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**IMPACT OF GLOBAL ECONOMIC CRISIS ON TAX POLICY IN  
RUSSIAN OIL INDUSTRY**

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***Abstract:***

The paper examines an anti-crisis tax regulation package in Russia and its impact on the current situation in the Russian fiscal sector, as well as the measures taken by the Russian Government in the oil industry taxation in 2015-2018. The objective of the paper is to analyze the anti-crisis measures applied by the Russian Government amid the global economic crisis and their impact on Russia's tax policy in the oil sector. The paper determines state anti-crisis policy trends for the oil industry taxation. It specifies challenges the state faced implementing anti-crisis measures. It is concluded that it is the state tax policy implementation where additional anti-crisis measures have to be taken in the Russian oil industry. The need for designing a taxation legal model for oil producers is justified, with due regard to interests of both the state and business. The oil industry taxation mechanisms and other tax regulation tools considered in the paper can be used to improve the taxation legal model of the oil industry in Russia. The proposed additional anti-crisis measures of the oil tax policy can also be included in the state strategic programs to overcome the economic crisis.

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**Keywords:** Global crisis, tax policy, oil industry, anti-crisis state policy, anti-crisis measures, anti-crisis tax regulation.



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## 1. Introduction

Amid the global economic crisis, sanctions imposed against Russia over the last years, and relatively low commodity prices, the importance of state focus on the global economic crisis impact on the tax policy in the Russian oil industry was repeatedly voiced by the Russian President in the Addresses to the Federal Assembly of the Russian Federation, involving commissions for a development strategy of the fuel and energy sector and environmental safety, as well as at meetings with chief executives of oil companies<sup>1</sup>.

Thus, President of the Russian Federation, Vladimir Putin, in his Annual Address to the Federal Assembly, held on March 1, 2018, noted "the new government needs to create new tax conditions as soon as possible; they are to be stable and secured for years to come."

Greater relevance is for research associated with the development of specific anti-crisis measures aimed at country's economic recovery, due to the oil industry taxation included.

In their works, G.R. Golovanov, V. S. Pancheva, S. V. Chernyakovskiy, M. A. Ilyichev and other researchers addressed challenges the government faces implementing anti-crisis measures and studied the Russian oil industry taxation itself as an economic recovery measure.

The economic situation in Russia is under significant influence of social and political factors, the great impact of resource industry and global crisis trends. That is why to make some significant changes, it is especially important to elaborate and create innovative economic instruments which allow realizing structural changes in the economy and give it sustainable development direction (Ashmarina, Zotova & Smolina, 2016).

Furthermore, this paper gives a comprehensive major trends study of budget, tax, and customs and tariff state policies applicable to the oil industry<sup>2</sup>. Particular emphasis is laid upon the oil industry taxation system to be one of the most important financial security elements amid unstable economy and sanctions imposed against Russia.

Thus, the need to solve pressing challenges and develop specific anti-crisis measures implementing state tax policy in the oil industry has determined the topic choice and problem statement in this paper.

## 2. Problem Statement

The key problem of the Russian economy centers around its very heavy continued dependency on oil exports. Federal budget reliance on oil price movements is slowly decreases, as evidenced by the non-petroleum deficit reduction (up to 8.3% of GDP in 2017): -1.5 pts compared to the 2014 rate) and drop in oil prices balancing the budget (at the primary level) with more than 100 USD per barrel in 2014 to 60-65 USD per barrel - in 2017. Due to this price movements, Russia compares favorably with many

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<sup>1</sup> See the Address of the Russian President to the Federal Assembly of the Russian Federation dated December 1, 2016. Access mode:

[http:// kremlin.ru/events/president/news/53379](http://kremlin.ru/events/president/news/53379) (access date March 1, 2018); The Address of the Russian President to the Federal Assembly of the Russian Federation dated March 1, 2018. Access mode: [http:// http://kremlin.ru/events/president/news/56957](http://kremlin.ru/events/president/news/56957) (access date March 2, 2018).

<sup>2</sup> See the project "Budgetary Policy Major Trends in 2018 and for 2019-2020 Planning Period". Access mode: [https://www.minfin.ru/ru/document/?id\\_4=119695](https://www.minfin.ru/ru/document/?id_4=119695) (access date March 1, 2018).

commodity-driven countries, which limited progress of fiscal adaptation poses a threat with painful developments in times to come.

According to the Russian Ministry of Finance, petroleum revenues to the budget in 2017 are expected to amount to 8.208 trillion RUB. At the same time, share of petroleum revenues in the overall structure of federal budget revenues will be decreasing from 51% in 2015 to 50.8% - in 2016, and to 49.6% - in 2017 (Golovetskiy, Evdokimov, & Grebenik, 2016).

