

Oil & Gas Industry: Indirect tax

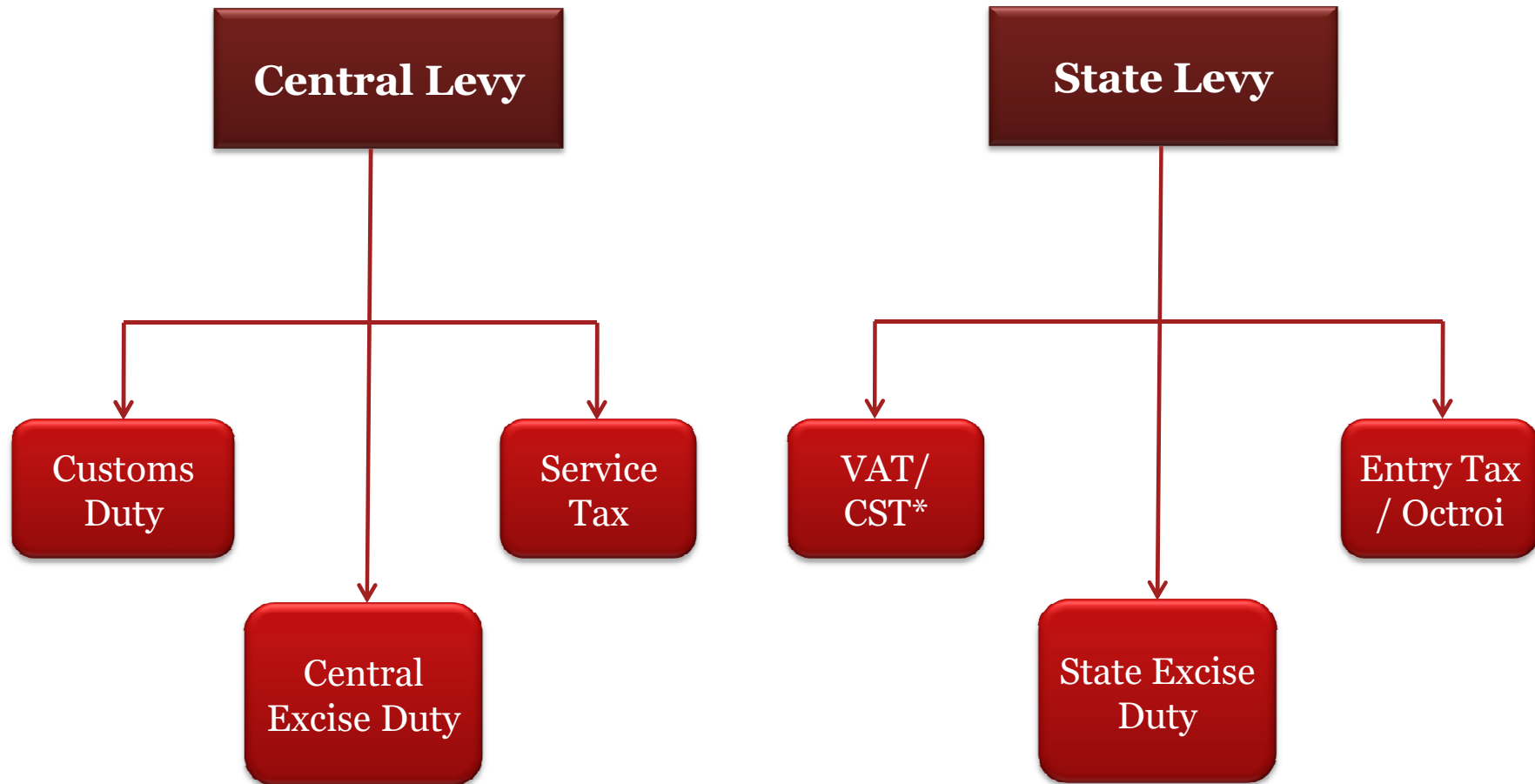
By Santosh R. Sonar
12 January 2013

Agenda

- Overview of indirect taxes
- Major indirect tax concerns for oil & gas sector
- Goods and Services Tax – An Overview
- Goods and Services Tax – Impact on Oil and Gas industry
- Conclusion
- Questions and Answers

Overview of Indirect Taxes

Indirect taxes - A Snapshot



*CST is levied by the Central Government and administered and collected/retained by the State Government

