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Taxation of upstream activity on the Norwegian Continental Shelf

Main elements as of December 2020

December 2020

Main Features

1. The NCS is one tax area
2. Taxable income based on net revenue with some modifications
3. Special Tax on exploitation, processing and pipeline transport of petroleum on the NCS
   3A. Preliminary rules for investments – PTA Section 11
4. Interest costs
5. Transfer pricing
6. Risk reducing elements
7. Withholding tax on dividends and certain interest, royalty and lease payments
8. Transfer of licenses – the PTA Section 10
9. Tax payments
10. Onshore elements
11. Indirect tax

1. The NCS is one tax area

- Special tax regime for exploitation, processing and pipeline transport of petroleum on the NCS
- No ring fence per field
- All upstream activity on the NCS consolidated per company
- Very limited consolidation with other activity

2. Taxable income based on net revenue

with some modifications

Revenue

- Norm price (so far: only oil and NGL)
- May request advance binding rulings for inter company gas sales
- Achieved prices (Fair Market Value)
- Timing is an area of focus

2. Taxable income based on net revenue

with some modifications

Costs

- Depreciation on “fixed” (permanently located) installations (production facilities and related items, including pipelines for transport of NCS petroleum): 6 years linear
- Exploration costs deductible as incurred
- Net finance (cost) allocated onshore (22%)/offshore (78%)
- Limitation in interest deduction against Special Tax
- Plugging and Abandonment (P&A) cost and dismantlement/decommissioning cost deductible when actual P&A/dismantling/decommissioning takes place

3. Special Tax

on exploitation, processing and pipeline transport of petroleum from NCS

Two elements:

1. Special Tax rate* 56% (+ 22% on Ordinary Income = all income)

2. Uplift = deduction: 4 years x 5,2% (total 20.8%) on ”fixed” installations against Special Tax base, only (works like an additional tax depreciation in the Special Tax base)
   - Transitional rules allow for 4 years x 7.5% (total 30%) on investments covered by Plan for Development and Operation received by the Ministry of Petroleum and Energy prior to 5 May 2013, provided the investments are made (costs are incurred) prior to 1 January 2021
   - Preliminary rules introduced for investments made i.a. in 2020 and 2021, ref. Chapter 3A (below)

* All tax rates referred to in this presentation are those announced for the income year 2021 as of the date of this presentation.

3. Linear depreciation - 6 years

- For investments made over several years, depreciation starts in each year. The asset is depreciated over 6 years both against the ordinary tax base (22%) and the Special Tax base (56%)

- Example:

	Investment	Depreciation			
		Per asset			total
Year 1	60	10			10
Year 2	180	10	30		40
Year 3	120	10	30	20	60
Year 4		10	30	20	60
Year 5		10	30	20	60
Year 6		10	30	20	60
Year 7			30	20	50
Year 8				20	20
Total	**360**	**60**	**180**	**120**	**360**

3. Uplift - 4 years

- Ref. example for deprecation: similarly, uplift starts each year, and is granted at 5.2%* over 4 years (only against Special Tax base)
- Example:

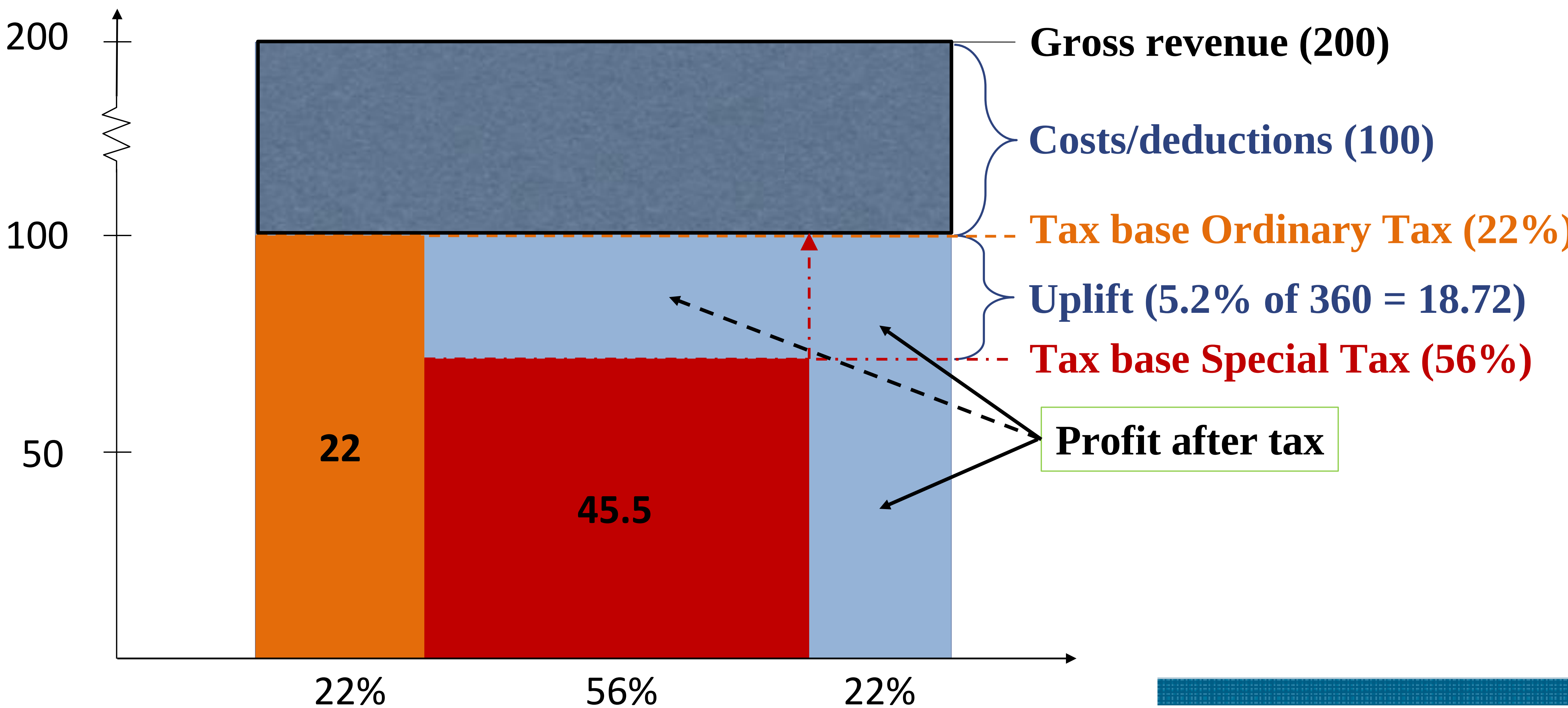
Investment			Uplift				
		Amount	**Per asset**			**Total**	
Year	1	60	3,12			3,12	
Year	2	180	3,12	9,36		12,48	
Year	3	120	3,12	9,36	6,24	18,72	
Year	4		3,12	9,36	6,24	18,72	
Year	5			9,36	6,24	15,6	
Year	6				6,24	6,24	
Year	7						
Year	8						
Total		**360**	**12,48**	**37,44**	**24,96**	**74,88**	(= 360 x 20.8%)

* 7.5% for 4 years if PDO to MPE prior to 5 May 2013 (investments prior to 2021, only)

3. Taxable income: Illustration

- Investments: 360
- Gross revenue: 200
- Costs, including depreciations: 100

Ordinary Tax: 100 x 22%	=	22.0
Special Tax: (100-18.72) x 56%	=	45.5
Total tax:	=	**67.5**