However, it is absolutely premature to say the federal budget does not depend on oil price movements and petroleum revenues. Urals crude prices are increasing gradually triggering petroleum revenues to the Russian budget grow as well.

According to the project "Major Trends of Budgetary, Tax and Customs Tariff Policies in 2018 and for 2019-2020 Planning Period" (hereinafter referred to as Major Trends of Budgetary, Tax and Customs Tariff Policies), efficient economic stabilizing state policy allowed one to reduce reliance on oil prices. The oil price, securing the current account's equation of the balance of payments, has dropped from over 100 USD per barrel in 2013 to 35-45 USD per barrel. Furthermore, in 2017 oil prices balancing the federal budget at the primary level (i.e. before performing national debt-servicing obligations) were at 60-65 USD per barrel, with the expected drop to 40-45 USD per barrel within the next three years, while as far back as in 2013-2014, prices at some 95-105 USD per barrel were required to balance the federal budget at the primary level.

In his time, Wolosky (2000), the former Director for Transnational Threats at the White House National Security Council performed the following calculations: Russia-based YUKOS Oil Company was purchasing oil at dumping prices and trading it abroad at higher market prices. In early 1999, YUKOS purchased 240 mln. barrels at 1,70 USD per barrel from its affiliated companies. Internationally, oil crude was traded at 15 USD per barrel. Only six months into 1999, YUKOS earned 800 mln. USD». Also, YUKOS exploited the following scheme for taxation optimization. Essentially, the company exploited its foreign-registered subsidiaries, which revenues (unless transferred to the headquarters accounts) were not taxable under Russian law. This scheme allowed YUKOS to reduce income tax rate by 5% (Lund, 2002).

In 2015-2017, the budget was being adjusted to a new external reality, as the budget policy was tailored based on the need on one hand, to ensure the balance and sustainability of the budgetary system amid decreasing equilibrium level of oil prices, and on the other hand, to prompt establishing a macroeconomic equilibrium with persistent and predictable economic, fiscal and financial conditions.

In 2018-2019, the draft budget included proposals to increase tax burden on the oil and gas industry by specifying a mineral extraction tax (hereinafter - MET) rate calculation procedure for oil as to complementing its calculation formula with a new addendum fixed at 357 RUB rate for 2018 and 428 RUB rate for 2019.

The second challenge is the lack of competitiveness in other economic sectors. This issue is clearly evident when hydrocarbon prices drop sharply in commodity sector.

The third challenge is the oil industry taxation currently in effect in the Russian Federation. To overcome adverse consequences of the global economic crisis, the state needs an oil industry taxation aimed at withdrawing the added income through imposing an added income tax (hereinafter - AIT). Besides, differentiation of the MET needs to be considered any time soon.

According to experts, the existing taxation system hampers investments in development of new hydrocarbon deposits and does not prompt maintaining the production volume in depleted fields. At present, the system is still focused on mature deposits. In order to attract oil companies to develop green fields, it is necessary to significantly reform the legislation (Gafarova, Gerasimova, & Solovyeva, 2016).

In recent years, the national economy has developed largely owing to external sources – high commodity prices, low-interest credits given by foreign banks; now Russia needs to come up with domestic sources of growth to recover from the crisis and secure long-term sustainable development.

### **3. Research Questions**

Hydrocarbon crude export, oil export in particular, is of great importance for Russia. At present, Russia needs strengthening its presence on the world oil market in order to maximize export opportunities of the domestic fuel and energy sector in two decades to come and contribute to economic security of the country, remaining a stable and credible partner for European countries and the entire world community.

The paper studies such issues as anti-crisis measures analysis taken by the government amid the economic crisis. It analyzes the federal budget reliance on oil price movements. Also, the oil industry taxation is being studied, as one of the anti-crisis measures amid the economic crisis. The article takes a closer look at the 'tax maneuver' impact analysis carried out at year-end of 2017.

In addition, it investigates comprehensively the major trends of tax, budgetary and customs state policies.

### **4. Purpose of the Study**

The purpose of this study is to research the anti-crisis state policy through the prism of oil industry taxes. As well as to identify the federal budget dependency on the oil industry taxation. Moreover, it is proposed to complement the anti-crisis measures program with the ones related to imposing a new additional income tax on oil companies.

According to the Russia's anti-crisis development plan for 2017-2018, it is primarily aimed at implementing the measures that would prompt the activation of core units, labor market balance, decline in inflation, and easing of pricing policy for low-income families. These goals are also achievable through changing the oil industry taxation and replenishing budget revenues due to taxes.

