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BUDGET ANALYSIS

IMPACT ON ENERGY & RESOURCES

February 2017

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Foreword

India has an overwhelming dependence on fossil fuels, particularly on coal, which caters to 58% of primary energy. Although India has ample reserves of thermal coal, due to environmental concerns and country's commitment to COP 21, Government has been trying to diversify sources of energy. Currently, we import 80% of our oil and almost 50% of our gas requirements. Given our low per capita consumption and our expected energy growth, India has been identified as the fastest growing oil & gas consuming countries in the World by all major energy forecasters. By 2035, BP Statistical Review of World Energy expects India's oil consumption growth to be the fastest among all major economies.

Given India's dependence on Oil & Gas, Government has taken several steps to increase domestic production of Oil & Gas and secure resources abroad for energy security. To help make these investments, in the Budget, the Government has announced creation of an integrated oil company. Although the details are awaited, pros and cons need to be studied. There are definite advantages of creating a large company that it will have a larger balance sheet to take major risks and absorb oil price variations, however challenges will remain on governance processes. In its attempt to diversify its energy sources, Government is trying to increase share of gas in the economy from current 6.5% to 15%. As a symbolic step, the Government has reduced BCD on LNG from 5% to 2.5%.

The Indian Power Sector is today the third largest in the world with installed capacity exceeding 310 GW and meeting peak demand of more than 150 GW. Renewable energy capacity addition has increased over recent years from 15 GW in 2010 to 46 GW by December 2017. However, the electricity demand has moderated, growing at less than 4.5% in energy terms over the current plan period. Thermal plants are currently operating at average Plant Load Factor (PLF) of less than 60% and this is flagged off as a concern in the Economic Survey released on 31st Jan 2017. Distribution utilities have been slow to procure long term power and hence several private plants are without long term Power Purchase Agreement (PPA). The budget has announced several

initiatives to boost the SME and MSME industries. It is hoped that due to this, industrial demand will revive and may help the companies improve their capacity utilization. The Government has re-iterated its commitment to provide electricity to all villages by May 2018 and has increased the allocation of funds to rural electrification programme. The Government continues its focus on renewable addition and has announced the second phase of solar park addition of 20,000 MW, which is keeping in track with India’s commitment to achieve 175,000 MW of Renewable Power capacity by 2022.

On an overall basis, the Budget provision offer a substantive promises to the energy & resources sector, however, as has been seen with earlier budgets of the extant Government, more detailing is required for implementation/delivery mechanism and follow-up of on the budget promises.

Key highlights

- The Government has maintained its target to achieve 100% village electrification by 2018 and continued with its plan for solar capacity addition to achieve 175 GW renewable capacity by 2022
- Creation of an integrated oil company is a major step, however, it needs to be ensured that we do not end up creating a large inefficient behemoth
- Increasing the strategic oil reserve to 15.33 MMT will create stock of almost a month to meet emergency requirements

Policy Updates

It needs to be seen whether, the various initiatives provided to SME and MSME translate into improved electricity demand. Unless there is a demand pick up, woes of conventional power sector will continue.