3A Preliminary rules for investments

PTA Section 11

- Costs incurred during 2020 and 2021 for acquisition of “fixed” (permanently located) installations (production facilities and related items, including pipelines for transport of NCS petroleum), plus 24 % uplift may be expensed directly against the Special Tax base (56%), only (in addition to 6 years depreciation in the 22% tax base).
- Similar costs, up to and including the year for *planned* production start, may also be expensed directly if included in either of the following plans, applications or notices received by the Ministry of Petroleum and Energy (**MP**E) before 1 January 2023 and approved by the MPE between 12 May 2020 and 1 January 2024:
  - Plan for Development and Operation (PDO)
  - Application for exemption from PDO
  - Written notice to the MPE of significant deviations from a presented or approved PDO
- The tax value of loss carried forward and unused uplift generated during 2020 and 2021 can be paid to the company on a bi-monthly basis (6 instalments per year), instead of carrying the tax loss forward

4. Interest cost

Restrictions on interest deduction

- Restrictions on deduction against Special Tax
  - Interest and exchange gains/losses on interest bearing debt allocated between onshore (22%) and offshore (78%)
- All other exchange gains/losses subject to onshore taxation
- Financial items to be allocated onshore (22%)
  - Interest income
  - Financial instruments (gain & loss)
  - Currency gain/loss (except on interest bearing loans)
  - Etc.
- Withholding Tax (15%) on interest payments to related parties in low tax jurisdictions outside the EEA
  - Effective and applicable for interest incurred from 1 July 2021

4. Interest cost

Restrictions on interest deduction against Special Tax

- PTA Sec. 3d:

$$\text{Interest cost deductible against Special Tax base} = \frac{\text{Actual interest cost } \mathbf{x} \text{ 50\% } \mathbf{x} \text{ Tax Value}}{\text{Average interest-bearing debt}}$$

- Interest cost includes exchange gain/loss <u>on interest bearing debt, only</u>
- Tax Value = Written down tax values at end of income year (after depreciations this income year)
  - May also include capitalized interest cost, but …
  - only the part deductible against Special Tax (PTA Sec. 3 j), and
  - excluding this year’s capitalized interest cost
- Average interest-bearing debt is based on daily average through year

4. Interest cost – "interest bearing debt"

(Sec. 18 & 19 in the Petroleum Tax Regulations, 1993 # 316)

- Interest bearing debt:
  - Project loan, company loan, overdraft facility, etc.
  - From third party or affiliated company
- Non interest-bearing debt:
  - Credit from suppliers, daily balance with operator, credit on PTA Sec. 10 transfer (consideration and pro & contra), deferred and payable tax, provisions for future cost, compensation, fines/penalties, amounts overdue, etc.

4. Interest cost - “debt” & currency gain/loss

(Sec. 18 & 19 in the Petroleum Tax Regulations, 1993 # 316)

- Debt:
  - = Daily average
  - In NOK and other currencies
  - Other currencies to be converted to NOK based on weighted average for interest and exchange gain/loss (each currency)
  - Long term debt ⇨ Revaluation Account (RVA), GTA Sec. 14-5 (5) ⇨ Deduction for unrealized positions:
    1. RVA Offshore = loss, and RVA Onshore = loss ⇨ Deduct total loss
    2. RVA Offshore = gain, and RVA Onshore= gain ⇨ Both = 0
    3. RVA Offshore = +/-, and RVA Onshore -/+ ⇨ Deduct net loss, only

4. Interest cost

Onshore ⇨ offshore, thin capitalization

- Insufficient income onshore

  ⇨ loss from financial items returned offshore, but only 22% tax base
  (interest on loss carry fwd, repayment of tax value if ceasing business, etc., PTA Sec. 3c)

- Loss from both financial items and other activity onshore

  ⇨ First: 100% of loss from financial items deducted against offshore 22% tax base

  ⇨ Next: 50% of loss from other onshore deducted against offshore 22% income

- Thin capitalization
  - Special Tax: not applicable (PTA Sec. 3 d)
  - Ordinary Tax: no special provision
  - General arm's length principle applies (General Tax Act/GTA Sec. 13-1)

5. Transfer pricing

- General arm’s length principle applies (GTA Sec. 13-1)
- OECD Transfer Pricing Guidelines important source of law
- The Oil Taxation Authorities are highly aggressive on transfer pricing in general
- Typical inter-company transactions subject to Oil Taxation Authorities’ scrutiny:
  - Gas sales
  - Financial transactions – loans, guarantees (interest/margins, fees)
  - Services, corporate charges and allocations (joint R&D, etc.)
  - Captive insurance