### **5. Research Methods**

Both Russian and international studies featuring economic and mathematical models and methods developed and applied for the analysis of oil extraction and taxation processes vary greatly. On the one hand, these are very sophisticated models developed in oil companies based on in-depth information on the geological structure of formations, properties and composition of extracted materials. On the other hand, these are the approaches implementable in theoretical models to solve research problems. Some models contain either approaches and are designed to study specific problems, for instance, those applicable to tax policy-making in the oil and gas industry (Smith, 2013).

Thus, the research specified, for example, in works by Nystad has had widespread application (Nilssen, & Nystad 1986; Nystad, 1987). In these studies, production dynamics are often set by an

exponential decline in oil production. In this case, the production dynamics appears not to be directly related to the decision of an oil company to invest in field development, wells construction and putting them into production, as well as in decommissioning and recovery (workover). A more appropriate approach to the behavior analysis problem of oil companies under different institutional environment is the one which establishes direct correlation between wells exploitation dynamics and oil production output.

## 6. Findings

Concerning the current status of the oil industry, one cannot but mention the Western sanctions impact imposed in mid-2014. Restrictive measures were imposed on a number of Russian oil companies, such as a ban on the high-tech oil production equipment supply to Russia, on the debt financing, etc. According to Fitch Ratings analysts, if sanctions are in effect for a long time, they can even make some projects unprofitable. Russian companies urge to develop new technologies themselves or try to find other partners in this domain (Petroleum Vertica, 2015).

In the future, sanctions impact will turn into a major setback to implementing joint projects with Western states. The companies will be left to operate at low hydrocarbon prices over ever-growing competition on the world market, dwindling prospects for international economic partnership, alongside scarce investment resources and possible increase in fiscal burden.

With a view to boost the development of green fields and the rational subsoil use, a new taxation system (added income tax – hereinafter AIT) is envisaged for pilot facilities, including both new and mature deposits. The new system is meant to reduce total amount of taxes dependent on gross indicators (MET and crude export duty), and to impose the additional income oil production taxation, which amount is determined within the entire duration of the investment project when developing a particular subsoil block, with the level of tax exemptions dependent on the estimated cash flow amount from the subsoil block development considering actual oil prices and production costs.

Furthermore, proposals for the AIT imposition are timely and in line with international trends. With proper tax administration, the AIT will provide an impetus to develop low-margin offshore fields (Uvarova, Adaeva, & Aliaskhabov, 2017).

Having analyzed expert opinions of the Russian Ministry of Energy, the Russian Ministry of Finance and chief officers of largest oil companies operating on the territory of the Russian Federation, the following principal positive aspects of the AIT imposition can be highlighted:

- ensuring a continued and sustainable tax revenues flow to the budget being one of the main tools of the state financial security;
- contributing to the long-term oil industry development;
- ensuring the tax burden differentiation and creating necessary environment for the green fields development with increased production costs;
- AIT application will boost investment due to actual exempting investors from the tax until full reimbursement of capital costs.

Also, MET improvement is possible through tax incentives for geological exploration, which can be implemented by introducing multiplying factor for corporate income tax costs. A tax deduction in the

amount of cost of effective geological exploration from the calculated MET amount within MET may serve as an alternative mechanism (Pavlova, Bloshenko, Ponkratov & Yumaev, 2014).

In addition, development of man-induced mineral deposits using cost-effective innovative technologies, which are to be proved and confirmed by government agencies, can be prompted through imposing a special tax regime, as well as extending a special economic zone regime to similar production facilities (Palyuvina, 2016).

We would like to highlight a number of key problems which the oil industry faces implementing the oil production taxation legislation in Russia:

Firstly, this is tax exemptions issues in oil production taxation. Either way, it becomes obvious that there is a need to provide MET deductions with the purpose to raise a geological exploration fund. This approach seems to be the most effective one to address the growth stimulation issue of new oil reserves, to maintain the annual hydrocarbon production output, and, in the long run, tax revenues and other mandatory payments to budgets from additional production.

Secondly, there are tax incentives issues for geological exploration works. The solution to this problem can be done by introducing the multiplying factor for corporate income tax costs. A tax deduction in the amount of costs for effective geological exploration work from the amount of the calculated MET within MET may serve as an alternative mechanism (Tordo, 2007. p 41).

Thirdly, the switch to the financial result taxation. This approach allows transferring the tax burden to the period when the project begins to generate actual revenue.

