

Tax Burden of Russian Integrated Oil Companies in 2000-2001

The aim of this study is an estimation of actual tax burden on Russian oil companies. Contrast to previous surveys, TNK¹, Surgutneftegaz (SNG) and Rosneft were added to the main list (YUKOS, LUKOIL, Sibneft and Tatneft). All these companies together produced 79 percent of oil, and provided 62 percent of primary refinement and 83 percent of oil and petroleum exports.

We used consolidated financial statements (US GAAP and Russian Accounting Standards) as long as other available, reliable and adequate information to produce this survey.

The survey particularizes estimation methodology, exploring accounting features and tax regime shift in 2001.

A comparative analysis of tax burden of seven largest Russian integrated oil companies is given in the survey.

We obtained following results:

- Volume of the tax & custom payments of oil companies grew for 12.1 percent (up to \$ 14 bn) in 2001 comparing with 2000.
- The increase in the tax burden was mainly due to export duties (+ \$2 bn) and excises (+\$850 million). At the same time, profit tax volume fell for \$ 450 million, VAT return grew for \$ 840 million
- Relative tax burden (sum of taxes related to extracted oil volume) grew from \$ 36.8 per ton to \$ 37.6 per ton
- The lightest tax burden was for Sibneft, TNK and LUKOIL, the heaviest – for SNG.
- If Sibneft, TNK and LUKOIL paid taxes like SNG, the budget would get an auxiliary payment of \$2.2 bn more in 2000 and \$1.4 bn in 2001.

US GAAP as interpreted by Russian Integrated Oil Companies

In 2001, a large number of firms started reporting according to international standards. This fact allowed us to add TNK, SNG and Rosneft to the survey.

It is important that publications US GAAP reports are either voluntary or the requirements are weak. So the information is scarce and varied.

2001 reports publication helped us to make substantial changes in previous estimations. Above all, it's about considerably altered profit & costs statement of LUKOIL. Sales of 13010 million rubles were not mentioned in 2000 report as gross, and there was no information concerning excises and export duties, so one could decide that the sales were net of expenses. However, in 2001 it turned out that these sales were gross, with underestimation of \$ 200 million in refinery and sales sector (see Table 1). At the same time, common, operational and sale expenses were raised to \$372 million and \$360 million. The sum of these figures is \$932 million, corresponding with the sum of excised and export duties paid in 2000 (according to 2001 statement). It should be noted that in 2001 statement, the changes in methodology and data are not mentioned by the management and auditors. The disclosure of information caused substantial overestimation of LUKOIL data. (see Table 1)

According to the accounting policy of YUKOS, the firm deducted oil and petroleum export transportation costs from revenue, along with export duties, excises and gasoline taxes. Internal transportation costs (of Transneft sales) were not included into revenue as they are born by purchasers. All other transportation costs were allocated to commercial, general and sales expenses. With such original method of revenue calculation, the management probably intended

¹ TNK International presentation was used. The financial statement later was claimed incorrect due to bad record of acquisitions, and the Eurobond issue was postponed

to emphasize that transportation costs are equivalent to turnover taxes, as Transneft is a state firm. In 2001, YUKOS added export transportation costs to the spending item.

After the publication of the reports, it became obvious that many firms are selectively consolidate operations with affiliated firms or intermediates, seriously impacting financial results. It is particularly clear for Sibneft or TNK statements. Thus, Sibneft consolidated two Kalmykia offshores in 2001, and it helped the firm to demonstrate 50 percent growth of revenue and double growth of profit. This surge of financial results could not be explained by 20 percent growth of extraction, as world oil prices fell for 14 percent.

The change in absolute tax burden for TNK was mostly determined by multiple acquisitions and operations with securities of affiliated companies. Thus, in 2000 the revenue grew 2.4 times, comparing with 1999. It was caused not only by oil price growth, but by Kondpetroleum and Chernogorneft acquisitions in December, 1999. In much the same way, purchases of LiNOS and ONAKO in June and September, 2000, influenced 2001 result. Net revenue grew for 22 percent, despite the fall in oil prices. In 2001, TNK acquired Orenburggeologia, related companies were returned to SIDANKO, and TNK eventually obtained 84 percent stake in TNK. In April, 2002, 15 percent stake of SIDANKO was sold to BP. These and subsequent changes in TNK structure will have a significant impact of the financial results of the firm and absolute tax burden in the future.

