subjected to the resource rent tax if and only if the project is very profitable.

Theoretically, a rent resource tax has very effective economic features. Being properly designed, it takes over as the natural resource rent which is a return over opportunity cost of the investment induced by the company. It is argued that the RRT makes any contract more stable by adding more revenues in favor of the government in high profitable business ventures. Ring fencing of every contract area makes the RRT more efficient. Ring fencing of any contract area is the mechanism to limit the utilization of costs incurred in one area to be offset against revenue of other contract area. There is an exception to rule fencing that, to allow unrecoverd costs from an oil field block or contract are which is not in opwtration or has been abandoned to carryover to a contract are or block which is active in operation. This acts as tool for non discrimination next side to exploration hence prevents RRT.

Resource rent tax although being a much theoretically appraised mechanism but has never been a significant source of revenue in practice. Many reasons maybe attributed to this failure. It reflects the difficulty in framing of tax policies, specifically to mention the option of discount and tax rate. If the discount rate is kept at high level, resources rent tax then most probably would never apply and if , on the other hand, it is kept at lower level it may not lure much investors, as tax will act as a deterrent for the investors. In either ways of it if it is kept at lower rates or at higher rates , companies will enter into ways of avoiding taxes through wrong ways which will cause lots of financial loss to the country and also will create a lot of trouble to control and detect the tax avoidance if administration of country is week.

4.2.2. PRODUCTION SHARING

It is a substitute to the tax/ royalty regime where the government and investors enters into a contract for the extraction of oil and gas from a any allotted block. In this case, government remains the owner of natural resources and the oil and gas companies (i.e. investors) are given an exclusive right to explore produce and develop the oil field. Government in return gets the profit petroleum which is pre- decided in form of revenues and share for production of natural resources. The government appoints company or group of companies as contractor to carry out the E&P activity and to assist the government in extraction.

Instead of paying the companies for the costs of such activity, government agrees to give the return in form of recovery of cost petroleum through future transaction, while government bears the risk of exploration, cost and expenses. Upon such conditions contractor agrees to perform the production and development of oilfield in the country. The contractor shall not pay anything in case of no discovery of the oil reserves and development doesn't occur. Theoretically in this model, government retains the ownership of natural resource and allowing contractor to extract on their behalf. The government may retain or dispose off their share of petroleum through contract entered into with the contractor or any marketing agreement.

The principle in which the PSC works is quite simple and straightforward. The mechanism specifies the total production out of which the amount equivalent to cost incurred in the activity is taken out as "*cost petroleum*" which is taken by the investors as the revenue retainer. The remaining amount of production is termed as the "*profit petroleum*" (any quantity above the cost petroleum) which is shared between the government and the group of investors involved in business as consortium, which is divided as per the pre determined formula on PSC agreement.

Royalties can also be charged in the production sharing contract regime. It has to be paid at the earlier point to the government before the division of cost and profit petroleum. In country like India, which has a hybrid system where the companies pays both royalties

and share the production with the government, there is explicit payment of royalty to the government.

The royalty in PSC regime can be removed if cost oil to be recovered is limited to a share (for ex- 60% of production can be recovered as cost) as a result it ensures that as soon as there is production it will be profit petroleum which will be divided equally between government and companies. When there is a cap in the recovery of cost petroleum, it will, as a result become the source of revenue for the government and w=have the same effect as that if royalty and benefits to the government on higher side with government receiving the share of petroleum at an earlier stage.

If any cost which is unrecovered in any year can be carry forwarded to subsequent years, and in some PSC regimes government allows these costs as interest factor which to be compensated for the delay in the recovery of cost mechanism. Generally, interest expense is not considered to be recoverable.

In the event that interest cost is permitted to be recuperated, then there ought to be no uplift for unrecovered costs as this would include a twofold including to the degree unrecovered expenses are debt financed. The division of profit oil is regularly altered—60 percent for the State and 40 percent for the companies, for instance. It might differ by level of discovery and production, the cost of unrefined petroleum, or the rate of profit earned for the task. Contractors frequently pay tax on their income as share of profit petroleum. This expense could be paid out of the government's offer, however then the government's share ought to be expanded.

