PETROFED

PF/9
21st July 2016

Sh. K.D. Tripathi
Secretary
Ministry of Petroleum & Natural Gas
Shastri Bhawan, New Delhi

Sub: Constitution Amendments and GST Bill

Dear Sir,

At the outset we would like to congratulate and compliment the Government in pushing forward one of the most significant business reforms in the recent years through release of the Model GST Law. Tireless efforts made by the Government in this direction have made this dream a reality which carries with itself the potential of transforming the economic landscape of the country and provide an impetus to its economic growth. However, the implementation of GST in its present form will have far reaching implications on the petroleum sector and if some of the anomalies in the GST bill are not corrected or suitably addressed at this stage, it is going to hurt all companies operating in the petroleum industry.

On behalf of Petroleum Industry, we would like to submit as follows.

1. The draft Constitutional Amendment Bill read with the draft GST Bill proposes to levy CGST and SGST or IGST on supplies of all goods and services other than on supplies of Crude Oil, Natural Gas, MS, HSD and ATF (hereinafter referred to as 'Excluded Goods').

2. The draft Bill referred to above also proposes that the said `Excluded Goods' would be subject to the levy of GST/SGST/IGST from a date to be recommended by the GST Council and until then, all the Excluded Goods would continue to be subjected to the levy of Excise Duty and either VAT or CST.

3. The Petroleum Industry is alive to the reality, wherein, the `Excluded Goods' have been carved out to allay the fears of revenue buoyancy of the States, for a country wide implementation of GST.

4. The Petroleum Industry is also alive to the reality that the 'Excluded Goods' would also get included into GST and the levy of Excise duty and VAT/ CST on those 'Excluded Goods' would be done away with from a date to be notified on the recommendation of the GST Tax Council. The Petroleum Industry's only concern is that the implementation of the GST levy on Goods and

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Services other than on `Excluded Goods' should not hurt the Petroleum Industry that produces and markets MS, HSD, ATF Crude Oil and Natural Gas.

5. The input as well as the output of petroleum sector is a mix of products subjected to GST and the above 'excluded goods'. The hurt to the Industry happens because of stranding of input taxes as explained in Annexure I, separately for refining and marketing as well as exploration and production sectors. Stranding of taxes in this Industry would result in this industry being worse off than they were, before the implementation of GST.

6. If the Government were to levy an appropriate percentage of GST on "Excluded Goods' (sufficient to allow recovery of input GST credits), in addition to the existing Excise Duty and State specific VAT/CST on these 'Excluded Goods', there would no stranding of GST in the hands of the producers of these 'Excluded Goods'. As is the current practice, credit of GST on MS & HSD may be denied to the consumers under GST regime also. The industry submits that in its understanding, as per the Constitutional Amendment, the recommendation of the GST Tax Council is necessary only when GST is to be levied in place of Excise Duty and VAT/ CST on the 'Excluded Goods'. However there is no bar under the amended constitution to levy both Excise Duty plus State specific VAT/CST as well as GST simultaneously on the 'Excluded Goods'. If considered necessary, clause 12 (5) of the Constitution Amendment Bill, 2014 could be appropriately worded.

7. In the alternative, to overcome the tax stranding the following remedies may be considered:

   a) Supplies of indigenous goods by indigenous suppliers for use in 'Petroleum Operations' in exploration and production of Oil & Gas could be zero-rated under GST Act;

   b) Supplies of refined 'excluded goods' such as MS, HSD, ATF could be zero-rated under the GST Act, since they continue to suffer excise duty and VAT / CST.

   In the understanding of Industry, the above two could be added to the definition of "zero-rated supply' by adding another explanation to Sec 2 (109) of the Model GST Act, along with the existing deeming fiction of treating 'exports' as 'zero-rated supply'. The rationale for the above is explained in Annexure I.

8. In addition, the Industry would also like to make the following submissions:

A. Since all other sectors of the economy are better off due to the introduction of GST, particularly the Trading sector/ retail sector, which gets tax credits under GST (compared with denial of tax credits under the existing regime), MS, HSD, ATF, Crude Oil and Natural Gas should be brought into the net of GST at the earliest on the recommendation of the GST Council and prior to that it should be ensured that all exemptions from duty/ GST to crude oil, Natural gas, LPG (dom), SKO (PDS) etc. are withdrawn.

Since the benefit of subsidy in respect of LPG (Dom) and SKO (PDS) is being given to the targeted population directly through Direct Benefit Transfer (DBT) linked with Aadhar, and would get extended to the entire targeted population, there is no justification now for exempting LPG (Dom) and SKO (PDS) from Excise Duty and hence the exemption should be withdrawn with immediate effect.

B. In terms of the Government's Exploration and Licensing Policy, the Government of India has signed many Production Sharing Contracts with many individual member companies (called Participating Interest holders) constituting a consortium, for the purposes of Exploration and Production of Oil, Natural Gas and CBM. In terms of Customs Circular No.21/2012-Cus dated May, 16 2013, "Consortium" unlike a "Joint Venture" is not a distinct legal entity capable of importing goods by themselves. Under the GST, a similar provision should be made in the GST Bill so that the Status of the Consortium in the GST regime is pari materia with its status under the Customs Act.

We shall be grateful if the above submissions of Petroleum Industry are considered favourably by the Government and necessary amendments are carried out in the proposed GST law. We shall be pleased to provide any further information that you may require in this connection.