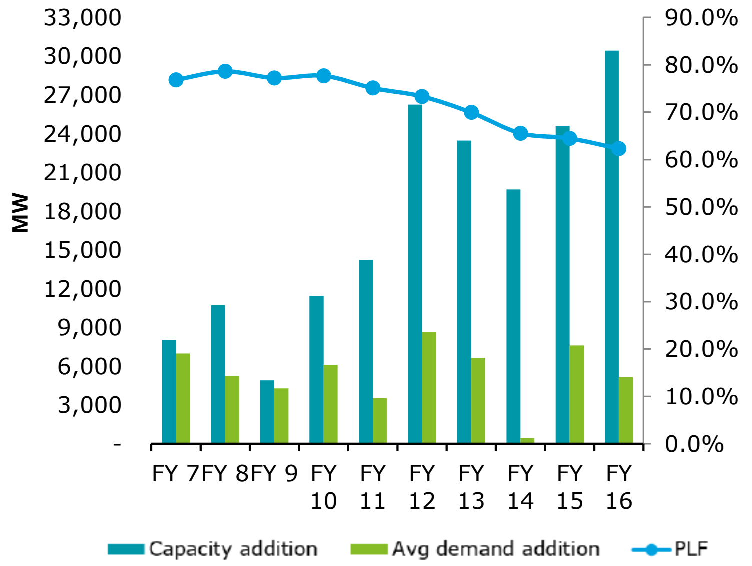
Conventional Power

Budget announcement

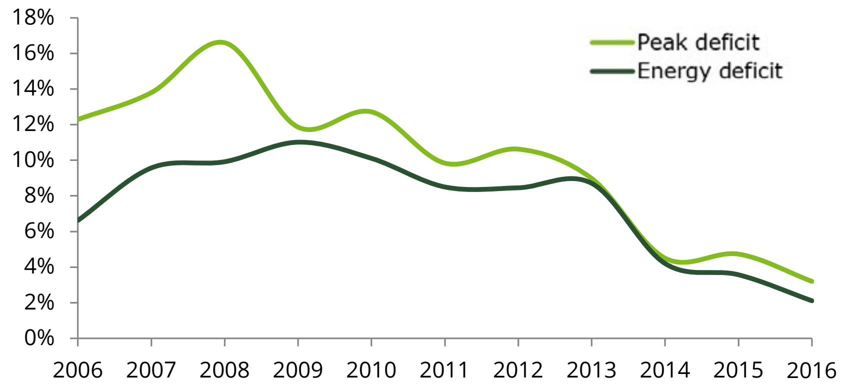
- The Government has maintained its target to achieve 100% village electrification by 2018 and continued with its plan for solar capacity addition to achieve 175 GW renewable capacity by 2022

Other recent policy updates

- As of January 2017, 21 States & Union Territories have joined Ujwal DISCOM Assurance Yojana (UDAY), covering 90% of the debt and allowing it to be restructured to lower interest rates.
- Government launched DEEP e-bidding & e-reverse auction portal for procurement of short term power. Distribution utilities have been mandated to purchase short term power from either DEEP or Power Exchanges.
- Government launched national program for replacement of energy efficient agricultural pumps and ceiling fans. Government distributed 200 million LED bulbs under the UJALA scheme.
- Union Cabinet approved National Tariff Policy to exempt hydro projects from competitive bidding and allowed them to enter into long term Power Purchase Agreements till 2022.
- Boost given to Micro Grids, the power generated would now be purchased by the Grid as and when the Grid reaches such areas.



Peak & energy deficit



Renewable energy / power

Budget announcement

- Government has proposed to use solar power in 7,000 railway stations. Work on 2,000 railway stations will be undertaken as part of 1,000 MW solar mission.
- Additional 20,000 MW of solar projects to be developed under second phase of Solar Park Development.

Other recent policy updates

- Procurement of 8% solar power to be mandatory by 2022.
- Bids invited for the first time for battery storage solar power plant.
- Competitive bidding introduced for wind power plants and bids called for 1,000 MW capacity. Bids received for more than 2,600 MW.
- Union Cabinet approved National Tariff Policy:
  - Zero inter-state transmission charges and losses for solar and wind power
  - Introduced renewable generation obligation for new coal/ lignite projects - after a date to be announced later
  - Ancillary services to be introduced to support renewable energy integration.
- Solar rooftop installed capacity crossed 1,000 MW.

GBI has not been extended for wind power projects and Government has continued with its solar programme.

In the oil marketing side it does not make sense to have a monopolistic entity having more than 90% market share. However, in the upstream space, it does make sense to have a company with a very large balance sheet, to withstand the fluctuations in oil prices and make large global acquisitions. One needs to be cautious that we don't end up creating an inefficient behemoth.

Oil and Gas

Budget announcement

- Government has decided to increase strategic crude oil reserves from 5.33 MMT to 15.33 MMT. India had three oil reserves in Visakhapatnam (1.33 MMT), Mangalore (1.5 MMT) and Padur (2.5 MMT). The additional reserves will be created at Chandikhole in Odisha and Bikaner in Rajasthan.
- Chandigarh and 8 districts in Harayana have become kerosene free.
- Government has continued the allocation to PM Ujjwala Yojana for providing free LPG connections at INR 25,000 million.
- The Government has reduced basic customs duty on LNG from 5% to 2.5%.
- The Government has announced formation of an integrated public sector oil company. The Government believes that this entity shall be able to take higher risks, will enjoy economies of scale, take higher investment decisions and create more value for shareholders.