6. Risk reducing elements

- No deadline for loss and unused uplift carried forward
- Interest on loss and unused uplift carried forward (post 2001)
- Loss carried forward and unused uplift (post 2001) may be transferred to a buyer if sold (merged) as part of entire E&P activity on the NCS
- The government will pay out annually the tax value (”negative tax”) of exploration cost for taxpayers not in tax paying position – claim on government may be used as collateral for loan financing
- The government will pay out the tax value of loss carried forward and unused uplift (both post 2001) if the taxpayer ceases upstream activity on the NCS

6. Interest on loss and unused uplift carried forward

- Set annually by the Ministry of Finance in January after income year
- "Normal borrowing cost after tax for investments with high security"
- For income year 2019 (balance on 31 December 2019): 1.3% (20 January 2020)
- Compound interest
- Interest element tax free (fully deductible against future income)
- Separate interest calculation on Special Tax base (56%), Ordinary Tax base (22%) and unused uplift (56%), respectively
- No interest on onshore tax base (22%)
- No interest on loss and uplift for period prior to 2002

6. Refund of "Exploration Loss"

- Costs accepted as "Exploration Cost" by the OTO (ref. annual government refund of "Exploration Loss") = costs (directly/physically) related to finding petroleum in the ground:
  - Seismic data collection/acquisition and processing
  - Interpretation of seismic data
  - Application fee to the Ministry of Petroleum and Energy for licenses
  - Drilling exploration wells
  - Evaluations related to data, drilling, etc.
  - Indirect cost (part of if also other activity)
  - Not a requirement to be pre-qualified at the time of incurring the cost

6. Refund of "Exploration Loss"

- Costs *not* accepted as "Exploration Cost" by the OTO: costs related to:
  - Obtaining/acquiring acreage
  - Area fee to the Ministry of Petroleum & Energy (**MPE**)
  - Establishing and structuring of the company
  - Obtaining pre-qualification with the MPE
  - License application (except for application fee to the MPE)
  - License acquisition
  - Pre-acquisition cost
  - Indirect cost (part related to above items)
  - Development cost (cost from PDO – Plan for Development & Operation)

6. Refund of “Exploration Loss”

- Exploration costs do not include finance cost
- Tax refund calculated on the lowest of
  - exploration costs (excluding any finance cost), and
  - loss carried forward in the Special Tax base (56%) and the Ordinary Tax base (22%), respectively
- Amounts applied for tax refund may not be included in loss carried forward

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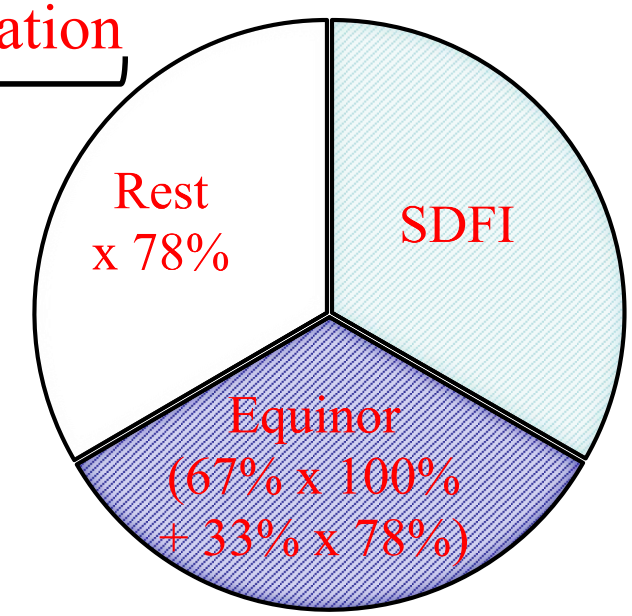
6. Risk reducing elements