A noteworthy point of interest of this methodology is that the contractors and investors would have monetary steadiness—any future changes in the assessment principles would influence just the assignment of the government's 's offer in the middle of tax and non tax oil. The certification of monetary stability is an imperative venture motivating force, conveying the expense of diminished adaptability for the government to increase tax on a given task in future. A flexible PSC can be appealing to both the investors and government since it can be acclimated to suit specific venture circumstances without

changing the overall financial structure. Be that as it may, it may incorporate plan and managerial complexities bringing on a PSC to be as intricate to oversee as profit based assessments. Challenges relate especially to the determination of allowable cost recovery. Additionally, it is conceivable that the ex ante understanding turns out to be entirely improper as the genuine productivity of an undertaking gets to be known.

4.2.3. TAX/ROYALTY REGIME OR PSC REGIME: THE BETTER ALTERNATIVE

The choice between regimes to be adopted is not a difficult as it becomes inherent that fiscal terms can be interchanged and what terms are there in PSC can be inducted in royalty regime and what is there in royalty can be inducted in PSC. (Table 1 depicts such example).For instance, In India explicit royalty is charged in PSC regime[103]. Also share of cost petroleum which is allowed to be recovered can be reduced in PSC regime to give it a effect of Royalty which will be a implicit royalty. Income tax and other corporate taxes, in PSC regime, are charged at the same way in any other registered company. Resource rent tax can also be impliedly or apparently put into picture by split of profit oil.

This is particularly true if unrecovered expenses are inspired by an interest component that approximates the contractor's opportunity expense of capital. In such cases, there would be no profit oil to be part, other than the profit petroleum representing inherent or implied royalty, until the undertaking has earned the discount rate of return.

PSC regime is a consolidated model regime in one standard form of contract. It provides a helpful framework to new investors in the business as it contains all necessary functions and provisions and operating requirements. The PSC is a much easy way in which *contractual* assurances, in addition to statutory rights, can be made accessible to investors.

[103] The regime is known as Hybrid regime

CHAPTER V

5. RECENT DEVELOPMENTS IN THE FISCAL REGIME OF INDIA O&G SECTOR

Even with a tremendous production-sharing contract (PSC) regime, Indian oil and gas block auctions have not engrossed the big investors in the business, the Exxons and the Chevrons. The reason, as per the experts of the industry, is the "vagueness in policy execution" and "government intrusion".

5.1.NELP- AN UNDER-ACHIEVEMENT

The New Exploration Licensing Policy (NELP) which was created in 1997 to bring more private participation and to liberalize the business has failed terribly in the country in 14 years of its implementation nine rounds of NELP have been conducted in which 254 numbers of blocks were allotted in round of auction, out of which 178 are active and the rest are relinquished.

Although there has been good number of commercial discovery made in 41 active blocks, but commercial production couldn't be possible in more than 3 blocks. Several reasons were cited for such delay extending from lack of technological advancement to regulatory approvals and from various compliances to governmental interferences in the business[104].

5.2.A NEW STEP UNIFORM LICENSING

Recently approved policy by the cabinet is a uniform licensing policy for all the hydrocarbons acreages under an overall new contractual regime and a new fiscal model altogether that is expected to remove all the restrictions and make the business more suitable from the investor's point of view. With this regime, the explorers and the contractor's shall have the license to explore all kind of natural resources for ex- shale gas, petroleum and cbm etc.

This new policy shall replace the existing policies for offering blocks i.e. NELP regime and CBM policy for coal bed methane.

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[104] India Brand Equity Foundation, Oil and Gas Industry in India (June 2013), http://www.ibef.org///industry/oil-gasindia.aspx

The blocks for the tenth round of NELP auctions will be offered under the new policy. This time too the hitch is the fiscal regime, with policy-makers yet to reach a consensus. The new policy does away the current system of cost recovery and replaces it with an incremental production-based system. Under the cost recovery concept, a contractor first recovers his expenditure before sharing the profit with the government.[105]

5.3.BENEFITS OF HELP

As quoted by Mr. Dharmendra Pradhan in an interview. *Cabinet has approved Hydrocarbon Exploration Licensing Policy (HELP) which is the new exploration policy today.*

I have made a statement in parliament, there are 2-3 main features in HELP.

