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Tax Tweaks Jeopardize City Road Spending

By Anatoly Medetsky

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The city treasury is on course to take a painful hit from new federal tax legislation — an annoying hurdle in the effort to elevate Moscow as a global financial center by spending big on roads and the subway.

Compelled by tax laws that took effect in January, some of the city's largest taxpayers — such as Gazprom — plan to reduce their payments here in favor of the regions where they actually operate.

The change could erase up to 200 billion rubles ($6.77 billion) from city revenues this year, or 14 percent of the total, said State Duma Deputy Oksana Dmitriyeva, who sits on the federal legislature's budget and tax committee.

The world's largest gas producer Gazprom and the country's biggest oil producer Rosneft have committed this month to create "consolidated taxpayer groups" that would reroute some of tax revenues away from Moscow. Russia's second-largest oil producer LUKoil said last week that it had already consolidated its tax payments.

"The others will gradually follow," Dmitriyeva said.

A large-scale outflow of oil and gas taxes could hamper City Hall's ambitions — first championed by outgoing President Dmitry Medvedev — to make Moscow more visible in the global financial world. A key element of the strategy to achieve that goal is to pour billions of dollars into relieving traffic congestion aboveground and improving mass transit underground.

Mayor Sergei Sobyanin said March 11 that the city would spend 219 billion rubles — slightly more than the potential loss of tax revenues — on improving the road network and extending subway lines this year. In a sign that the imminent slump in revenues aroused concerns in some government quarters, a State Duma deputy has proposed amendments that would mitigate the effects of the transition by obligating the consolidated groups of taxpayers to spread it over several years.

If the blow to city coffers grows "tangible and serious," the city could raise its property-lease rates and review other tax breaks, said City Duma Deputy Alexander Krutov, a member of the legislature's budget and finance committee.

"Of course, it's annoying to have different revenues than we expected," he said.

Standard & Poor's said the city of Moscow could have to restart borrowing in the future to keep up the momentum of increased spending on roads and the subway. The city didn't raise any money on financial markets last year.

The dimensions of the revenue shortfall remain a moot point.

A Rosneft spokesman was unable to say how the company's tax contribution would change in Moscow. A LUKoil spokesman said the company didn't have an estimate.

The tax take from Gazprom alone could drop by 52 billion rubles this year, the federal Duma's budget and tax committee learned in hearings last week, Dmitriyeva said.

It remained unclear whether TNK-BP, the country's third-largest oil producer, is contemplating consolidation of its profit-tax payments. A company spokesman asked for questions in writing but did not respond to an e-mail from The Moscow Times.

Krutov agreed with Dmitriyeva's estimate that a 200 billion ruble plunge in profit-tax revenues was the most that the city could suffer. But a decline of that size is unlikely, he added.

He said the city's total tax take from oil and gas companies measured 300 billion rubles, or 20 percent of budget revenues.

Vladimir Nazarov, an economist at the Gaidar Institute, a think tank, predicted that the city's collection of the profit tax would contract 8 percent this year, which works out to 116 billion rubles.

"This may cause the need to economize," he said. "But if the oil price remains high, they will make do without economizing."

Standard & Poor's analyst Boris Kopeikin said the company didn't expect that the tax change would inflict substantial damage on the city's finances in the short term. Any borrowings by the city to fund road and subway construction would likely not occur before the end of this year, he said. One of the reasons for this forecast is the 240 billion ruble municipal budget surplus from last year that is available for spending.

Some of the major resource companies with production units all over the country are looking at the option of consolidating their profit-tax payments because another law — on transfer pricing — that came into effect in January threatens to disrupt their day-to-day business. The law makes it difficult for head offices to use "transfer," or nonmarket prices, in relations with subsidiaries. The tax-consolidation option allows these companies to proceed as before.

As consolidated taxpayer groups, companies evaluate the proportion of their total headcount — or the payroll — in a region of operation to determine how much they pay in profit tax to that region. The other factor that comes into play is the value of a company's assets in that region.

That way, the city of Moscow will still have a share of the profit tax.

"Something will definitely stay in Moscow," said Kirill Vikulov, an associate at Baker & McKenzie. "These companies normally have high-paid employees, office buildings and some other property in the city."

Gazprom could be liable for as much as 650 billion rubles ($22 billion) a year in extra taxes on its earnings from higher domestic tariffs, Alfa Bank said, Bloomberg reported.

The government may tax 80 percent to 100 percent of Gazprom’s profits from domestic tariff increases, which may result in a windfall of 140 billion to 650 billion rubles annually in the next five years, Alfa Bank analysts Pavel Sorokin and Maria Yegikyan wrote in a note Monday.

“Discussion is worrying, with a high chance of further tax increases exceeding the scheduled pace,” Alfa Bank said. “The proposed measure can indeed become a cash-flow killer.”

A ruling could come within the next two weeks, as the government discusses what percentage of profit will be taxed, the bank said. It isn’t clear whether the proposal will use “additional revenue or actual profit received from indexation,” Alfa Bank said.

The government may decide on the size of the tax within the next two weeks, Deputy Finance Minister Sergei Shatalov said in comments posted on the ministry’s website on March 16.