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Tax Regime Changes Mulled for Oil Companies

By The Moscow Times

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The Finance Ministry says it opposes a proposed shift to a profit-based tax for oil companies rather than taxing output and exports, because its priority is to maximize revenue for state coffers.

Russian tax authorities have long relied on counting barrels to ensure steady revenues, but with output in the world's largest oil producer reaching a plateau, the industry has lobbied for a profits-based system that better reflects exploration costs and risks.

Energy Minister Alexander Novak said this month that the long-mooted idea of profit-based tax could be tested in a pilot project this year.

"We are decisively against it. Lots of tax benefits have already been introduced for the oil companies," Ilya Trunin, head of the tax, customs and tariff department at the Finance Ministry, said in an interview Friday.

The oil-producing heartland of western Siberia accounts for 60 percent of Russia's production of more than 10 million barrels per day equivalent. Output in the region has been falling about 1 percent per year.

Analysts say these "brownfields" will continue to account for the lion's share of Russian production in the years to come, despite companies' push to extract oil in new oil provinces such as eastern Siberia and the Arctic offshore.

Growth from these "greenfields" alone would not be enough to boost overall output, and unconventional reserves such as hard-to-recover tight oil would need special tax treatment to be economically viable.

Tweaks to the tax system in recent years have reduced the marginal tax rate on each barrel of crude exported to 82 percent from about 87 percent, which an adviser to the Energy Ministry says is still too high to create an incentive to invest.

"Fiscal stimulus measures should be taken before oil production starts to decline. And one of the key such measures should be the introduction of a profits-based tax," Denis Borisov, director at Moscow's oil and gas center at Ernst & Young, said.

The Russian oil industry pays two main oil levies: mineral extraction tax, or MET, and export duty. Exemptions are available for new or challenging fields. A proposal is also on the table to provide easier terms for tight oil.

Putting these tax breaks into effect is vital for an alliance to progress between state oil major Rosneft and U.S. major Exxon Mobil, which aims to develop a vast tight oil play called the Bazhenov formation.

The Finance Ministry cited guidelines set by President Vladimir Putin, who before his return to the Kremlin last year promised to increase state salaries and other social spending.

"Our task is to increase the tax burden on the commodity sector," Trunin said.

Russia, which is heavily reliant on high oil prices to fill the state coffers, ran a budget deficit of 0.9 percent of gross domestic product in the first quarter.

Industry experts say profits-based taxation will allow companies to cut their tax base by artificially reducing their profits.

The tax authorities calculate MET based on Reuters pricing, and export duties from the Argus agency's average price for Russian Urals blend.

"The Finance Ministry does not trust oil companies. It would not believe them should the tax be based on their profits. Mineral extraction tax based on a certain oil price, which is impossible to change," said one industry expert.

The government has been tweaking the tax regime with a range of one-off measures to stimulate production of crude and of high-grade refined products. In 2011 it implemented the so-called "60-66" system, which cut the export duty on crude oil and most light oil products.

''The key problem is not MET in this light but the new export duty regime, which led to perverse incentives as it increased the trickle of fuel oil abroad, not a very wise move from the standpoint of the economy,'' said Alexander Fak, an analyst with Sberbank Investment Research.

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