



Ref. No.: PF/9
June 28, 2016

Shri Anant Kumar Singh
Additional Secretary & Financial Adviser
Ministry of Petroleum & Natural Gas
Shastri Bhavan
New Delhi

Sub.: Clarification on Non-applicability of Service Tax on Transactions between UJV under PSC and its Members for Petroleum Operations.

Dear Sir,

1. Indian economy is one of the fastest growing economies in the world. It is experiencing exponential growth in the per capita consumption of energy including petroleum and petroleum products. Presently, over 80% of the demand of petroleum and petroleum products are met through import. In order to step up the level of indigenous production of hydrocarbons, Government of India is making all out efforts to attract investment from domestic as well as overseas investors in the Hydrocarbons sector.
2. Against this backdrop, the Government of India announced New Exploration Licensing Policy (NELP) in the year 1999. The NELP provides exemption/ substantial reduction in taxes & duties such as exemption from Customs duty on import, exemption from Oil Industries Development Cess (OID Cess), lower rates of Royalty etc. so as to ensure that funds are invested in the activity of exploration & production of Hydrocarbons and not for payment of taxes & duties. The NELP also provided for fiscal stability for the entire period of contract.

Recently, the Government has approved Hydrocarbon Exploration Licensing Policy (HELP), and offered 67 small discovered fields to domestic as well as overseas investors under liberal terms to monetize these discoveries. These Policies are aimed to bring administrative simplicity, facilitate ease of doing business and bring transparency in the sector.

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3. Exploration of hydrocarbon is a high risk and capital intensive business with exploration success rate of only about 20-30%. With 50-60% reduction in global oil prices, levy of Service Tax on upstream hydrocarbon sector shall result in further increase in the cost of exploration putting a question mark on their commercial viability which will ultimately lead to reduced investment in this crucial sector of the economy. It is submitted that upstream hydrocarbon sector is already incurring substantial service tax expenditure on input services which is a stranded cost as no credit is available.
4. In contrast to the Government's stated aim for ease of doing business in India, recently DGCEI, Vadodara has issued Summons to almost all upstream hydrocarbon operators in the country apprehending evasion of service tax and asking personal appearance before Senior Intelligence Officer along with a plethora of documents/information for a period since April 2011. In some of the cases, Show Cause Notices (SCN) have also been issued by the field formations on levability of Service Tax on capital contributions (cash call) / revenue sharing (cost recovery/ profit petroleum) under Production Sharing Contracts (PSCs)/other re-imburement.

The SCN posits that a consortium/ un-incorporated joint venture (UJV) formed under the PSC is an association of person (AOP) or body of persons and, operator/ consortium partners are distinct persons. Accordingly, SCN alleges that operator under PSC is providing service to the other member(s) which is leviable to Service Tax.

5. In this connection, the following are submitted:
 - (a) Govt. of India has entered into PSC with each member of consortium individually for exploration and production of hydrocarbons from the NELP blocks. Therefore, such consortium/ UJV should not be treated as AOP for levy of service tax, as under Income Tax Act also, each member is assessed in respect of its share of income and not assessed as AOP

- (b) Under a PSC all members come together as a consortium/ UJV with a common objective of carrying out Petroleum operations in terms of PSC and each member bears the cost and resources for the above in the ratio of its Participating Interest at their own risk to achieve a common objective of exploring hydrocarbon resources. Such cost sharing among the members of the consortium/UJV does not tantamount to provision of Service which interpretation would be in conflict with the basic spirit of PSC.

Without prejudice, as operator is contractor under PSC and apportionment of Common Costs is towards production of crude oil and natural gas, the same will fall under negative list as provided in section 66D(f) of the Finance Act.

- (c) In terms of PSC, one of the members of consortium/ UJV is designated as the operator who alone is responsible for carrying out Petroleum operations. Each member of consortium/UJV contributes/invests in the ratio of its participating interest. Such investment is in the nature of capital contribution and cannot be treated as a consideration for any service. This has already been clarified by CBEC, MoF vide circular dated 24th September 2014.

6. Issuance of Summons, SCN to E&P Companies across the country has created uncertainties and unpredictability in the mind of investors. It is also submitted that invitation of bids for the blocks for Petroleum operations and PSCs signed with successful bidders provided fiscal stability to the Contractors therefore any fiscal burden imposed subsequently, apart from acting as deterrent to the investors, may lead to potential litigations with the Government.

Further, the Government has offered discovered small fields through open international competitive bidding round and any uncertainty will act as deterrent to the current and potential new investors.

7. In a recent clarification circular no. 192/02/2016-Service Tax dated 13 April, 2016, in case of services provided by Government or a local authority to any business entity, one of the items on which service tax has been levied in the context of natural resources is monthly payments with respect to the coal extracted from the coal mine or royalty payable on extracted coal.

There is apprehension that due to above clarification, field formation may levy Service tax on royalty which is a tax and levied under Section 6(A) of Oilfields (Regulations and Development) Act, 1948 on domestic production of crude oil and natural gas.

8. In view of the criticality explained above and the fact that the Government is currently in pursuit of attracting investment for small fields, I would request your urgent intervention to resolve the issues by way of clarification that no Service Tax is applicable on any transaction between UJV and its members including re-imburement of overhead cost by operator from members and further that no Service Tax is applicable on the payments of Royalty/ dead rent made under ORDA, 1948.

In the interim, I would request that suitable instructions maybe issued by Ministry of Finance (MoF) expeditiously to the field formation/authorities not to take any coercive action and put the matter on hold.

Thanking you,

Yours faithfully,



Dr. R. K. Malhotra
Director General

- cc: 1. Shri K. D. Tripathi, Secretary, MoP&NG
2. Shri Binaya Srikanta Pradhan, PS to Minister of State