Six of seven surveyed companies keep accounts in USD, and Tatneft in RUR, converted to USD in the end of the year using purchasing power parity. YUKOS started publication of financial statements in USD since September, 25 of 2002, and so it's possible to compare statements. Reports in rubles are extremely inconvenient for a comparison of different periods and, what is more, this method distorts the results of the reporting period. Actually, all incomes and disbursements, including tax expenditures are in nominal rubles. Adjusting the financial results to ruble terms leads to overstating of all incomes and expenditures due to the falling purchasing power of dollar. E.g., in 2001 inflation measured by CPI was 18.8 percent, and the exchange rate changed for just seven percent.

For correct estimation of the tax burden for Transneft, all data of other firms was adjusted from end-of-period ruble terms to nominal exchange rates of 2000-2001 and then converted into USD by average exchange rates. Adjustment to nominal rubles could be done with the use of $(1+i/2)$ coefficient, where i is CPI for the reporting period. In 2001 the coefficient was 1.094, in 2000 – 1.1. If one converts original report data by dividing by end-of-period exchange rate, then all items, including taxes paid, will be overstated for 4 percent in 2001 and 9.7 in 2000. This methodology was checked on YUKOS data (which is reported both in USD and RUR). The error of the adjusted data is less than 2 percent.

Table 2.

Russian Integrated Oil Companies are fulfilling external expansion. LUKOIL grabbed the leadership, with several oil refinery plants in Ukraine and in Eastern Europe and a branched network of filling stations in Europe and in the USA. However, segmented information (export and domestic sales) is not complete for most of the companies. E.g. LUKOIL reports exports together with export branches sales. Most likely, it is practiced just to hide negative information, as profitable Russian exports compensate for low profit margins of abroad refinery and retail enterprises.

All aforesaid means the volume of information publicly provided by Russian firms in US GAAP or RAS standards is not sufficient, and the methodology substantially complicates the estimation of the tax burden. Data in special reports, made for investors and proposed during Eurobond or ADR/GDR road-shows, is better, but these reports are not always available and complete.

Despite of these shortcomings, we believe that our estimations fairly show tax burden of the firms, with error less than 10 percent. What is more, even substantial faults, mainly caused by incomplete information and bad presentation (as in LUKOIL case in 2000) do not lead to major errors in tax burden estimation.

Our methodology and obtained results are shown below.

Tax burden estimation

Main taxes for energy sector were

- Gross revenue taxes: VAT, excises, petroleum sales tax, export duties
- Other taxes (license fees, mineral base compensation tax, road tax, off-budget payments)
- Profit tax

Gross revenue taxes

Many oil firms (and Russian firms as well), include excises and specific oil taxes to gross revenue volume. We use the term "gross" for revenue with all taxes, including VAT, "net " – for revenue without excises, petroleum sales tax and export duties.

export duties

Goods that cross the border of the Russian Federation are subjected to custom duties. Export duties are levied if goods are transported beyond the borders of Tax Union countries (Belarus, Kirghyza, Kazakhstan, Tadjikistan). Available information does not allow us to separate intra-union export from export to other countries. However, main physical volume of exports (93 percent for crude oil and 97 percent for oil products) falls to foreign countries beyond the union. If one takes Ukraine into account, then countries which aren't members of the union consume almost all Russian export of fuel, so the lack of information doesn't lead to substantial errors in the estimation of paid duties.

In 2001, average export duties grew substantially (for crude oil and also for oil products), despite of the fall in world oil prices.

Table 3

Export duties are reported by YUKOS, Tatneft and LUKOIL. TNK provides combined data for export duties, excises and petroleum tax. SNG, Sibneft and Rosneft do report on export duties. To estimate the sum of paid duties, we multiplied physical volume of exports by average rates. The estimation was hindered by the absence of information concerning physical volume of exports of oil and/or oil products. Also, when comparing different reports of one company, some variant readings emerged. In such case, the physical volume was estimated on the basis of external sources of information. We used InfoTEK, Oild&Gas Vertical and Petroleum Argus data to verify foreign exports data. Full export was also adjusted, and, if there was related information, we divided export revenues by average sale prices.

YUKOS and Tatneft

Average sale price of ton of oil exported for YUKOS was above average, due to Customs Office data. (table 4). There were no export volume data for Tatneft, and therefore we made the estimate as noted above. The sale prices were provided by the Customs Office. Eventually, export duties for were close to the reported data, with the error less than 8.5 percent.