Bird's eye view of indirect tax structure – Oil and Gas

Differential treatment with multiple levies / high tax rates

Multiple levies along with cess, NCCD and higher VAT rates

Benefits/Concessions

Benefits/concessions are available mostly for upstream sector

Cascading effect i.e. break in the tax chain

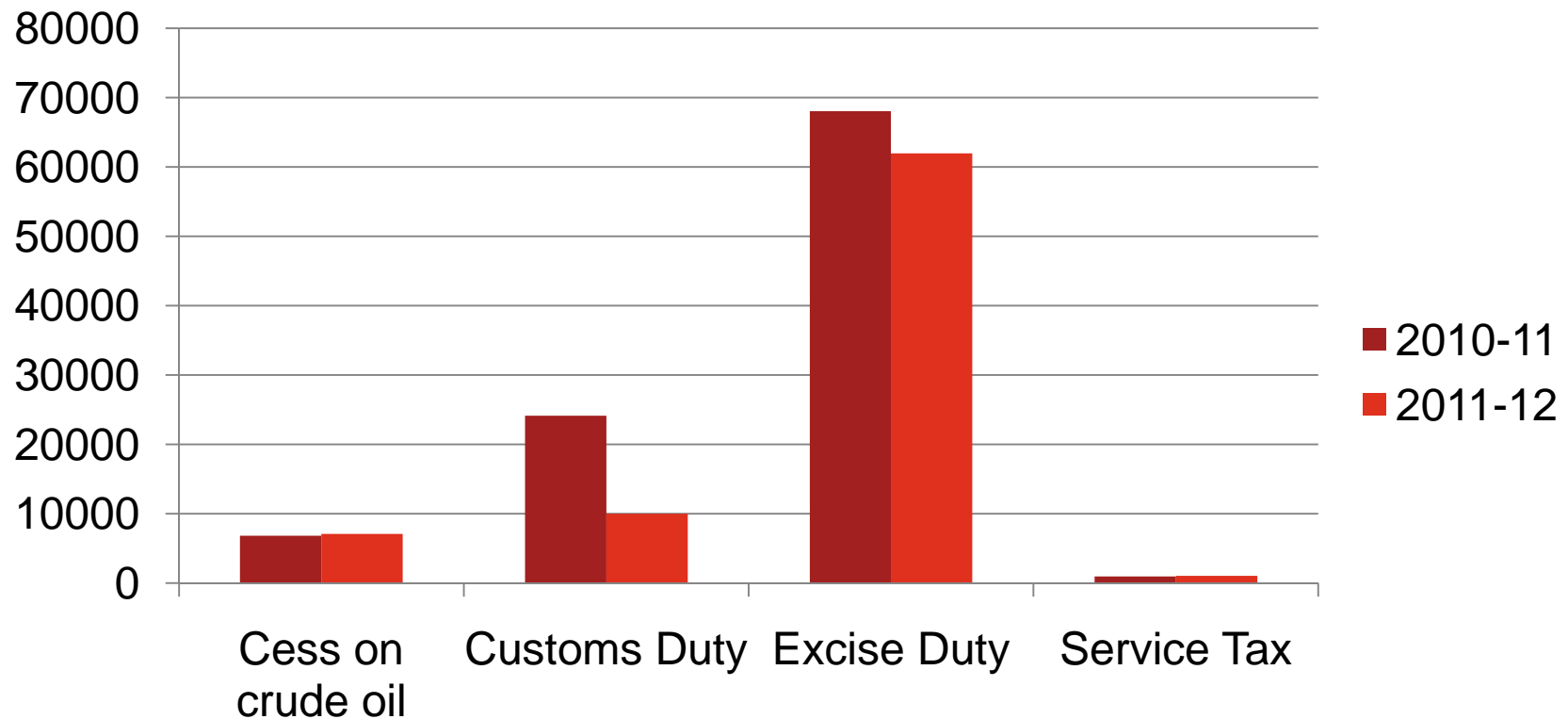
Restrictive credit regime resulting in cascading effect of taxes