Thanking You,

Yours faithfully

Dr. R.K. Malhotra
Director General

Encl. Annexure I

cc. Shri Binaya Srikanta Pradhan, PS to Minister of State (I/C), Ministry of Petroleum & Natural Gas

Refining & Marketing Sector **Annexure I**

The major downstream sector that uses Crude Oil and Natural Gas is the Refining Sector. All the chemicals, catalysts and all services supplied to a Refinery which refines Crude Petroleum would be liable to GST, whereas output of a refinery would necessarily be a mix of GST goods (like LPG, SKO, Naphtha, furnace oil, Coke etc.,) and 'Excluded Goods' viz. MS, HSD and ATF.

As per Section 16(6) of the model GST Act, where the goods and / or services are used by the registered taxable person partly for effecting taxable supplies and partly for effecting non-taxable supplies, including exempt supplies, but excluding 'Zero-Rated Supplies', the amount of credit shall be restricted to so much of the input tax as is attributable to the taxable supplies including `zero rated supplies'.

MS, HSD, ATF produced by a Refinery attract levy of Excise Duty and VAT / CST and it is also a fact that they suffer the highest rates of tax, both under the Central and State legislations all over the Country. Hence, it would be *a misnomer* to call supplies of MS, HSD, and ATF, either 'non-taxable Supplies' or 'exempt supplies'.

The model GST Act provides for taking care of the anomaly that may be caused by terming the supply of MS, HSD, ATF as "non-taxable supply" or "exempt supply" by giving a third option of terming supplies of the most heavily taxed Excluded Goods as 'zero rated supply' thru explanations to the definition of 'Zero-rated supply'.

Currently, Explanation to Section 2(109) of the Draft GST / SGST Bill states that 'Exports *shall be treated* as zero rated supply'. In as much as Supplies of MS, HSD, ATF are neither `non-taxable supplies' nor `exempt supplies' as explained earlier, but are *`covered for the levy of Goods and Services Tax'* in terms of paragraph 2(g) of the Statement of Objects and Reasons of the Constitution 122nd Amendment Bill, supplies of MS, HSD, ATF, which have suffered tax under the Central Excise Act or State VAT /CST could be `zero rated', by adding another explanation to the definition of Zero-rated supply in Section 2(109), stating 'Supplies of MS, HSD, ATF shall be treated as zero rated supplies', so that GST related to the following supplies, viz.,

(1) Exports of MS, HSD, ATF, are eligible for refund of input GST credits.

(2) DTA supplies of MS, HSD, ATF, Crude Oil, Natural Gas which are liable to Excise Duty or State VAT / CST are allowed input tax credit of GST / SGST/ IGST used or intended to be used in the furtherance of business are admissible in terms of Section 2(109) of the Bill read with Section 16 of the model GST Act.

The above would not result in any revenue loss since all the final products of petroleum refining would continue to be liable to tax albeit under existing statutes and the tax proceeds accruing to the very same Union Government (Excise Duties) and State Governments (VAT/ CST).

Non-inclusion of the above supply of the `Excluded Goods' in the list of zero rated supplies under GST would be unfair to the Refining sector, since there would be stranding of input taxes in the hands of the Refining sector resulting in loss of input credits even though the output is subjected to high rates of taxes.

Exploration and Production Sector:

Similarly, in the exploration and production of crude oil and natural gas (upstream sector for short), the output of the upstream sector would also be a mix of GST & Excluded goods. The excluded goods would include Crude, natural gas and in some cases HSD & ATF, where as GST goods would include Propylene, LPG, Naphtha, Propylene, extracted out of rich natural gas (which issues out of some oil wells). The excluded goods would be liable to Excise Duty and VAT/CST. Thus it is a misnomer to call supplies of such excluded goods, which are liable to excise duty & State VAT as 'exempt Supplies'.

The crude oil / gas / CBM exploration and production sector is currently given the benefit of exemption from BCD, CVD and SAD of goods used in `Petroleum Operations', in terms of Customs Notification No. 12/2012-Cus dated 17/3/2012 bearing entry numbers 356, 358 and 359. This exemption has been given on imports of goods of Certified by the DGH as required for Petroleum Operations ("Essentiality Certificate") in order to ensure that the moneys committed to be expended by the explorers in exploring and developing oil fields / CBM fields (in line with the declared policy at the time of invitation of bids), is spent on procurement of goods and services and not in paying taxes to the Government.

In order to continue with the promise made by the Government, IGST on import of Goods required for Petroleum Operations should be exempted.

Since import would be duty free, to provide a level playing field to indigenous suppliers of the goods required for `petroleum operations', the supplies of indigenous goods by indigenous suppliers for use 'petroleum operations' in exploration and production of oil & gas should be zero-rated, so that there are no stranded taxes in the hands of the indigenous suppliers supplying to such 'Petroleum Operations'. The above request is in line with the recommendations on Negative Protectionism read with Table 3 and the illustration on the effect of CVD exemptions'(refer Paragraph 2.18 to Paragraph 2.28 of Shri Arvind Subramanian Committee Report on the RNR and Structure of rates for GST dated 4th December, 2015).

There would be no revenue loss to the Governments because of the above proposals, because

(1) imports for Petroleum Operations are any way exempt and

(2) any VAT paid on production of Crude oil and Natural gas is currently available as VAT credit in States like Andhra Pradesh, Gujarat, Maharashtra states, where most of the indigenous goods are being procured for Petroleum Operations.