
The law was devised to implement key tax policy objectives for 2018 and the planning period 2019-2020.

As far as the taxation of oil and gas companies is concerned, refinements are made to the rules governing the taxation of offshore development activities. In addition, the law lowers mineral extraction tax (MET) on natural gas for certain categories of taxpayers and introduces additional MET deductions for oil and for gas condensate when processed to produce natural gas liquids (NGLs).

The law also establishes new excise duty rates for oil products for the period 2018-2020.
New Offshore Hydrocarbon Deposits

Profits Tax

The Law clarifies the concept of new offshore deposit development activities. In particular, work is classified as new offshore deposit development activities commencing from the date of State registration of a licence for subsurface use.

Furthermore, as from 1 January 2018 the exploration and appraisal of new offshore hydrocarbon deposits will be treated as new offshore deposit development activities only if carried out on the basis of a combined licence covering both geological study and mineral extraction. This means that where taxpayers engage in the exploration and appraisal of new offshore hydrocarbon deposits on the basis of a licence for geological study alone, their expenses will be subject to the general taxation rules.

Special provisions are laid down for costs incurred in the period from 1 January 2014 to 1 January 2018 under licences to engage in geological study for the purpose of the exploration and appraisal of new offshore hydrocarbon deposits and were not previously taken into account in computing the tax base. Specifically, natural resource development expenses and other costs associated with the exploration and appraisal of new offshore deposits may be deducted in even amounts over 36 months.

The new law refines the rules governing the recognition of income and expenses by taxpayers that develop new offshore deposits. In particular, amounts of income and expenses are to be recognised in the period in which they occurred, but not earlier than:

- the date on which a new offshore deposit was designated within a subsurface site, or
- the date of the decision to terminate work owing to economic inexpedieney or lack of geological potential or for other reasons

The new provisions also stipulate that amounts of income or expenses denominated in foreign currency are to be translated into roubles using the exchange rate current on the date on which the income or expenses in question are recognised.

In addition, the new law abolishes the expiry dates for the right to determine the tax base as the value of hydrocarbons extracted at a new offshore deposit. This means that extraction companies will be able to apply ad valorem rates of MET for the length of time established by the Tax Code without being subject to a cut-off date.

It will also be recalled that the following rules regarding the treatment of natural resource development expenses took effect from 1 January 2017:

- a taxpayer may apply a coefficient of 1.5 to natural resource development expenses incurred for the exploration and appraisal of new offshore hydrocarbon deposits;
- all or part of natural resource development expenses may be treated as costs relating to new offshore deposit development activities carried out at another subsurface site (or other subsurface sites).

Previously, the law allowed this only when the right to use subsurface resources had been terminated and limited the amount of costs attributable to each deposit situated within another subsurface site to no more than 1/3 of the total amount of costs.

Transfer Pricing

Under the current wording of the Tax Code, transactions between a company that holds a subsurface licence and an operator of a new offshore hydrocarbon deposit are not viewed as controlled where they carry out new offshore deposit development activities in relation to one and the same deposit.

The new law adds that transactions between such entities will likewise not be considered as controlled where new offshore deposit development activities are carried out in relation to one and the same subsurface site before the first new offshore hydrocarbon deposit has been designated at that site.

Excise Duties on Oil Products

A new category known as “medium distillates” was introduced from 1 January 2016 with a view to improving the oil and gas taxation framework. The Tax Code defines the term to
mean blends of hydrocarbons possessing certain physical and chemical characteristics.

Practice in the application of the tax rules for medium distillates since 2016 has revealed a number of deficiencies in the law that enable excise duty to be avoided for hydrocarbon blends which have different characteristics from those specified in the Tax Code but are still essentially medium distillates.

In order to eliminate tax evasion opportunities, the new law restates the physical and chemical characteristics of the “medium distillates” category. Medium distillates are defined as hydrocarbon blends in liquid state (given a temperature of 20°C and an atmospheric pressure of 760 mm of mercury) that are obtained as a result of the primary and (or) secondary processing of oil, gas condensate, associated petroleum gas and oil shales, and that have a density of not more than 930 kg/m³ at a temperature of 20°C. The law also specifies oil products that are not included in this category for tax purposes.

In addition, the law introduces the concept of a certificate of registration of a processor of medium distillates and specifies processes involved in the processing of medium distillates (for example, primary refining of oil, hydrotreatment of hydrocarbon fractions, et al.).

As a result, the following items are added to the list of operations that are assessable to excise duty:

1. the receipt of medium distillates by a company possessing a certificate of registration of a processor of medium distillates;
2. the recording of medium distillates as received by a company possessing a certificate of registration of a processor of medium distillates.

The law also provides for a larger deduction to be applied in relation to those operations involving medium distillates.

The deduction is determined as the amount of excise duty calculated upon receiving medium distillates (recording them as received), multiplied by a coefficient of 2 where medium distillates are processed using production facilities that are needed for processing operations. A coefficient of 1 applies in other cases of the use of medium distillates.