No respite under proposed tax structure

Petroleum products i.e. Petrol, HSD and ATF is proposed to be kept out of GST

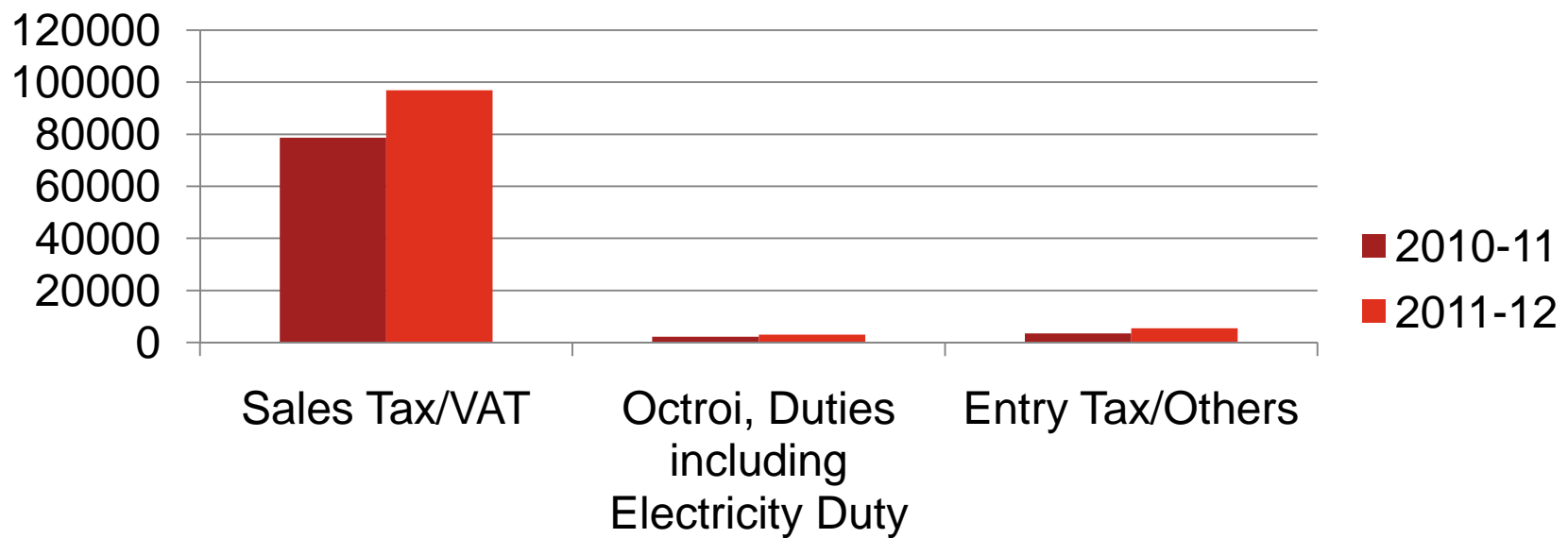
Oil and Gas – Contribution to Central Exchequer

Amount in Crores



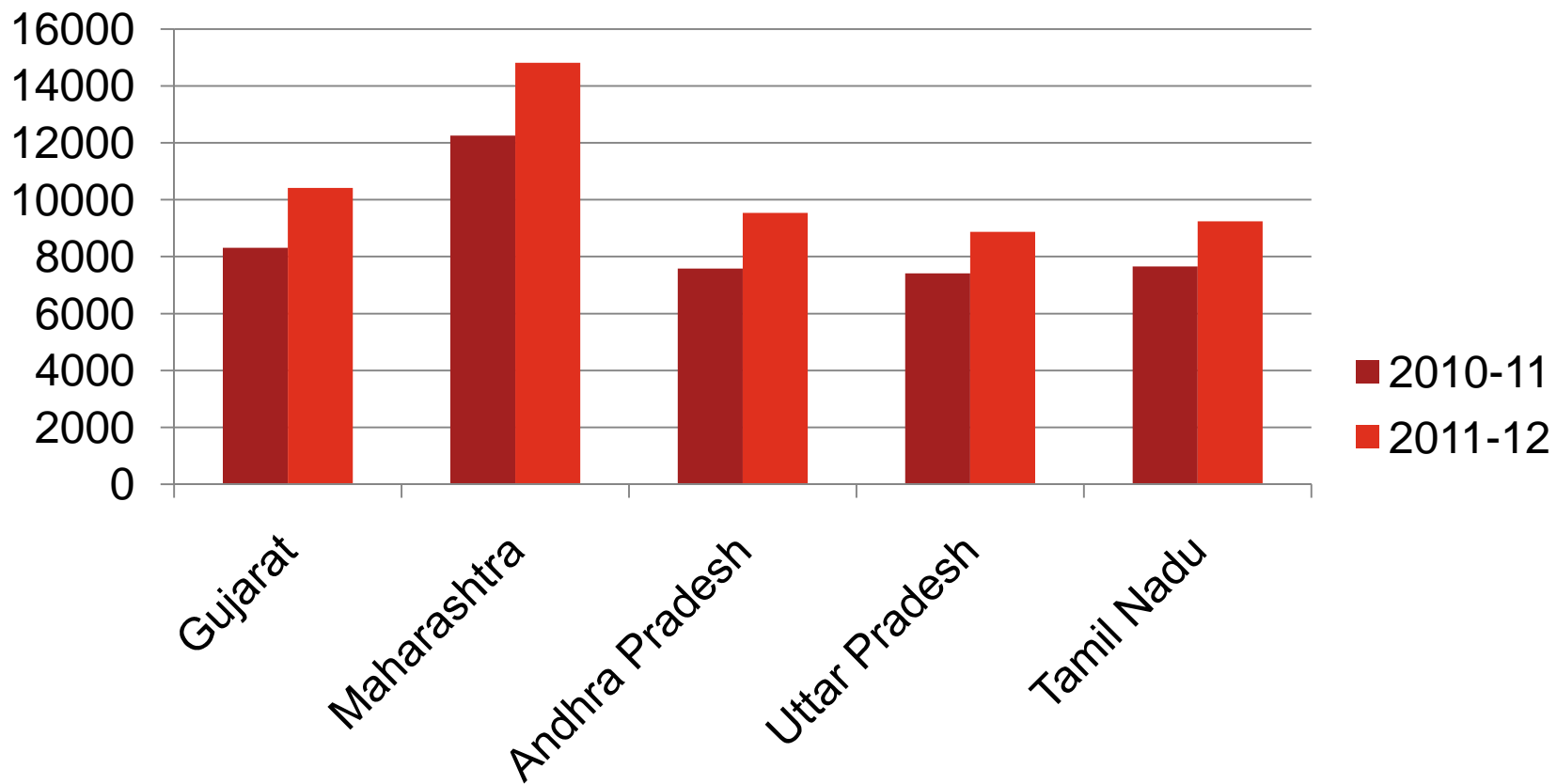
Oil and Gas – Contribution to State Exchequer