Fourthly, the switch to a differential oil production taxation in Russia. The main problem is the taxation system itself, where taxes (MET and export duty) are calculated based on the oil production output. With this approach, the government enjoys the same amount of oil per ton, regardless of the production costs. A similar system works perfectly when production costs for all the reserves are approximately the same. However, in Russia this cost varies considerably not only between different oil fields, but also within particular oil fields.

The World Trade Organization calls on Russia to abolish totally export duties on crude commodity. Also, World Bank experts claim that export customs duties have changed prices of export sales and domestic supply, they are generally not charged in the oil and gas sector, but Russia remains to be a notable exception (Palyuvina, & Kashirina, 2016).

The most important mechanism in international relations is the discrepancy between prices, tariffs and sanctions in international trade (for example, unfair price competition, customs restrictions, violation of WTO rules, imposition of punitive sanctions against Russia) (Dyatlov, Bulavko, Balanovskaya, Nikitina & Chudaeva 2016).

High export customs duties on crude oil and a relatively low MET rate, having direct impact on domestic prices for petroleum products, helped keep these prices at a fairly low level. Accordingly, the change in the value of export duties and MET rates in accordance with the "tax maneuver" contributes to the rise in domestic prices for oil and petroleum products. Despite this, it is highly unlikely that the tax base for the corporate income tax in petroleum industry organizations will increase due to the fall in world oil prices, causing additional risks both for federal and regional budgeting (Yumaev, 2011). On January 1, 2015, the legislation changes entered into force, providing for the implementation of tax

maneuver in the oil industry. Tax maneuver features were determined amid the global oil prices at 100 USD per barrel and the USD exchange rate at 38 RUB.

The decline in global oil prices, dated back to the fourth quarter of 2014, creates more favorable conditions for oil and refining industries as compared to that of the previous tax system.

However, actual oil production revenues of the Russia's budget system as of January-May 2015 following the oil price drop are lower than the revenues calculated at 100 USD per barrel by 25.6% (679 billion RUB)<sup>3</sup>.

If the "tax maneuver" was not implemented as of January 1, 2015, the foregoing reduction would increase by 20-60 billion RUB, depending on the chosen oil industry taxation scenario.

Thus, the tax maneuver implementation analysis shows that, despite the issues existing in the sector on refinancing foreign currency loans and financing long-term investment projects, no reduction of financial resources in the oil industry happened, on the contrary, there is an increase (Gorbunova, 2016).

## **7. Conclusion**

We can draw the following general conclusions of flexible taxation system issues in the oil industry.

1. In the long term, it seems appropriate to switch to the tax system based on the economic approach, i.e. on the financial result taxation. The financial result tax will boost investments and development of green fields. Such a system is to ensure the withdrawal of a higher share of rental income from high-margin units and provide for the development of low-margin subsoil blocks.

2. When a company implements tax optimization, the state may lose a significant part of rental income (withdrawn through special taxes), which the company eventually "appropriates". In this case, the internal rate of return for the investor may significantly increase, exceeding the minimum required level for investors.

3. Apart from imposing the flexible taxation system, it is necessary to draft and develop legislation (rules and regulations) that controls the completeness and promptitude of taxes to be paid by oil companies. That is, the imposition of both general and specific taxes aimed at the withdrawal of rental income shall be carried out with regard to the rigidity of institutional environment in oil taxation domain; otherwise, the imposition of differentiated and flexible taxation systems will not bring the expected benefits.

4. Drafting a new oil industry taxation, one should consider best international practices, with the taxation dependent on the economic result (profit, net present value or the like indicators). To monitor and control the oil production taxation, special posted (market) prices calculated by the state can be used, as it is in Canada, Norway, etc. Costs control can be carried out through technical regulation mechanisms. It should also be noted that carrying out measures to monitor and control subsoil users will be associated with significant government costs, but they are necessary to create adequate environment for tax reforms and the switch to the oil industry taxation differentiation.

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<sup>3</sup> See Official website of the Russian Government. On tax maneuver implementation in the oil industry. June 20, 2015. URL: [https://www.minfin.ru/ru/document/?id\\_4=119695](https://www.minfin.ru/ru/document/?id_4=119695) (access date March 1, 2018).

Moreover, the AIT imposition is seen to be effective, mainly in green oil and gas fields. The basic difference between taxes on additional income and on financial result from the current tax system is their focus on oil and gas production return, i.e., on the oil company financial performance. With such system, economists believe that the natural and climatic conditions of oil production will be by far taken into account. In the aftermath of the AIT imposition in high-margin production, petroleum revenues to the budget will increase, while with a low-margin production the tax burden on oil producers will decrease, which, in aggregate, will boost oil production in the country (Abdulkadyrov & Efimova, 2016).

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