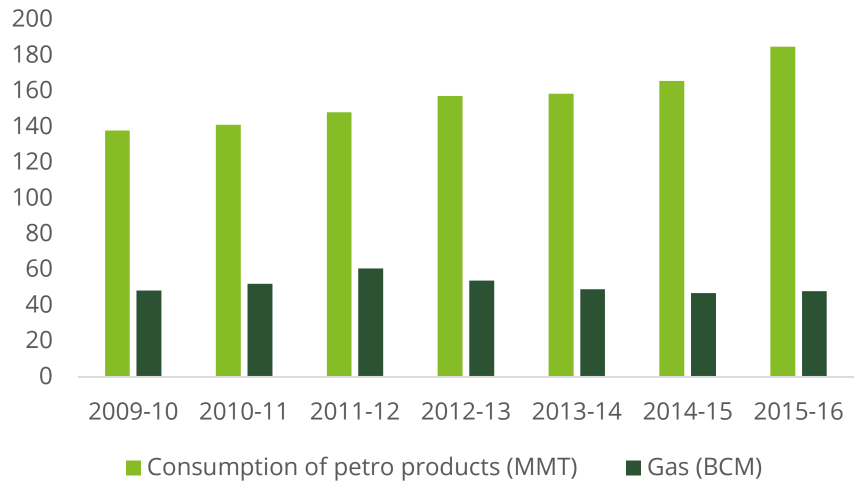
Other recent policy updates

- Under Discovered Small Fields policy, 134 e-bids were received for 34 contract areas from 42 companies.
- To provide connectivity of gas in eastern India and incentivize industrial and fertilizer plants in the region, government has agreed to provide 40% monetary support

of capital cost to GAIL for implementation of Jagdishpur-Haldia pipeline of almost 1,850 km.

- Under the Pradhan Mantri Ujjwala Yojana launched on 1 May 2016, the OMCs have provided 16.6 million free LPG connections to BPL families as of January 2017, increasing the overall coverage of LPG to 70%.
- Promotion for production of Biofuels in India by promoting production of ethanol from non-food feedstocks.
- Jharkhand became first state to implement the direct benefit transfer scheme for Kerosene.
- Various online initiatives introduced for cashless payment for petroleum products including petrol, diesel, LPG and even PNG.

Consumption of petroleum products in India



Reducing duty on LNG is an indication that the Government wants to encourage use of cleaner fuels, however, they could have waived the duty altogether. Cutting the import duty by half is not going to make much of a difference in landed price for consumers unless matched by increase in duty on polluting fuels.