Amount in Crores



Oil and Gas – Contribution of VAT

Amount in Crores



Indirect Tax Provisions – Upstream sector

Customs Duty

- Customs duty applicable on import of crude oil and natural gas
 - Crude Oil : BCD Nil, however, NCCD of Rs.50/- per MT
 - Natural gas : BCD 5%
- Exemption from customs duty on import of specified goods for undertaking petroleum operations (exploration activities) subject to conditions

Excise duty

- No central excise duty applicable on Crude oil
- Crude oil is subject to Cess under Oil Industries (Development) Act, 1974
- Additionally, Crude oil produced in India subject to NCCD of Rs.50/- per MT

Indirect Tax Provisions – Upstream sector

VAT/CST

- Inter-State sale of crude oil and natural gas are subject to CST@ 2% against Form C
- Local sale of crude oil, being a declared goods, is subject to VAT @5%
- Local sale of natural gas is generally taxable @12.5%

Service Tax

- Oil and Gas Services cover wide range of activities that originate from prospecting phase and continue till the final stage of delivery
 - supply of equipment, vessels, tools and materials,
 - construction or laying of platform, pipeline and associated structures, etc
- No specific exemption from service tax for undertaking petroleum exploration operations

Indirect Tax Provisions – Downstream sector

- Petroleum products are treated differently for levy of indirect taxes
 - Different rates of duty specified for various petroleum products such as petrol, diesel, etc which are subject to both specific and advalorem duty
 - Generally, petroleum products subject to higher excise duty except Kerosene, Liquefied Petroleum Gas ('LPG') and Aviation Turbine Fuel
- Single point levy of VAT on petrol and diesel in most States
 - Key petroleum products (e.g. Petrol, Diesel and ATF) are not entitled for ITC
 - Inter oil company sales are either taxable with ITC or are exempt
 - The rate of VAT varies from 0% to 32% for various petroleum products