Table 4

LUKOIL

In RAS consolidated statement LUKOIL reports on oil exports of 32768 and 28380 thousand tons in 2000 and 2001, respectively; for oil products the figures are 10778 and 7801 thousand tons. In total, it corresponds with 57 and 48 percent of the total extraction amount of branches and affiliated companies. Reasoning from average tax rates (see Table 3), the volume paid should have been 1168 and 709 million dollars, respectively, whereas in RAS statement the figures are 831 and 590 million dollars (see Table 5).

Such discrepancies may be caused by several reasons. Most likely, the stated volume of oil exports is substantially less than declared. Actually, in US GAAP statement, revenue exports

amounted 3951 and 4380 million dollars, and average sale price – 21.13 and 25.31 dollars per barrel. It corresponds with annual oil sale in amount of 25.6 and 23.8 million tons. It follows that export sales cannot exceed these figures. Overseas projects sales amounted 2065 in 2000 for LUKOIL. Thus, export sales amounted 21.7 million tons, not 28.4 million, as it is stated in the report. According to Petroleum Argus agency, LUKOIL exported 22.7 and 20.8 million tons in 2000 and 2001, respectively, and Oil&Gas Vertical magazine reports on 21.9 and 20.8 million tons. The estimation of the volume of export duties, based on overseas exports, is about 883-904 million dollars in 2001 and 552-554 million dollars in 2000, close enough to the data reported.

So, a question emerges: how come that LUKOIL exported 32.8 and 28.4 million tons of oil and paid duties like if the volume of exports was less for 10.5 million and 7.5 million tons in 2001 and 2000, respectively?

Certainly, LUKOIL partly delivers to Custom Union countries. Main supplies fall on Belarus – 11.4 million tons in 2001 and 11.8 million tons in 2000. However, only 1961 thousand tons were delivered to oil refineries in Belarus, and the figure is not included in export data. Thus, supplies to Custom Union countries do not explain unaccounted exports.

Sales data, according to US GAAP report, lead to conclusion that the unaccounted volume of exports could have been supplied to oil refinery plants situated abroad, mainly to oil refineries of LUKOIL. Actually, according to the firm's report, LUKOIL delivered to Neftohim, Petrotel and Odessa refinery about of 8.7 million tons of oil, what is even more than previously calculated 7.5 million tons. In such case, LUKOIL had a possibility to proceed refining outside the custom area. According to Article 87 of the Tax Code of the Russian Federation, under this regime, Russian goods are moved abroad without impact of economic policy and are processed into manufactured products, which are to be returned within the custom area of the Russian Federation, also without impact of measures of economic policy; and duties are avoided fully or partially. According to Article 93 of the Tax Code, duties and other taxes are raised for such goods, and then returned when the products are brought back. The Customs Office, in concordance with the Ministry of Finance, may dismiss the duties levied, and the taxes could be returned if the good transfer the customs border.

Even if LUKOIL yet profited by this regime and escaped paying export duties, it has to pay afterwards, if the products had not been returned to Russian custom area. Indeed, the fact didn't occur.

Two conclusions may follow. The first one is that in 2000-2001 LUKOIL escaped export duties for the sum of 456 million dollars. The second one is that exports were partially switched to management-affiliated firms, which were not represented in consolidated reports. In this case, the duties are actually paid, but the profit diminishes, so stockholders suffer losses. To sum up, one may admit that oil exports data of LUKOIL produces a lot of questions. It's possible that both conclusions mentioned above are wrong, yet available public information doesn't allow to deny them.

Sibneft

According to commentaries to US GAAP report, revenue excludes taxes, but includes transportation costs. Export duties may be treated as transportation costs, as in LUKOIL's report of 2000, so duties could be included into the revenue. All analytical reports on Sibneft it is supposed that the revenue is net, excluding VAT, excises and export duties. Our search shows it is not so.

Table 6.

In the financial presentation for 2001 (dated June, 25 of 2002) it was mentioned that the revenue from exports of oil and oil products amounted 1739 million dollars. At the same time, if one multiplies reported volumes of physical exports by average world prices of oil and diesel oil, she gets nearly the same results. Average export sale price was \$154.9 per ton for Russian oil and \$148.5 per ton for oil products. Probably the firm manages to charge higher prices for oil and oil products, and petroleum and diesel fuel take better part in the firm's exports. Yet even with that assumption, the revenue less export duties would be \$300 million below the reported revenue.