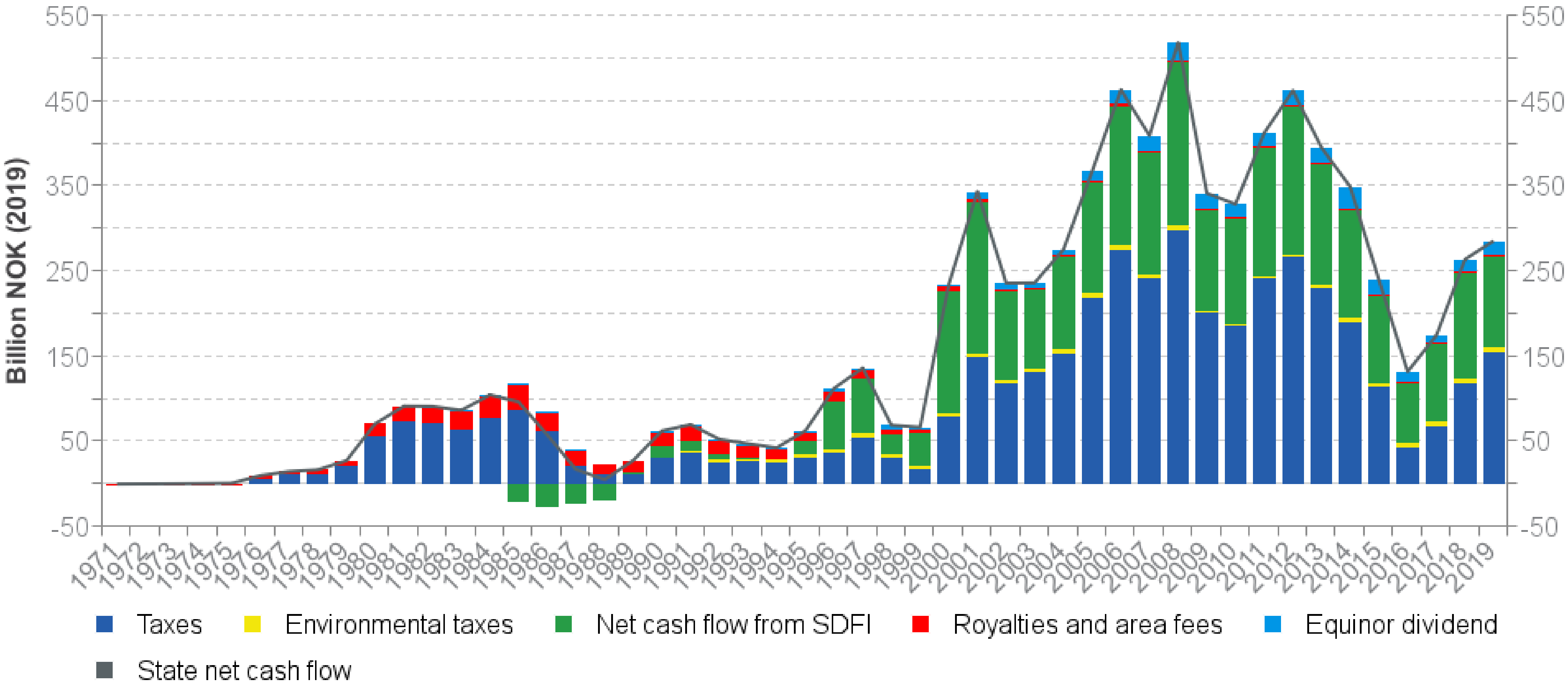
Rationale for «beneficial» tax rules

Justification for high nominal tax rate:

- ➢ Reduce risk
- ➢ Maintain stability (1975/1992)