Indirect taxes constitute a major part of the pricing of petroleum products

Major Indirect Tax Issues

VAT/CST – Supply of goods beyond 12 NM

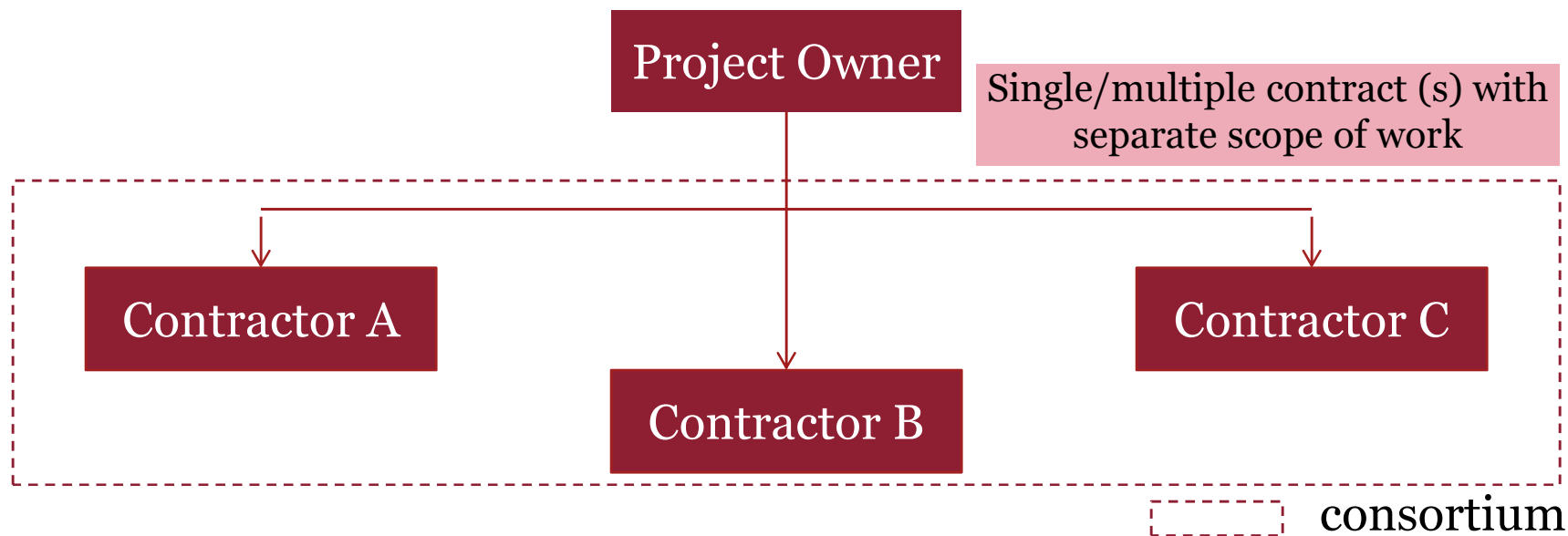
- State VAT Acts extend to the Territorial Waters of India
 - The limit of the Territorial Waters is up to the point of 12 nautical miles from the nearest point of the appropriate base line
- Applicability of VAT/CST on supply of goods to offshore installations beyond 12 nautical miles – contrary views
 - *Supply of Helium gas at Bombay High (beyond 12 NM) will not be subject to CST* [Larsen and Toubro vs. Union of India [2011 (46) VST (361) Guj HC]
 - *Sales effected from Maharashtra to Bombay High would be subject to CST* [Industrial Oxygen Co. Ltd. vs. State of Maharashtra [2010 (ST2) GJX (0443) STMAH]

Whether such sale would be treated as a local sale or an inter-State sale or a sale in the course of export ?

Service Tax – Works contract executed beyond 12 NM

- Applicability of service tax when works contract is executed beyond 12 nautical miles
 - the term ‘works contract’ [Section 65B(54)] means
 - a contract wherein transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods; and
 - such contract is for the purpose of carrying out construction, erection, commissioning, installation, completion, fitting out, repair,
 - of any movable or immovable property or for carrying out any other similar activity or a part thereof in relation to such property
- States do not have jurisdiction to tax sale effected beyond 12 nautical miles
- Hence, treatment of such indivisible works contracts for levy of service tax is highly debatable

Service Tax – Consortium of contractors executing works contract



- If such consortium of contractors is held as AOP then whether it will be subject to service tax separately from its members?
- If yes, how to determine the value of services as provided by the consortium of contractors?
- Whether CENVAT credit in the hands of such consortium would be available in respect of duty/tax paid by the individual members?

Service Tax – Liquidated damages/ recovery of similar nature

- Typically, a contractor is required to pay liquidated damages for delay in completion of facilities as agreed in the contract
- As per the new regime of Service Tax Law:
 - Any activity for a consideration is a service including declared service but excluding services specified in negative list or exempted services
 - ‘agreeing to tolerate an act or a situation..’ is a declared service
- Treatment of liquidated damages or other similar recovery in the hands of project owner is debatable

Project Owner to revisit service tax implications on the amount recovered from contractor

Service Tax – Project Office in India

- Generally, Oil & Gas service providers provide services to E&P Companies through their Project Office in India
- As per ST Guide, the term ‘Fixed Establishment means:
 - a place (other than business establishment) which is characterized by a sufficient degree of permanence; and
 - suitable structure in terms of human and technical resources to provide the services that are to be supplied by it, or to enable it to receive and use the services supplied to it for its own needs
- Determination of Fixed Establishment where
 - Project office in India undertakes only coordination and support activity and all the decisions and essential activities are undertaken by the Parent Company located outside India