One, there will be marketing and pricing freedom to the promoter. This was the spirit in New Exploration Licensing Policy (NELP) also but unfortunately at one point in time government put its hand in that policy. Government has burnt its hand also. Now we are again leaving it to the market forces.

Second, there will be open acreage policy. At any point of time without waiting for formal bid if a investors comes that I am ready to go for a bid, I am ready to go for investment, they can bid. They can take the data from the data repository and they can bid at any point of time.

Third is revenue sharing. Previously it was production sharing contracts (PSC's). Production sharing was much debated, it was clumsy, there was more interference from government's side, there was a regular submission from the promoter and there was a constant spying eye on promoter also. Government need not interfere in day to day operation of that field. So, government rightly took this decision that government is only interested for the higher revenue. How do you do that, what technology will you bring, how do you manage it, it is up to the promoter. How much cost you will incur for development that is up to you.

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[105] *Good policy marred by poor implementation*, FRONTLINE.IN, available at http://www.frontline.in/other/data-card/oil-gas-policy/article5702002.ece

Fourth feature is uniform licensing policy. With single licence a promoter can produce oil, gas and unconventional hydrocarbon whether it is Coal Bed Methane (CBM) or shale gas.

These are the main four features. These four features will lead to more investment, more production, more employment, transparency will be there, little government interference should be there, all these features will come. That is why we are saying this is a paradigm shift in hydrocarbon sector with this HELP scheme[106].

Some of the benefits of HELP are listed below:

1. Uniform license for all the hydrocarbons
2. All the conventional and non conventional sources are included in it.
3. Open acreage bidding shall be conducted where the investors can choose an area of choice.
4. Lower rates of royalties to attract more and more investors
5. RSC i.e. revenue sharing contract shall substitute the PSC regime where no cost recovery will be allowed but profit will be majorly taken by the company and minimum share as rent to be offered to the government
6. No interference from the government side in the business
7. No auditing and lesser CAG interference in the business
8. More benefits to the company
9. Easy to administer revenue sharing model
10. Cess and import duty exemptions have been retained from the NELP era
11. More pricing freedom to companies, promoters.

5.4.DIFFERENCE BETWEEN HELP AND NELP

Hydrocarbon Exploration Licensing Policy (HELP) offers a single-license, revenue-sharing mechanism to substitute the multiple-license system for different hydrocarbons and profit-sharing with government under NELP.

[106] Transcript Available at http://www.moneycontrol.com/news/business/govt-clears-new-hydrocarbon-explorationlicensing-policy_5835341.html

A single universal license for exploration and production of all forms of hydrocarbons including shale gas offering the utmost revenue to the government.

Allotment of blocks shall be done under open acreage policy where investor can bid for block of their choice.

Concept of revenue sharing regime shall be made applicable. In PSC regime profit petroleum is hared after cost recovery by the company, but under RSC definite rate of share of profit petroleum shall be given to the company for example 80% to the company and rest to the government as rent for natural resources with no allowable cost recovery.

As quoted by the finance minister "*Revenue-sharing will not be subjected to cost recovery, monitoring will be simple, and the government share will accrue immediately on production, unlike in cost-recovery where the contractor first claimed its costs before splitting leftover profits, if any*" .

5.5.HYDROCARBON EXPLORATION AND LICENSING POLICY (HELP)[107]

The Union Cabinet, chaired by the Prime Minister Shri Narendra Modi, has approved the ***Hydrocarbon Exploration and Licensing Policy (HELP)****.*

Four main facets of this policy are:

i. uniform license for exploration and production of all forms of hydrocarbon,

ii. an open acreage policy,

iii. easy to administer revenue sharing model and

iv. marketing and pricing freedom for the crude oil and natural gas produced.

The decision will enhance domestic oil & gas production, bring substantial investment in the sector and generate sizable employment. The policy is also aimed at enhancing transparency and reducing administrative discretion.

The uniform licence will enable the contractor to explore conventional as well as unconventional oil and gas resources including CBM, shale gas/oil, tight gas and gas

[107] As published by press information bureau, India

hydrates under a single license. The concept of Open Acreage Policy will enable E&P companies choose the blocks from the designated area.

