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Oil & Gas, Energy & Resources, Mining

Legislative Update 2016

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Key industry developments

Energy price volatility

Energy prices remain highly volatile, presenting challenges both for the market players and for the government in terms of financing its spending.

In early 2016, oil prices hit their lows, and even though they have nearly doubled since, they are still not high enough to attract substantial new investments to the sector – while supporting a much more optimistic outlook for the market players and their further plans.

Sectoral sanctions

Sectoral sanctions continue to apply in full, holding back the development of several important oil and gas regions.

Bashneft privatisation

One of the biggest deals recently, the privatisation of this state-owned asset and its further sale to Rosneft results in an even stronger consolidation of the major vertically integrated holdings and further monopolisation of the natural resources market.

On the other hand, the ensuing partial privatisation of Rosneft evidences the government's readiness to draw minority shareholders into oil and gas industry.

Andrey Panin
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"It is not quite clear yet what is going to happen to the tax burden on oil and gas companies.

The period of tax incentives for the downstream companies will end soon.

At the same time, the introduction of an added income tax is planned to incentivise the exploration of new fields. However, the new tax multipliers for oil and gas extraction increase the administrative workload for producers and bring the tax burden on old fields to the brink of unprofitability at the current oil prices."

Legislative changes

Regulation of regional investment project participants

Federal Law No. 144-FZ of 23 May 2016 changed the taxation regime for participants of regional investment project (RIPs). In particular, the Law introduced an alternative, 'declarative' procedure for claiming tax benefits.

Any additional regional eligibility requirements will now apply solely to the companies that obtain the status of a RIP participant via the RIP register.

To obtain the status of a RIP participant via a declarative procedure, the entity and its regional project must meet the following eligibility criteria:

- The entity does not apply any special taxation regimes;
- The entity or its separate subdivision is located in the Russian Far East;
- The entity is not a member of a consolidated group of taxpayers
- The entity is not a resident of any special economic zone or of a territory of advanced social and economic growth
- The entity is not a participant (successor of a participant) of any other ongoing regional investment project.
- Capital investment requirements:
  - RUB 50 million invested within three years of the first RIP investment, but not before 1 January 2013 and not earlier than three years prior to claiming the tax incentive;
  - RUB 500 million invested within five years of the first RIP investment, but not before 1 January 2013 and not earlier than five years prior to claiming the tax incentive.

New MET component

The tax burden on oil and gas sector is expected to increase in 2017-2019, as a new component will be introduced into the MET calculation formula.

Federal Law No. 401-FZ of 30.11.2016 introduces changes to the MET calculation formula by adding a new component Cc (its value for 2017 set at RUB 306, for 2018 at RUB 357, and for 2019 at RUB 428).

MET = (Base rate * Cp) - Em, where **Em** is an oil extraction factor and Cp is an international oil price indicator.

Em is calculated based on the following formula:
Em = Cmet*Cp*(1-Cd*Cr*Cde*Crd*Ccan)- Cc

The taxation of multicomponent ore extraction will also change as a region-specific MET rate of RUB 730/t will be introduced for ores extracted in Krasnoyarsk Kray.

The amendments entered into force as of 1 January 2017.

Deductibility of exploration expenses

Federal Law No. 463-FZ of 28 December 2016 introduces amendments to Article 261 of the Russian Tax Code “Exploration expenses”:

- **Excluding** the provision that the exploration expenses may be deducted not earlier than the first new offshore subsurface hydrocarbon deposit is identified within the explored area, or the date the taxpayer decided to terminate the works in the area due to a lack of economic feasibility, poor geological outlook, or other reasons
- **Excluding** the provision limiting the deductibility of exploration expenses upon termination of subsurface rights (according to the previous version, if the subsurface rights are terminated, the taxpayer may not deduct more than 1/3 of the total exploration expenses incurred in the respective area)
- **Introducing** a multiplier of **1.5** for exploration expenses of the taxpayers which explore and evaluate new offshore subsurface hydrocarbon deposits according to duly obtained licenses.

The changes entered into force as of 1 January 2017.

Increase of excise tax on gasoline and diesel

Federal Law No. 401-FZ of 30 November 2016 introduced amendments to Article 193 "Tax rates" of the Russian Tax Code. As of 1 January 2017, the following excise tax rates apply:

Type of excisable goods	2016 (1 January – 31 March)	2016 (1 April–31 December)	2017 (after amendments)	2018	2019
Gasoline:					
Class 5	7,530	10,130	10,130	10,535	10,957
Other classes	10,500	13,100	13,100	13,100	13,100
Diesel fuel	4,150	5,293	6,800	7,072	7,355
Motor oils	6,000	6,000	5,400	5,400	5,400
Straight-run gasoline	10,500	13,100	13,100	13,100	13,100
Benzol, paraxylene and orthoxylene, jet kerosene	3,000	3,000	2,800	2,800	2,800

Recovery of excise tax related to activities with straight-run gasoline

Federal Laws No. 225-FZ of 30 June 2016 and No. 401-FZ of 30 November 2016 introduced changes to Article 200 "Tax deductions" of the Russian Tax Code. Excise tax paid on straight-run gasoline operations can be recovered by the taxpayer that has a permit to engage in that type of operations. The following multipliers are applied to the recovery of the excise tax on straight-run gasoline recognised for petrochemical production purposes:

Type of excisable goods	2016		Starting 2017
	2016 (1 January– 31 July)	2016 (1 August–31 December)	
Straight-run gasoline	1.60	1.40	1.70

Implementation of added income tax in oil & gas sector

Draft Law "On amendments to Parts I and II of the Russian Tax Code and other regulations of the Russian Federation" was developed to introduce tax on added income from extraction of hydrocarbons (the hydrocarbon tax).

This taxation regime is meant to reflect the economics of hydrocarbon production over the entire investment period, with the tax exemption amount depending on the profitability of each separate field, which allows to launch production at low-profitability fields, including those with tight hydrocarbons.

The draft will be submitted to the Russian Government on 1 October 2017.
Also, several options are being discussed for the Samotlor field, such as a reduction of MET or including it in the added income tax pilot.

If the Russian Government resolves on lowering MET rates for the Samotlor field, the Ministry of Finance will not include the brownfields in the added income tax pilot.

According to the original plan, the added income tax pilot was supposed to cover the Caspian shelf fields developed before 2016, the greenfields of Eastern and Western Siberia (with the depletion rate not exceeding 5 percent), and the brownfields of Western Siberia (depletion rate of 80 percent and higher).

MET is currently charged on the total volume of extracted oil and condensate, while the added income tax, as envisioned by the Ministry of Finance, will be charged as 50 percent of the difference between the planned revenues from sale of oil and the cost of extraction, transportation and payment of MET (charged at a lower rate than now).

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