Service Tax – Cost Allocation by the Parent Company

- Typically, the Parent Company outside India incurs various expenditure for the projects executed by the subsidiary or group company in India
- The nature of allocations typically include:
 - technical expertise cost;
 - technology support cost;
 - manpower support cost;
 - infrastructure support cost.
- Applicability of service tax on the allocation of such costs to the subsidiary company
 - Whether the cross charge by Parent Company be considered as a mere cost allocation without involving any activity or consideration for services

Service Tax or VAT – Supply of tangible goods

- Use of specialised machinery or equipments for undertaking petroleum operations is common
 - Considering the complexity of such operations, generally, there could be restrictions on free movement/ use of equipment
- Transfer of right to use goods is liable to VAT whereas supply of tangible goods for use is liable to service tax
- Meaning of ‘transfer of right to use goods’
 - transfer of possession and effective control of goods without transferring the ownership of the same

Bharat Sanchar Nigam Limited vs. Union of India [2006 (146) STC (91) SC 3 member bench]

CST – Procurement against Form C

- Goods can be procured at a concessional rate against Form 'C' only if the goods are intended for the following specified purposes:
 - re-sale and use in manufacture or processing of goods for sale;
 - use in telecommunications network ; use in mining;
 - use in the generation or distribution of electricity or any other form of power
- Determining the eligibility of a service provider engaged by the oil exploration company to make inter-state purchases against Form C
- Apex Court in the case of Indra Singh & Sons (P) Ltd. held:
 - that the expression “in mining” used in Rules 13 of the CST Rules cannot be read to mean in the business of mining. The goods must be intended to be used only in the actual activity of mining

Customs Duty – Setting up of Crude Petroleum Refinery vis-à-vis Substantial Expansion

- Concessional BCD for import of goods required for setting up of crude petroleum refinery
- Whether expansion of existing unit by installing or replacement of a new state of art Crude Distillation Unit along with the associated facilities can be construed as setting up of crude petroleum refinery
 - however, the exemption has been interpreted by the courts
 - In case of Mangalore Refinery and Petrochem Limited v/s Commissioner of Customs, Mangalore [2005 (187) ELT (466) Bang Tri];
 - In case of Hindustan Petroleum Corporation Limited v/s Commissioner of Customs, Chennai [2007 (213) ELT (609) Chennai Tri]
- The courts have held that factual evidences are required to substantiate that the substantial expansion involves setting up of crude petroleum refinery

Exempted Services and CENVAT Credit

Clarity on the ambit of “exempted services” and CENVAT Credit reversals required

- Inherent ambiguity in the law on what constitutes “exempted services”
- Trading of goods cannot be classified as a services. However, included in the negative list of services
- Treatment of income from investments – whether to be treated as “exempted service” and consequently, treatment of CENVAT credit of services used for earning income from investments

Other Issues

“Works contract services” – Valuation by the recipient of services

- Joint charge liability imposed on the recipient of services for payment of service tax,
- however, a service recipient has the option to choose the valuation method as per its own choice

Other Issues

CBEC Circular on recovery of demands against the assesseees

- The CBEC has issued a recent Circular instructing recovery of demands raised against the assesseees, if a confirmed order is passed within specified number of days, if stay is not granted
 - This is a draconian instruction and against the remedies of appeal available under the law

Goods and Services Tax

GST – Current State of Play

- First Draft discussion Paper published on 12 November 2009
- Report of the GST Task force issued on 15 December 2009
- Fourth draft of the Constitutional Amendment Bill (draft bill) — tabled in Parliament and referred for comments to the Parliamentary Standing Committee (The report of the Committee is awaited)
- Central Government in dialogue with the State Governments and Stakeholders to finalise the GST design
- Special CST Compensation Committee and GST Design Committee to be set up and reports to be submitted by 31 December 2012
- ‘GST Network’ to provide common technology infrastructure to the Centre and the States is being implemented by the Central Government