Rough, private illustration



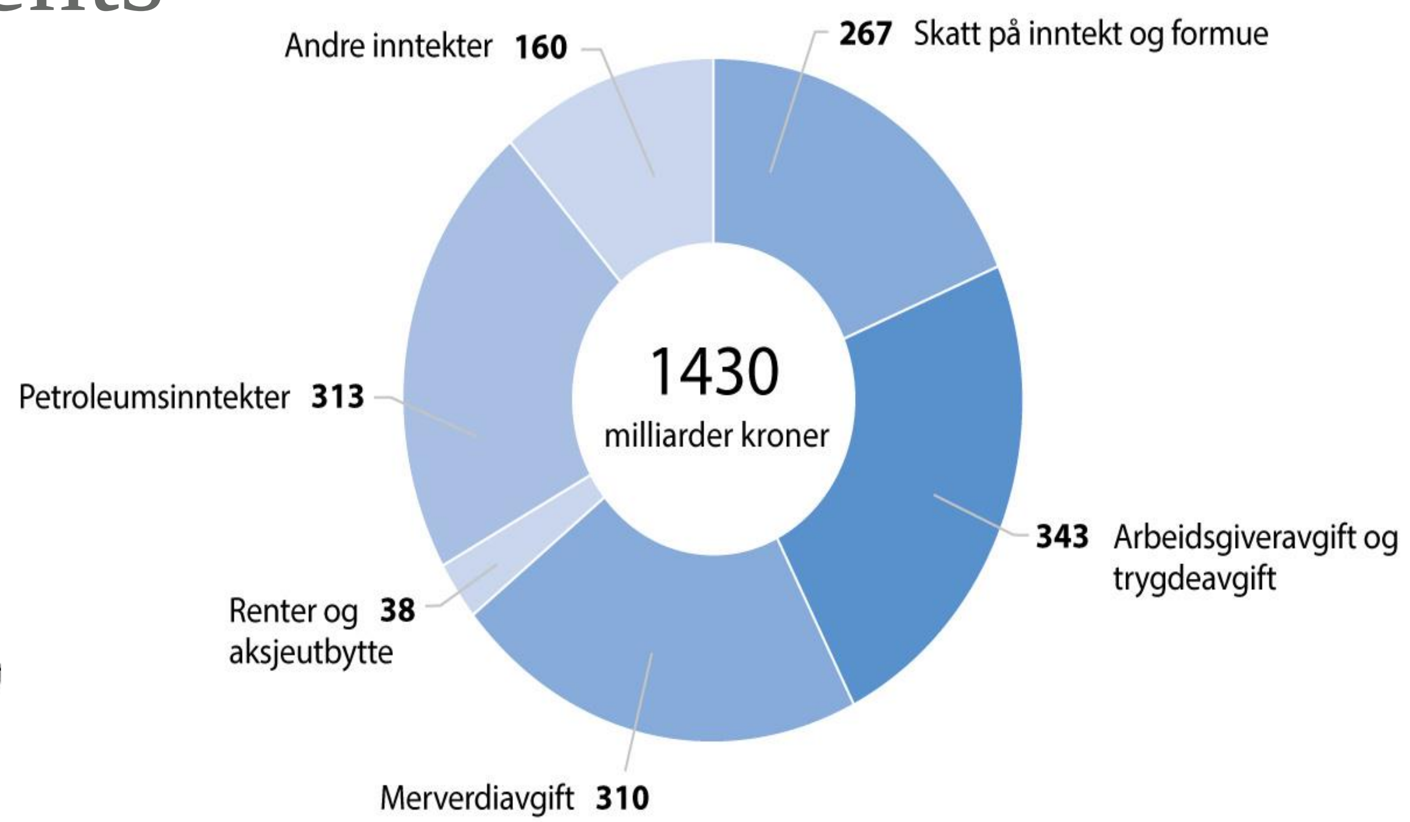


Source: http://www.norskpetroleum.no/en/economy/governments-revenues/ - Ministry of Finance, Statistics Norway (2019)

