



ELSEVIER

Contents lists available at ScienceDirect

## Energy Policy

journal homepage: [www.elsevier.com/locate/enpol](http://www.elsevier.com/locate/enpol)

# Russian petroleum tax policy – Continuous maneuvering in rocky waters



Daniel Fjaertoft, Lars Petter Lunden\*

Sigra Group, Akersgata 1, 0158 Oslo, Norway

## HIGHLIGHTS

- Petroleum tax revenue is the Russian government's largest single source of revenue.
- Tax legislation has not maximized government revenue from the petroleum industry.
- The December 2014 tax reform is just one in a long line of reforms and amendments.
- Russian petroleum taxation is set to change perpetually.

## ARTICLE INFO

## Article history:

Received 11 June 2015

Received in revised form

26 September 2015

Accepted 29 September 2015

## Keywords:

Russia

Tax policy

Petroleum

Government revenue

## ABSTRACT

This article maps and analyses petroleum taxation policy in Russia to investigate the extent to which it reaches the goal of maximizing government revenue from new petroleum field developments. Expected cash flows from four real-world fields in Russia are modeled in four real-world tax regimes in an attempt to determine whether the so-called 'tax maneuver' of December 2014 helps the government to reach its goal. Russia's tax policy is further analyzed in terms of the desirable tax system design features of simplicity, flexibility, stability and competitiveness. The article concludes that the changes to the tax system introduced additional incentives for field developments but failed both to improve tax system design *per se* and to maximize government tax revenue.

© 2015 Elsevier Ltd. All rights reserved.

## 1. Introduction

As of December 2014, Russia has introduced yet another amendment to its petroleum taxation legislation. In what has come to be known as the 'tax maneuver', the mineral extraction tax was set to be increased and the export tax reduced. In addition, a large number of existing geographical exemptions from the mineral extraction tax have been replaced by coefficients that reduce the MET payable on a field-by-field basis, while a new formula reduced export taxes for a range of fields.

At first glance the reform appears to rectify two major deficiencies of Russian petroleum taxation. First, it addresses the destructive optimization in the refinery sector by creating incentives for refining crude to inferior petroleum products. Second, it seemingly signals an end to the field-by-field haggling for tax holidays that has complicated petroleum sector development for years.

The objective of this article is twofold. First, Russian petroleum

taxation policy is reviewed and analyzed in terms of its strengths and weaknesses. Second, we ask whether Russian petroleum taxation has now found its final form, or whether the latest step is still deficient, carrying the seeds of yet another reform in the near future.

The analysis is conducted by investigating research questions such as: are tax breaks necessary to induce investment? Does field-by-field taxation maximize government revenue? Have the adjustments to taxation policy jeopardized the tax system's initial virtues of simplicity, low risk, and early timing of government revenue? Could Russia gain in terms of total tax revenue by choosing another design for petroleum taxation?

To shed light on these questions we use a standard cash flow model to analyze four real Russian field developments under four different tax systems. Two tax systems reflect current Russian taxation, of which the first builds on the current base-case without field-by-field MET calculation and reduced Export Taxes (Russia General), and the second applies field-by-field MET and reduced export taxes (Russia Individual). The Sakhalin-II PSA and Norwegian Petroleum Taxation are included as points of reference for an assessment of current Russian petroleum taxation in relation to the design criteria: competitiveness, simplicity, flexibility and

\* Corresponding author.

E-mail address: [lars.lunden@sigragroup.com](mailto:lars.lunden@sigragroup.com) (L.P. Lunden).

stability (Tordo, 2007; Goldsworthy and Zakharova, 2010).

The following section discusses resource taxation from the perspective of economic theory and thereafter describes Russian practice. Section 3 provides necessary field data and information about taxation while Section 4 presents results. Section 5 discusses the results, and Section 6 presents the conclusions.

## 2. Principles and practices of resource taxation in Russia

An informed analysis of Russia's taxation policy must be founded on the theory of optimal petroleum resource taxation. Therefore, we provide a brief summary of key principles of natural resource taxation before Russia's tax policies are described.

Petroleum extraction, like other extractive industries, often generates economic rent, i.e., income above the profits that can be expected from the same capital investments in other industries at the same risk. For this reason, the petroleum industry is generally subject to specific taxation and can be a significant source of income for the government. In order to maximize total government revenue from the industry, the government should collect resource rent while leaving the economic profit to the companies in order to incentivize developing the country's resource base.