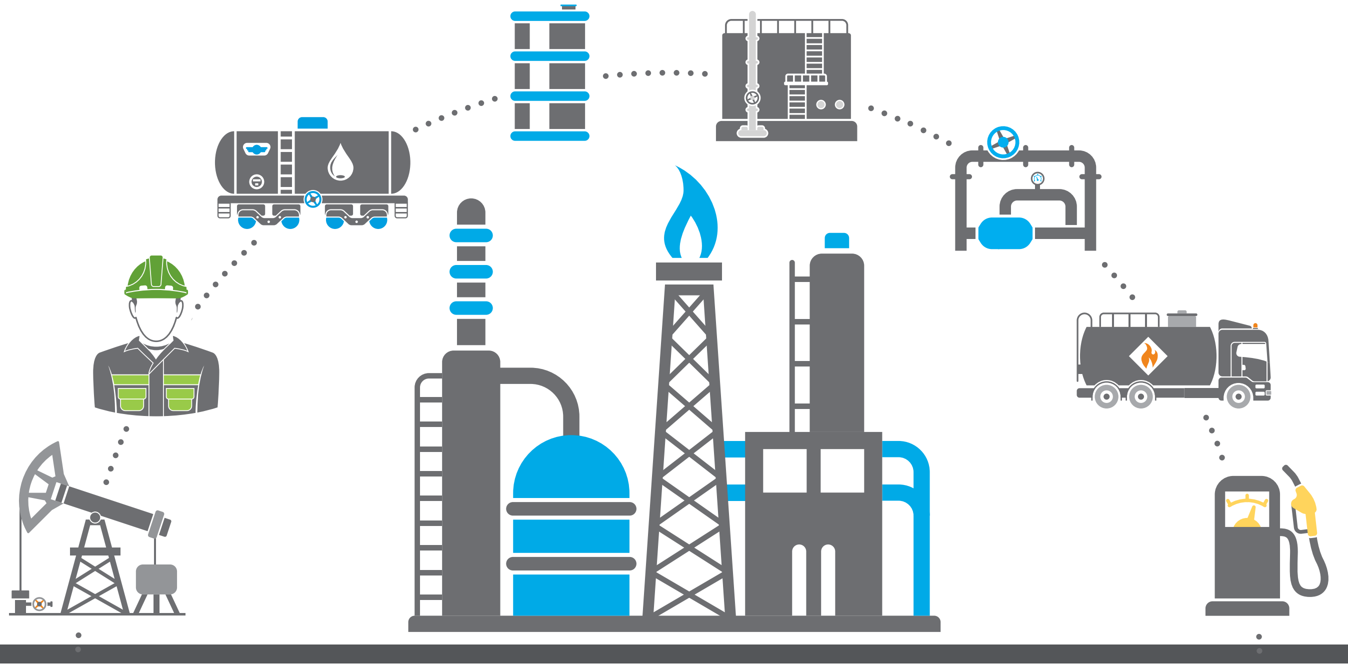
Mining

Budget announcement

- There is no specific announcement.

Other recent policy updates

- Ministry issued policy on flexibility in optimal use of domestic coal in efficient central and state power generating stations.
- Coal rich states allowed to set up plants with up to 35% power procured by Discoms on regulated tariffs.
- Competitive auction of coal linkages conducted for non-regulated sectors



Direct Tax

- Corporate tax rate for Financial Year ('FY') 2017-18 remains unchanged @ 30% plus surcharge and cess (except for Small & Medium Enterprise (SME) companies stated below). The proposed effective maximum marginal rate for Indian companies is 34.61% and for foreign companies is 43.26%.
- Corporate tax rate for FY 2017-18 proposed to be reduced to 25% plus surcharge and cess for SME companies with turnover or gross receipts not exceeding INR 500 million in the FY 2015-16. The proposed effective maximum marginal rate for Indian companies would be 28.84%.
- General Anti Avoidance Arrangement Regulations continues to come into effect from FY 2017-18.
- Determination of residency of foreign companies on the basis of Place of Effective Management applicable from assessment year 2017-18.
- In line with the Base Erosion and Profit Shifting plan, thin capitalisation norms have been introduced. Where debt has been issued by non-resident associated enterprises, the maximum amount of interest deductible would be 30% of Earnings before interest, tax and depreciation. The rule also seeks to cover soft lending / guarantee by associated enterprises.
- Period for getting benefit of long term capital gain in case of immovable property (being land or building or both) is proposed to be reduced from 3 years to 2 years.
- Base year of indexation for the purpose of computing capital gain tax is proposed to be shifted from 01 April 1981 to 01 April 2001.
- The concessional withholding tax rate of 5% in respect overseas borrowing has been extended from 1 July 2017 till 1 July 2020. The benefit of concessional withholding tax rate is extended to Rupee Denominated (Masala) Bonds too.
- Income from transfer of carbon credit to be taxed at the concessional rate of 10% (plus applicable surcharge and cess) on the gross amount of such income.
- Payment in cash above INR 10,000 (earlier limit INR 20,000) to a person in a day shall not be allowed as deduction.
- Transactions of more than INR 0.3 million in cash in a single day or from a single party or relating to one event prohibited.
- Conversion of preference shares of a company into equity shares shall not be regarded as transfer for the purpose of capital gains.
- Cost of acquisition of shares of Indian company in the hands of resulting foreign company shall be the same as in the hands of demerged foreign Company.

Income from transfer of carbon credit to be taxed at the concessional rate of 10% (plus applicable surcharge and cess) on the gross amount of such income.