The law provides for excise duty rates for certain oil products (class 5 petrol, diesel fuel and medium distillates) to increase further in the period 2018-2020:

<table>
<thead>
<tr>
<th>Oil product</th>
<th>Tax rate, roubles/tonne</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2018 (previously)¹</td>
</tr>
<tr>
<td>Class 5 petrol</td>
<td>10,535</td>
</tr>
<tr>
<td>Non-class 5 petrol</td>
<td>13,100</td>
</tr>
<tr>
<td>Straight-run petrol</td>
<td>13,100</td>
</tr>
<tr>
<td>Diesel fuel</td>
<td>7,072</td>
</tr>
<tr>
<td>Medium distillates</td>
<td>8,112</td>
</tr>
</tbody>
</table>

MET on Natural Fuel Gas

The new law alters the procedure for calculating the reduction coefficient $C_{do}$ reflecting the depth of occurrence of a hydrocarbon reservoir where natural gas is extracted from a hydrocarbon reservoir for which the smallest depth of occurrence is greater than 3,300 metres.

As from 1 January 2018, $C_{do}$ will be determined as the quotient obtained from dividing 0.5 by the value of the coefficient $C_{gp}$ (previously, $C_{do}$ was set at 0.5).

It should be pointed out that the value of the coefficient $C_{gp}$ has been set as follows for the period from 1 January to 31 December 2018:

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¹ Based on Federal Law No. 254-FZ of 29 July 2017.
1.4022 for companies that are Unified Gas Supply System owners and their affiliates;

1 for other taxpayers.

This means that such reservoirs will not be subject to the coefficient $C_{gp}$, the application of which results in Unified Gas Supply System owners and their affiliates paying higher amounts of tax than independent gas producers.

Mineral Extraction Tax Deductions

Tax Deduction for MET on Oil

As from 1 January 2018 it will be possible to apply a tax deduction in relation to oil extracted at subsurface sites situated wholly within the borders of the Nizhnevartovsky district of the Khanty-Mansiisk Autonomous District-Yugra.

The law establishes additional conditions for the application of the tax deduction:

- the subsurface licence must have been issued before 1 January 2016;
- initial recoverable oil reserves must amount to 450 million tonnes or more as at 1 January 2016.

The amount of the tax deduction is set at 2,917 million roubles for a tax period for all subsurface sites taken as a whole.

The deduction is applicable from 1 January 2018 until 31 December 2027.

This means that the aggregate amount of the deduction over 10 years will be around 350 billion roubles.

It should be pointed out that only the Samotlorskoye deposit, which is under development by NK Rosneft PAO, meets the criteria specified by the law. The exemption is intended to increase investment in this unique deposit in order to facilitate increased production.

In addition, the law removes the provisions allowing for the application until 31 December 2016 of a tax deduction for oil extracted at subsurface sites situated wholly or partially within the borders of the Republic of Tatarstan.

Tax Deduction for MET on Gas Condensate

As from 1 January 2018 a tax deduction may be applied in connection with the extraction of gas condensate where it is processed to produce natural gas liquids.

The amount of the deduction is to be determined using the following formula:

$$D_{gc} = C_{ngl} \times M_{gc} \times D,$$

where

- $C_{ngl}$ is the NGL recovery factor, which is calculated as the ratio of the quantity of NGLs obtained for the tax period which has ended to the total quantity of processed gas condensate;
- $M_{gc}$ is the quantity of extracted gas condensate processed using process equipment for the purpose of obtaining NGLs;
- $D$ is the rate of the tax deduction in roubles per 1 tonne of NGLs, which is calculated as follows:

$$D = 147 + (n - 1) \times 147,$$

where

- $n$ is the sequential number of the tax period, counted from 1 January 2018 onwards (the sequential number of the tax period beginning on 1 January 2018 is 1).

Starting from the 36th tax period the value of $D$ is taken to be 5,280, thus placing an upper limit on the amount of the tax deduction.

It should be pointed out that a taxpayer may use the deduction both when the processing of gas condensate is carried out using its own equipment and when it is carried out by other Russian companies, provided that specified supporting documents are available.

The aim of the amendment is to align the levels of production costs for NGLs obtained from different raw materials (gas condensate, natural gas and associated petroleum gas). The deduction is intended to help stimulate production of NGLs used in the petrochemical industry as feedstock for downstream production operations.

It should also be recalled that the MET deduction for natural gas extraction from a subsurface site situated wholly or partially in the Black Sea will
have effect from 1 January 2018 until 31 December 2020.\(^2\)

That deduction is available to taxpayers that underwent State registration in the Republic of Crimea or the city of Sevastopol before 1 January 2017.

The amount of the deduction is determined as the amount of expenses actually paid by the taxpayer in the period from 1 January 2018 until the last day of the tax period in which the tax deduction is applied for the acquisition, construction, manufacture and delivery of fixed assets, and may not exceed an amount equal to the product of the coefficient 0.9 and the total amount of tax which it reduces.

The application of the tax deduction is also conditional upon the fixed assets in question being included in an investment programme for the development of the gas transportation system of the Republic of Crimea and the city of Sevastopol.

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\(^2\) Introduced by Federal Law No. 286-FZ of 30 September 2017.
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