According to economic theory, optimal taxation policies have a non-distortive, or neutral, effect on investment decisions by keeping relative profitability estimates such as the internal rate of return the same before and after tax (Sandmo, 1989). The neutrality condition implies that the tax system does not undermine marginally profitable projects, and at the same time does not make uneconomic investments profitable by stimulating projects that would not have been developed in a tax-free world. Accordingly, neutrality in the tax system protects against both over- and under-investment (Lund, 2002).

Since rent is pure surplus, it can theoretically be taxed without creating distortions, thereby maximizing total revenue for the government by allowing for development of all economically viable projects. However, collecting the full resource rent without creating distortions is often difficult in practice. For example, Lloyd (1984) argues that taxation must be project-specific to maximize tax receipts since the nature and magnitude of risks vary from project to project. However, this approach requires the government to possess sufficient information *ex-ante* to justly discriminate between projects, which may be challenging, particularly since a project's true nature is more often revealed only *ex-post*.

In practice, countries' choice of tax system is often a matter of political preferences. Impatient countries prefer so-called front-end loaded tax regimes, i.e., systems with early tax revenue collection most often at the cost of total tax revenue, whereas patient

countries can increase total tax receipts by utilizing back-end loaded tax systems (Smith, 2012). Risk-averse countries tend to prefer more predictable revenue through signature bonuses and gross income taxes, for example. But the government can increase its total tax receipts if it accepts higher risk and greater revenue volatility by leaning on profit-based tax systems, for example Tordo (2007) and Goldsworthy and Zakharova (2010) point out that in addition to appropriating resource rent, governments may give preference to job creation, technology transfer as well as local infrastructure development. See Table 1 for an inventory of typical tax mechanisms available to the host government.

Furthermore, countries with limited institutional capacity are more prone to gross taxes due to their apparent simplicity from a collection perspective (Lovas and Osmundsen, 2009). However, as pointed out by Goldsworthy and Zakharova (2010), administering gross income taxation may be more challenging than at first glance since companies and governments attempt to re-negotiate conditions to reflect changing production costs and oil prices, thus complicating tax administration down the road. Lovas and Osmundsen (2009) find that the government's strive for simplicity in fact leads to an administrative complexity of the fiscal system that is inversely proportional to the government's administrative capacity.

### 2.1. Petroleum taxation in Russia

Russia's petroleum tax system has undergone numerous changes since it was introduced following the demise of the Soviet Union. The 1990s were characterized by field-specific taxation and poor revenue collection abilities (Dyachkova, 2011). Moreover, imperfect cost monitoring, a symptom of the country's institutional weakness at the time, allowed companies to report high costs with resulting low taxable profits, which lead to low tax receipts in the 1990s (Kryukov and Moe, 2007).

In order to increase tax revenue, the government reduced the number of taxes levied and shifted the tax burden to 'easy to monitor' gross income taxes in the early 2000s. The main elements of the new system were the mineral extraction tax (a royalty) and export taxes, while other elements such as the standard company profit tax, property tax and lease auctions were also maintained. The new system was in line with theory stating the rationality of combining net and gross taxation in environments with limited capacity to accurately monitor costs (Lund, 2002).

The initial simplification enabled the Russian state to increase tax receipts, but due to the inevitable distortionary effects of gross taxation, Russian authorities have been forced to introduce an increasing variety of tax breaks and custom-made adjustments to incentivize investments in the petroleum industry (Dyachkova, 2011; Gustafson, 2012; Lunden, 2014). This tendency has

**Table 1**  
Tax tool inventory.

Tax	Description	Advantages	Disadvantages
Royalty (Gross Tax)	Taxes per unit of production, percent of production or percent of gross revenue.	Easy to monitor and collect	Regressive and insensitive to costs they quickly distort investment decisions.
Profit Taxes	Tax on net revenue	Less distortionary	More complex to manage – need cost monitoring capabilities
Rent Taxation	Taxation commences after investor has received return on capital	Neutral and hence non-distortionary	Difficult to approximate rent – too much risk shifted toward governments
Government Equity	State companies participate in projects on par with private companies	Full offset for windfall revenue and possibly enhanced local revenue creation	Conflicts of interest as states become both regulators and benefactors
Export Taxes	Levy on exported products	Easy to administer	Creates foreign/domestic price wedges (subsidies) and insensitive to costs (a gross tax)
Import Duties	Levy on imported products.	Early government revenue	Increased project cost and risk for companies
Other Taxes	Signature and production bonuses, property taxes, VAT etc.	Similar to Import Duties	Similar to Export Taxes

Download English Version:

<https://daneshyari.com/en/article/7400567>

Download Persian Version:

<https://daneshyari.com/article/7400567>

[Daneshyari.com](https://daneshyari.com)