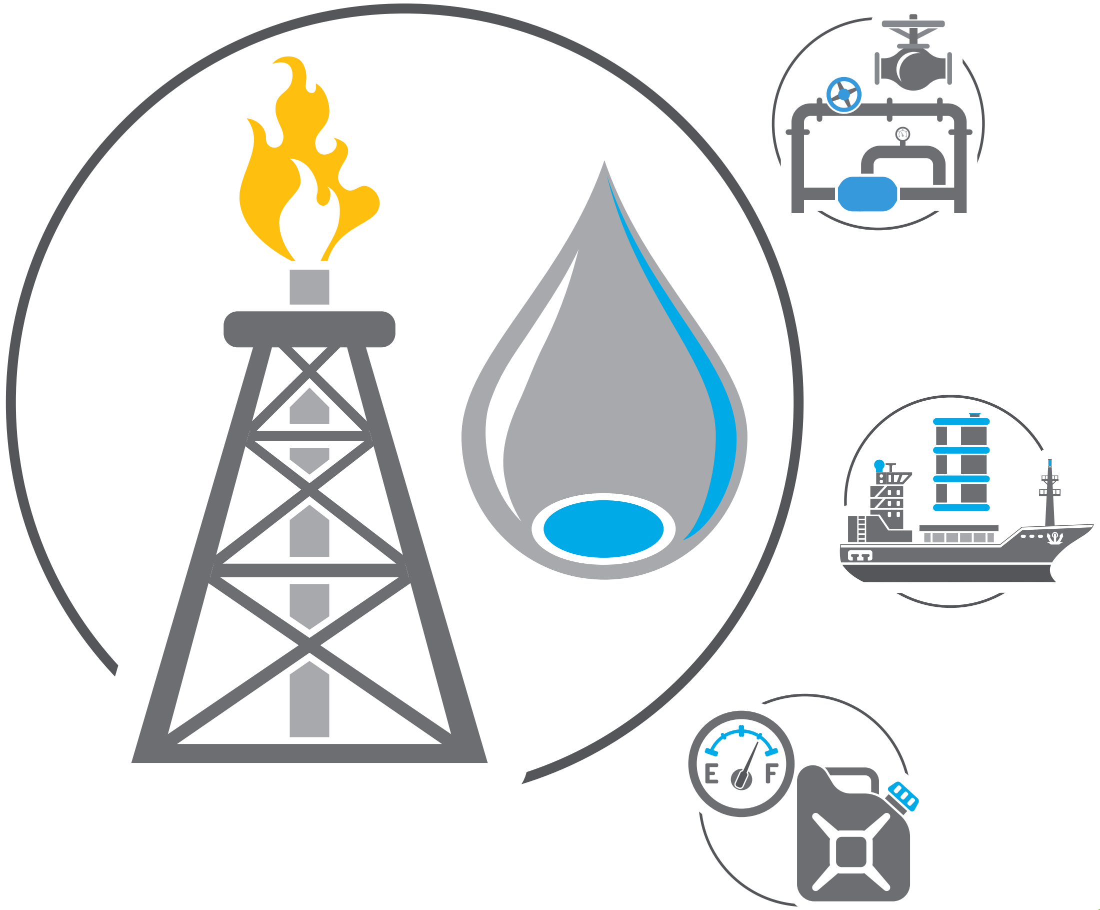
- Carry forward and set-off of tax credit in respect of Minimum Alternate Tax and Alternate Minimum Tax credit extended from 10 years to 15 years.
- Provisions of Minimum Alternate Tax rationalised to provide the framework for computation of book profits for Indian Accounting Standard compliant companies in the year of adoption and thereafter.
- Scope of specified domestic transaction reduced to exclude transactions relating to payment of expenditure made to a person referred to in under section 40A(2)(b).

- Introduction of Secondary Adjustment by re-characterizing the primary transfer pricing adjustment, as a deemed advance made by the assessee to the associated enterprise in case the excess money is not repatriated to India within the prescribed time, leading to imputation of notional interest.
  - The primary transfer pricing adjustment could result either from suo-moto action (by assessee), or as made by the assessing officer (accepted by the assessee), or under an advance pricing agreement, or as per the safe harbour rules, or as a result of resolution by way of mutual agreement procedure.
  - No secondary adjustment shall be made if the amount of primary adjustment does not exceed INR 10 million rupees, or the primary adjustment pertains to assessment year 2016-17 or before.
- Last year's Budget in February 2016 announced that income from storage and sale by the foreign company of crude oil to Indian residents would be exempt subject to the conditions that the storage and sale by the foreign company is pursuant to an agreement or an arrangement entered into by the Central Government or approved by the Central Government and having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Government in this behalf. The benefit of this exemption is now extended to sale of leftover stock of crude oil, if any from a facility in India even after expiry of the said agreement or arrangement.

Carry forward and set-off of tax credit in respect of Minimum Alternate Tax and Alternate Minimum Tax credit extended from 10 years to 15 years.