So it seems that either revenue includes export duties (about \$154.1 million in 2000 and \$270.6 million in 2001) or the firm underestimates physical exports. The latter is less likely, as the volume of exports is confirmed by other sources. From now on, we'll stick to the point that Sibneft's revenue estimation includes export duties.

Surgutneftegaz (SNG), TNK & Rosneft.

For these firms, duties were estimated using physical exports data. We used overseas exports data of SNG, as it delivers mostly to Belarus. (see Table 7)

Excises and Petroleum&Oil products taxes

The Federal Law of December, 6 of 1991 No 1993-1 "On excises" was valid up to January, 1st of 2001. According to the law, excises were levied on oil, natural gas liquids, and petroleum for cars. Fixed rates were set for these goods, periodically adjusted with inflation. Foreign-economy activity was divided into interaction with CIS countries and remote abroad countries. Excises were raised both for domestic sales and for exports. Oil products were delivered to foreign countries on excise-free basis. For exports within CIS, excises were levied as if the products were sold in Russia. As diesel fuel and black oil take great parts in the structure of exports, oil products export had not influenced much of receipt of excises.

Since January, 1st of 2001 the law became invalid, and the Chapter 22 of the Tax Code went into operation. From that moment, car petrol, diesel fuel and engine oil became excisable goods. What is more, new methodology of indirect taxes calculation used "country of consignment" principle in case of exports to the CIS countries. The exceptions are oil, gas concentrate and natural gas. The Code states that the sale of excisable goods to the CIS countries does not cause repeating levying of excises, so the taxation regime was unified for the overseas exports and the export to the CIS.

In Russia, an oil refinery pays excises, not a filling station. So we estimated the volume of excises with multiplying rates by volume of produced petrol of different grades. Exports of petrol were not included in analysis, whereas diesel fuel exports, on the contrary, was included. Engine oil excise was calculated on the basis of average share of engine oil in total oil production (52.1 percent in 2000, largely varied among oil refineries)

Separate information on excises was provided by LUKOIL (RAS), YUKOS and Tatneft (US GAAP). For YUKOS, estimated excises consisted with reported data. For Tatneft, the divergence of 2001 could be explained by the fact that since 1996 to 2000 the firm transferred excises both to the federal budget and to the budget of Tatarstan. What is more, until 1998, payments to federal budget were accounted as VAT payments. In May of 1998 the President signed a decree, prohibiting this practice. As a result of bargaining with the Government of Tatarstan Republic, Tatneft obtained 1810 million rubles, diminishing 2001 excise payments.

Table 12

It seems that LUKOIL included petroleum & oil sales tax in excise data in 2000. As for difference between estimated and reported data in amount of 3.6 bn rubles, it could be explained by the fact that the firm actively uses tax optimization schemes. According to the data provided by the Accounting Chamber, Nizhegorodnefteorgsintez and Permnefteorgsintez used Baikonur offshores as production facilities leasers. As a result, federal budget didn't get an amount of 254 million rubles in 2000 and 2.7 billion rubles in 2001.

As LUKOIL consolidates both domestic and foreign branches, not all taxes reported in the US GAAP statement are received by the Russian federal budget. It's mostly about excises and profit tax.. With all that, data on export duties and excises match well. In 2000, they matched almost perfectly, and in 2001 the difference of \$264 million is explained by Getty impact, which sold about 2.8 million tons of oil products for the sum of one billion dollars. Main Getty's sale article is petrol (2.6 million tons), the rest is diesel fuel and heating oil. In the US, petroleum excise for retail is ten cents per liter and 12 cents per liter for diesel fuel. We estimate the sum of excises paid by Getty as 260million dollars.

Table 13

Until 1st of January, 2001, the Petroleum & Oil products tax rate (for petrol, diesel fuel, engine oil, compressed gas and liquefied gas) was 25 percent of difference between sale amount less VAT and acquiring costs.