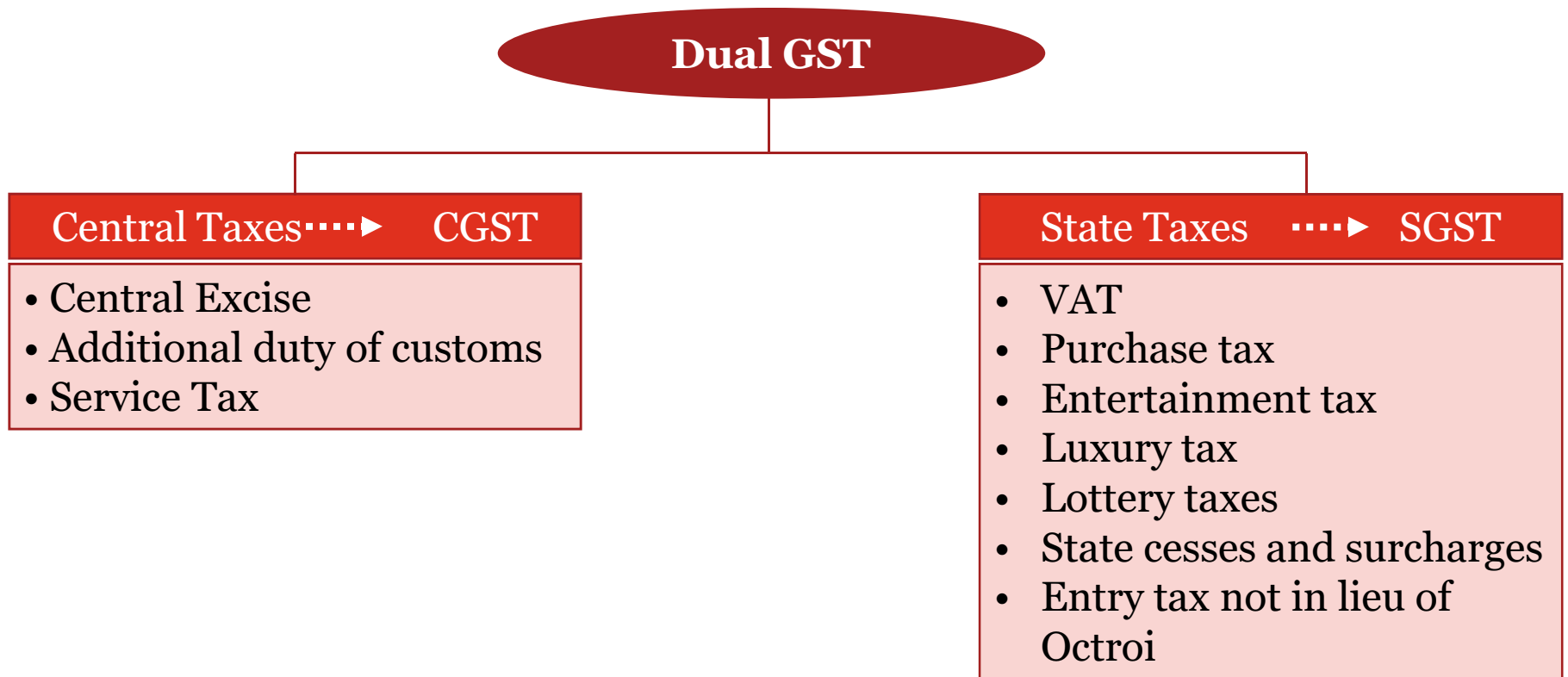
GST – Current State of Play

- Ground work for GST in Budget 2012:
 - Negative list of services introduced
 - Place of Provision of Services Rules introduced
 - Drafting of GST legislation in progress