Indirect Tax

- Merit rate of customs duty and excise duty as well as standard rate of service tax has remained unchanged.
- Research & development cess, as being levied on import of technology, is proposed to be repealed.
- Basic Customs Duty (BCD) is being reduced from 7.5% to 5% and Special Additional Customs Duty (SAD) has been completely exempted on Catalyst [38159000] and Resin [39094090] for use in the manufacture of cast components of wind operated electricity generator subject to actual user condition. Exemption from SAD will be valid till 30 June 2017.
- Excise duty / Counterveiling Duty (CVD) is also being exempted on Catalyst [38159000] and Resin [39094090] for use in the manufacture of cast components of wind operated electricity generator subject to actual user condition.
- Rationalization of customs and excise duty structure for solar tempered glass:
  - BCD is being reduced from 5% to NIL on solar tempered glass or solar tempered (anti-reflective coated) glass for manufacture of solar cells / panels / modules, subject to actual user condition.
  - Excise duty exemption on solar tempered glass for use in the manufacture of solar photovoltaic cells or modules, solar power generating equipment or systems, flat plate solar collectors, or solar photovoltaic module and panel for water pumping and other applications is being withdrawn and 6% concessional excise duty is proposed to be imposed on the same, subject to actual user condition. This 6% concessional excise duty will be valid till 30 June 2017.
  - Excise duty is being reduced from 12.5% to 6% on parts / raw material for use in the manufacture of solar tempered glass, for use in solar photovoltaic cells or modules, solar power generating equipment or systems, flat plate solar collectors, or solar photovoltaic module and panel for water pumping and other applications, subject to actual user condition. This 6% concessional excise duty will be valid till 30 June 2017.
- Rationalization of custom and excise duty proposed for fuel cell based power generation systems:
  - BCD is proposed to be reduced from 10% / 7.5% to 5% on all items of machinery, including, instruments, apparatus and appliances, transmission equipment and auxiliary equipment (including those required for testing and quality control) and components, required for initial setting up of fuel cell based system for generation of power or for demonstration purposes subject to certain conditions.
  - Concessional excise duty at 6% is proposed for all items of machinery, including, instruments, apparatus and appliances, transmission equipment and auxiliary equipment (including those required for testing and quality control) and components/parts, required for initial setting up of fuel cell based system for generation of power or for demonstration purposes subject to certain conditions. The concessional excise duty will be valid till 30 June, 2017.
- Changes in custom and excise duty proposed for biogas or bio-methane or by-product hydrogen power plant:
- BCD is proposed to be reduced from 10%/7.5% to 5% on all items of machinery, including, instruments, apparatus and appliances, transmission equipment and auxiliary equipment (including those required for testing and quality control) and components, required for balance of systems operating on biogas or bio-methane or by-product hydrogen subject to certain conditions.



- Concessional excise duty at 6% is being prescribed for all items of machinery, including, instruments, apparatus and appliances, transmission equipment and auxiliary equipment (including those required for testing and quality control) and components/parts, required for balance of systems operating on biogas/ bio-methane/ by-product hydrogen, subject to certain conditions.
- Custom duty structure changes proposed for inputs, parts used in manufacture of Light Emitting Diode (LED) lights / LED lamps:
  - BCD at 5% is proposed on all parts for use in the manufacture of LED lights or fixtures including LED Lamps, subject to actual user condition.
  - BCD at 5% is proposed on imports of inputs for use in the manufacture of LED driver or Metal Core Printed Circuit Board (MCPCB) for LED lights and fixtures or LED Lamps, subject to actual user condition.
- Export duty is being imposed at an effective rate of 15% on 'Other aluminium ores, including laterite' falling under tariff item 26060090. However, goods other than the said goods falling under tariff item 26060090 (concentrates) will continue to attract Nil export duty.
- BCD on import of LNG is reduced from 5% to 2.5%. Full exemption from BCD, as available on import of LNG by specified importers or for specified purpose shall continue.
- The condition no. 40A corresponding to Entry No. 357A of the Notification No. 12/2012 – Customs has been amended to resolve the ambiguity with regard to demand of customs duty on unused, surplus or obsolete goods for oil & gas exploration, which were imported by claiming full exemption from BCD. In view of this amendment, such unused, surplus or obsolete goods can be disposed-off on payment of applicable customs duties, on the depreciated value calculated as per straight line method (subject to depreciated value not being less than 30% of the original value) of such goods.

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