YUKOS and Tatneft are the only companies in our list that report on paid oil & petroleum tax. For LUKOIL, the value is calculated by subtracting estimated excises from RAS figures. The minimal value of this tax could be estimated by multiplying produced volume of petrol and diesel fuel by average sale prices at oil refinery plants. Each firm should actually pay higher tax, as partly they sell oil products by retail, at higher prices. However, even estimations based on wholesale prices were substantially higher than reported figures. Most likely, firms actively used minimization schemes through affiliated intermediaries. What is more, traditionally oil products retailers are not prone to pay taxes. We estimate the volume of accrual tax as 43 percent of the calculated value.

Since the beginning of 2001, the tax was abolished.

The taxes mentioned could be tracked in the reports of four companies (LUKOIL, YUKOS, TNK, Tatneft). In table 15, we provide both estimated and reported data, and the former were higher in each case. It shows that the estimate is upper one for other firms.

VAT

The law No 1992-1 on December, 6th of 1991 "On the value added tax" lost validity from the 1st of January, 2001, with the exception of some regulations that lost validity a year later. VAT is regulated by the Tax Code, chapter 21.

The VAT is not imposed on oil and oil products exports. Until the 1st of January, 2001, the tax was imposed on exports to the CIS countries on the basis of the country of origin, with 20 percent rate, and since the 1st of July the regime was switched to the country of destination principle for all CIS countries, with the exception of Belarus.

As the VAT is showed in GAAP reports only in balance items in case when there is a debt to the government, it should be calculated. To do this, we subtract reimbursed tax sums from the sums paid.

The results of estimation of the tax burden

The absolute value of the burden increased for 1.4 billion dollars (plus 15 percent) in 2001, due to the higher level of duties and excises. Reimbursed VAT rose, and profit tax value decreased.

Table 35

For Russia as whole, the tax burden for oil industry is % to stimated as 12.5 billion dollars in 2000 and 14 billion in 2001. These sums contributed for 12.9 and 11.5 percent in 2000 and 2001, respectively. In 2001, export duties, excises and oil products taxes equaled 61 percent of the total sum of taxes (45 percent in 2000). Profit tax share fell (35 percent and 25 percent), reimbursement value (of the VAT returned) grew from 11 percent to 16 percent. Shares of other taxes remained almost unchanged.

It's slightly improbable, but still possible that our estimation contains some mistakes. It's possible to see two sources of the shortcomings. Firstly, companies provide insufficient information in their reports. We supposed that the figures shown in US GAAP reports are close to the taxes accrued and paid. If the assumption is wrong, then the reports are false. However, for export duties, excises and profit tax, our estimations either coincide with reported figures, or they are supported by alternative information sources. If case the firms provide further information, it'll be possible to make adjustments to the estimation.

Secondly, US GAAP reports do not report accurately on reimbursed VAT. Still it's easy to calculate the maximum error of the value of the reimbursement. It is well-known that integrated oil companies claim for return from the budget greater sums than they had added on previously. It was backed by the Tax Service data. However, even if one supposes total VAT as zero, the calculated error is 11 percent in 2000 and 16 percent in 2001. In fact, probable error is substantially lower as the firms claim for VAT return. What is more, calculated excises and export duties are upper estimates, so the error is not higher than 7-10 percent.

Relative tax burden

Russian oil companies' production chains consist of three links – exploration, refinery and sales. It is quite different to compare firms with each other, as they differ in processing, extraction levels and possibilities to sell oil and oil products abroad.

As domestic oil companies use vertical integration mostly to transfer profits from exploration and extraction sector to sales departments and to traders to optimize taxes, it's useless to compare different segments of companies between each other or with Western rivals.

Taking these differences into account, we relate total taxes to oil production and to gross revenue. None of these coefficients take into account variability of the structures of companies, especially the tax-extraction relation. Share of taxes in revenues could be treated as integral index, which embraces refinery, sales, share of exports and other structural differences. Still some distortion is possible, as firms buy and sell oil and oil products at the market, increasing revenues, but almost not affecting taxes.

Each coefficient provides different ranking of companies on tax burden. However, if a firm is ranked above or below in both rankings, one can unambiguously make a conclusion concerning tax burden. In 2001, rates of tax burden growth passed ahead of production growth rate, and relative burden increased. Average figures grew from 19.5 percent to 21.1 percent. Average relation of taxes to revenue grew from \$36.8 per ton to \$37.6 per ton. TNK, Sibneft and Lukoil had the lowest tax burden, SNG and YIKOS had the highest levels of burden. YUKOS outperformed Tatneft and Rosneft due to high average export share, high production growth rate and high profitability.

To conclude, we admit that in the observed period