GST – Salient Features

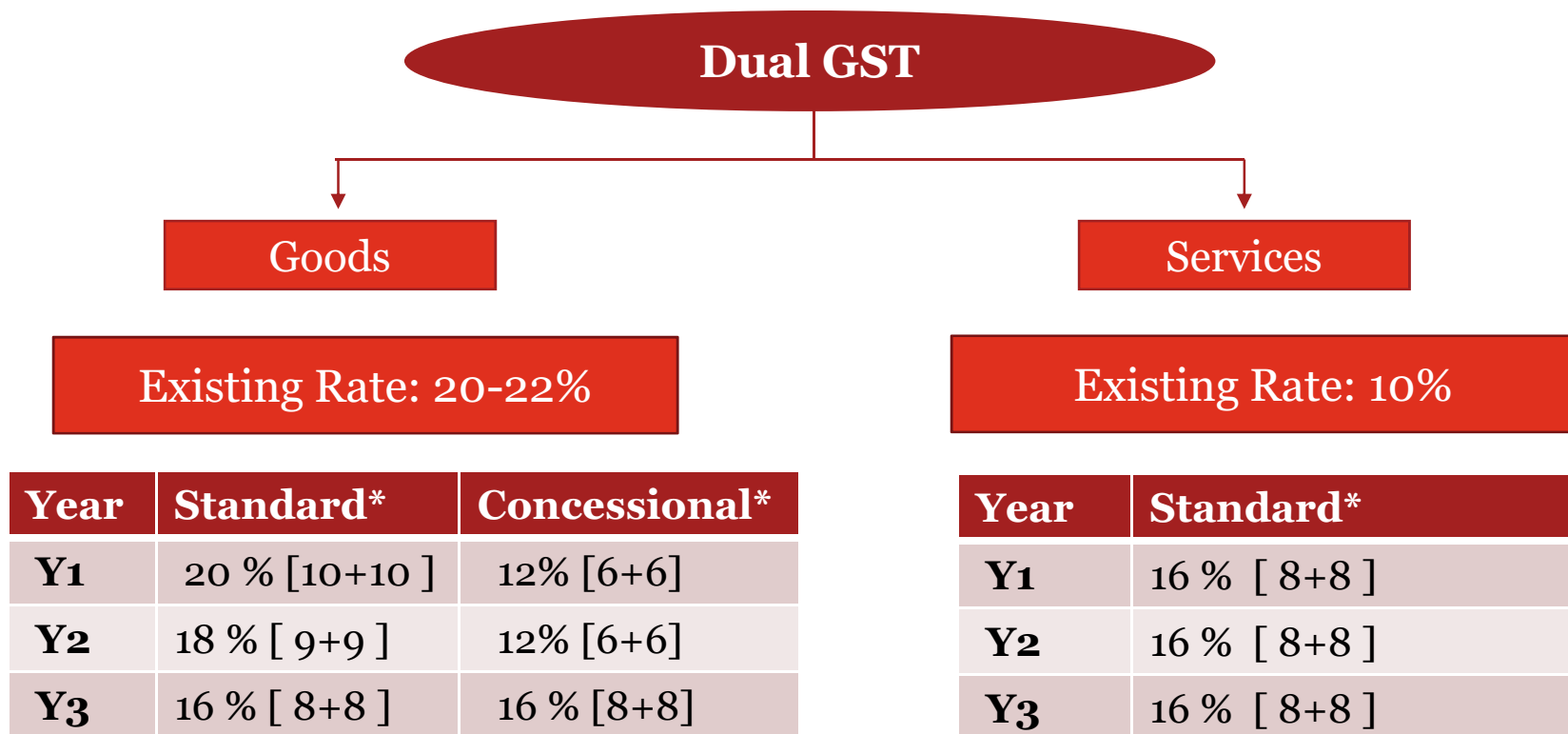
- GST is the most significant reform proposed in the taxation system of the country
- Taxable event in GST would be ‘supply’ as against ‘manufacture’ or ‘provision of service’ or ‘sale’
- GST will rationalise the Indian indirect tax system by amalgamating Central and State levies such as excise, service tax, VAT and CST into GST thus levying a comprehensive tax
- GST to comprise parallel levy of the following in order to constitute dual levy:
 - Central GST (to be levied by the Centre)
 - State GST (to be levied by the State)
- GST to be levied on all supplies viz., goods and services
- Exports to be zero rated, with benefit of refund of input taxes

Taxes proposed to be subsumed in dual GST



CST will be phased out

Proposed GST Rates



*** Proposed by the Central Finance Minister on 21 July 2010, yet to be agreed by the States**

Rate convergence @16 % across goods and services in Y3

GST Impact – Oil and Gas Industry

- Proposal to keep key petroleum products viz. crude oil, petrol, diesel, aviation turbine fuel and natural gas outside the purview of GST as per the Constitutional Amendment Bill, 2011
 - Multiplicity of Indirect tax laws remains
 - No change from current regime for E&P Companies as no credit of taxes paid during exploration and production phase available
 - Exclusion of ATF from GST regime which is currently eligible for ITC under Excise will reduce the credits
 - No clarity on continuation of levy of Cess under Oil Industry (Development) Act, 1974 and NCCD on Crude oil
 - Cascading effect of input tax credits to continue for E&P Companies
 - Lack of clarity on how both the taxes will have parallel operation (either as stand alone acts or will be merged with GST but the point of taxation will be changed)

To conclude..

To conclude

- Oil & gas industry is treated differently for taxation purpose and has its own challenges
- Uncertainty and challenges to continue till GST is introduced
- Oil & Gas sector needs to represent for comprehensive GST regime, else the challenges will enhance

Q & A

Thank You