Present fiscal system of production sharing based on Investment Multiple and cost recovery /production linked payment will be replaced by a easy to administer revenue sharing model. The earlier contracts were based on the concept of profit sharing where profits are shared between Government and the contractor after recovery of cost. Under the profit sharing methodology, it became necessary for the Government to scrutinize cost details of private participants and this led to many delays and disputes. Under the new regime, the Government will not be concerned with the cost incurred and will receive a share of the gross revenue from the sale of oil, gas etc. This is in tune with Government's policy of "Ease of Doing Business".

Recognising the higher risks and costs involved in exploration and production from offshore areas, lower royalty rates for such areas have been provided as compared to NELP royalty rates to encourage exploration and production. A graded system of royalty rates have been introduced, in which royalty rates decreases from shallow water to deepwater and ultra-deep water. At the same time, royalty rate for onland areas have been kept intact so that revenues to the state governments are not affected. On the lines of NELP, cess and import duty will not be applicable on blocks awarded under the new policy. This policy also provides for marketing freedom for crude oil and natural gas produced from these blocks. This is in tune with Government's policy of Minimum Government –Maximum Governance. [108]

5.6.REVENUE SHARING AND PRODCUTION SHARING REGIME

1. Under the on hand production sharing contract (PSC), the contractor first recovers the expenditure before sharing profit that is cost petroleum and then after cost recovery profit petroleum is shared between government and the company.
2-Under the new proposal i.e. RSC, oil companies would have to pay the Government an agreed percentage of profit petroleum depending on the output, and not on the investment

[108] HELP, HTTP://PIB.NIC.IN/, available at http://pib.nic.in/newsite/PrintRelease.aspx?relid=137638 accessed on 17.03.2016.

in the exploration block. Cost recovery is not allowed but the share of companies is increased.

3-The shift in regime is a result of C. Rangarajan Committee. This newer regime is not a regime that will help government top earn more revenue but favors the contractors and there is progressively higher revenue for the government.

4-Rangarajan, in his report, had argued that the auditing and scrutiny by the CAG and Government in the affairs of company is interference in the business and as a result new regime is a benefit able regime for the companies.

5-The government's share shall be fixed and agreed determined separately for crude oil and natural gas as per the outcome or the production, Companies shall bid the amount they will offer as share with the government at different levels of discovery and production as well as special rates for oil and gas discoveries.

5.7.IMPLEMENTATION ISSUE AND CONTRADICTORY VIEWS

On the other hand, in contradictory to RSC and HELP, experts of the industry and hydrocarbons have supported the PSC regime wherein contractor can recover the costs; also few from the government side also support the existing regime of cost recovery, as it is contended that PSC regime is appropriate because risk is shared between contractor and the government and it's not only the contractor that will suffer the loss in case of non production and discovery.

Experts comment that, "The cost recovery regime requires close scrutiny of costs since there is an incentive for the contractors to book as costs all expenses that do not reflect the true economic cost to them."

"A shift in regime may not directly result in more revenues for the government but it will ensure that as the contractor earns more, the government will get progressively higher revenue. Besides, it will also safeguard the government's interest in case of a windfall arising from a price surge or a surprise geological find. Uniform exploration will also mean that there will be no overlaps of blocks for exploring oil, gas, shale or CBM. At present, when implementing the CBM policy and the NELP, it is seen that resources in certain blocks cannot be explored owing to separate contractual conditions. Besides,

shale horizons, which are not yet awarded to private players, have remained unexploited."

"The government also wants to simultaneously launch the Open Acreage Licensing Policy (OALP), which allows an explorer to study the data available and bid for blocks of his choice. It remains to be seen what kind of fiscal regime will be offered for the OALP. Also, blocks already awarded under the nine NELP rounds will continue to operate under the existing regime.

RECOMMENDATIONS AND CONCLUSION

The lessons from the experiences of Nigeria and other countries which are rich in oil can act as a testimonial for India in formulating its petroleum tax regimes and the policies. The hunt for the relevant and the most convenient form of legislation has led to a conflicting accumulation of tax laws in different legislative instruments. However, some legislation also existed decades before the actual oil and gas which repeals to be in consonance with the contemporary laws to ensure smooth compliance.

India must take certain action to streamline all contentious taxation issues to fortify and uplift the much needed local and foreign investments. It should also look after the investments in other potential sectors of the economy. The rewriting of tax legislation isn't a matter of concern. The nation shouldn't turn all the investments through eccentric taxation statutes and sideline major stakeholders; rather, it should create incentives.

According to the research it has been suggested that past petroleum bills should be synchronized to remove the differences, as it creates disharmony amongst tax payers. A panel for Petroleum Tax Review was established to analyze practical issues which were to be connected with a tax law. The Institute of Chartered Accountants, India (ICAI) could be drafted into the preparation of petroleum tax bills and the following discussions by Parliament to ensure the technical issues. The Tax holidays which was taken back after 2011 biding and block allotment is a deterrent to the investors. And the further application of GST is also important to reduce the cascading effect, which expressly excludes oil and gas sector from the applicability.

To conclude, India's oil and natural gas sector is emerging as a potential one from a commercial and business point of view as there are vast potential oil and gas reserve which is still unexplored. And too many huge offshore blocks are still to beexplored. With the introduction of NELP, E&P scenario in India has drastically changed for the betterment and upliftment. An assessment with the pre-NELP rounds in itself will succor the proclamation. Additionally NELP regime indicated the entry of the competitors of Oil and natural gas industry such as RIL & BP. Also the repose in FDI norms, allowance of 100% FDI under the mechanical route of E&P, infrastructure related to marketing tactics

of oil and natural gas. It also includes the “marketing of natural gas, petroleum products, petroleum product pipelines, natural gas pipelines, liquefied natural gas regasification infrastructure, market study, and formulation”. Oil refining in private sector, is positively a novel pace as it would give confidence to prospective investors in the near future. In additionally, the “new Shale gas policy initiative” is quite admirable and expectantly private players shall be permissible to put in this sector as well. “In Budget 2014-2015, Union Govt. has proposed an additional gas pipeline (15,000 km)”. This will be done using public private partnership in order to complete the gas grid and to help in reducing the usage of energy sources. Recently, the Ranagarjan’s committee recommendation has been taken to implementation and government has decided to substitute the production sharing model with revenue sharing model (post royalty payment revenue sharing) is praiseworthy. In revenue sharing regime, no cost recovery shall be allowed and the profit will be shared from the very first commercial production. Optimistically the union government will take all necessary steps to to bring suitable changes on existing thepricing framework of natural gas. Very pertinently the SC has given very important judgments on pricing mechanism and quote that the companies involved in oil and gas operations like E&P, refining and in retail can reasonably expect the fair competition[109].
Moreover, the significance of “freedom of contract” has been efficiently defined and has been effected by the Supreme Court and the CCI time to time and is subjected to reasonable conditions. Further Foreign direct investment in the oil and gas has been raised to 100% by the Indian government is a commendable step to boost the sector. “The middle of British petroleum and RIL (US$ 7.2 billion arrangement)” is one of the best example for this. The oil and gas business done by the private companies are much innovative and will more money into the sector, also it leads to development of the sector. Recently approved policy by the central government, Hydrocarbon exploration licensing policy is an innovative step for the business as it is a uniform license for all the hydrocarbons which also provides for open acreage bidding and also remove hurdles which a company may face if any unconventional resource is found during exploration of petroleum (they have to enter into a different contract for extracting the same , which is a

[109] See generally, Oil & Natural Gas Commission & Anothers. v. The Association of Natural Gas Consuming Industries of Gujarat and Ors. (1990) Supp. 1 SCC 397

costly mechanism). The policy also propose a contractual regime new fiscal model altogether that is RSC, and is expected to remove issues and challenges from the investor point of view. HELP shall replace the existing policy CBM for coal bed methane and NELP.

Universally, comparing and analyzing, India's fiscal regime and contractual model is acknowledged despite several challenges like government interference and not much technologically advanced, also India's strategic geographical location plays an important role. With wide scope of legislations and policies in the sector, we can put forward that Indian government is paying much attention in the business and also can say that a very good regime and financial outlook has been created in upstream that attracts more and more investors into the business. Additionally the regime is also a profitable one from the government's point of view. Despite of these laws and policies and being a successful regime there is strong need to reframe the laws and enact new policies to focus more upon fiscal regime of upstream regulation of oil and gas and also from investor's point of view.

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