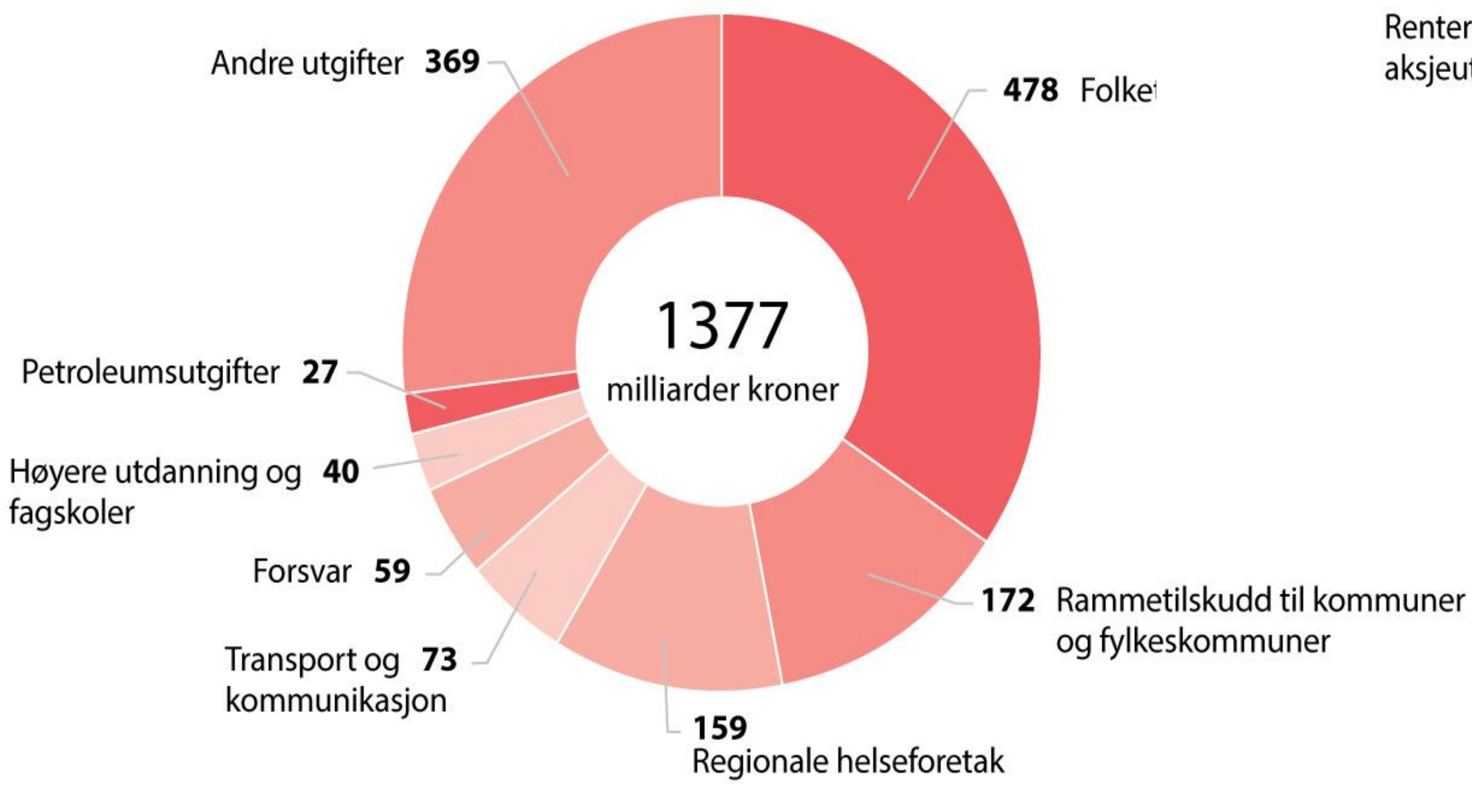
6. Risk reducing elements

Rationale & justification

Income (BNOK) in the National Budget, 2019 (excluding loan transactions)



Expenses (BNOK) in the National Budget, 2019 (excluding loan transactions)



Relative importance of petroleum industry:

- GDP: 17%
- State's revenue: 21%
- Total investments: 19%
- Total export revenue: 43%

Source: https://www.norskpetroleum.no/en/economy/governments-revenues/ (December 2018)

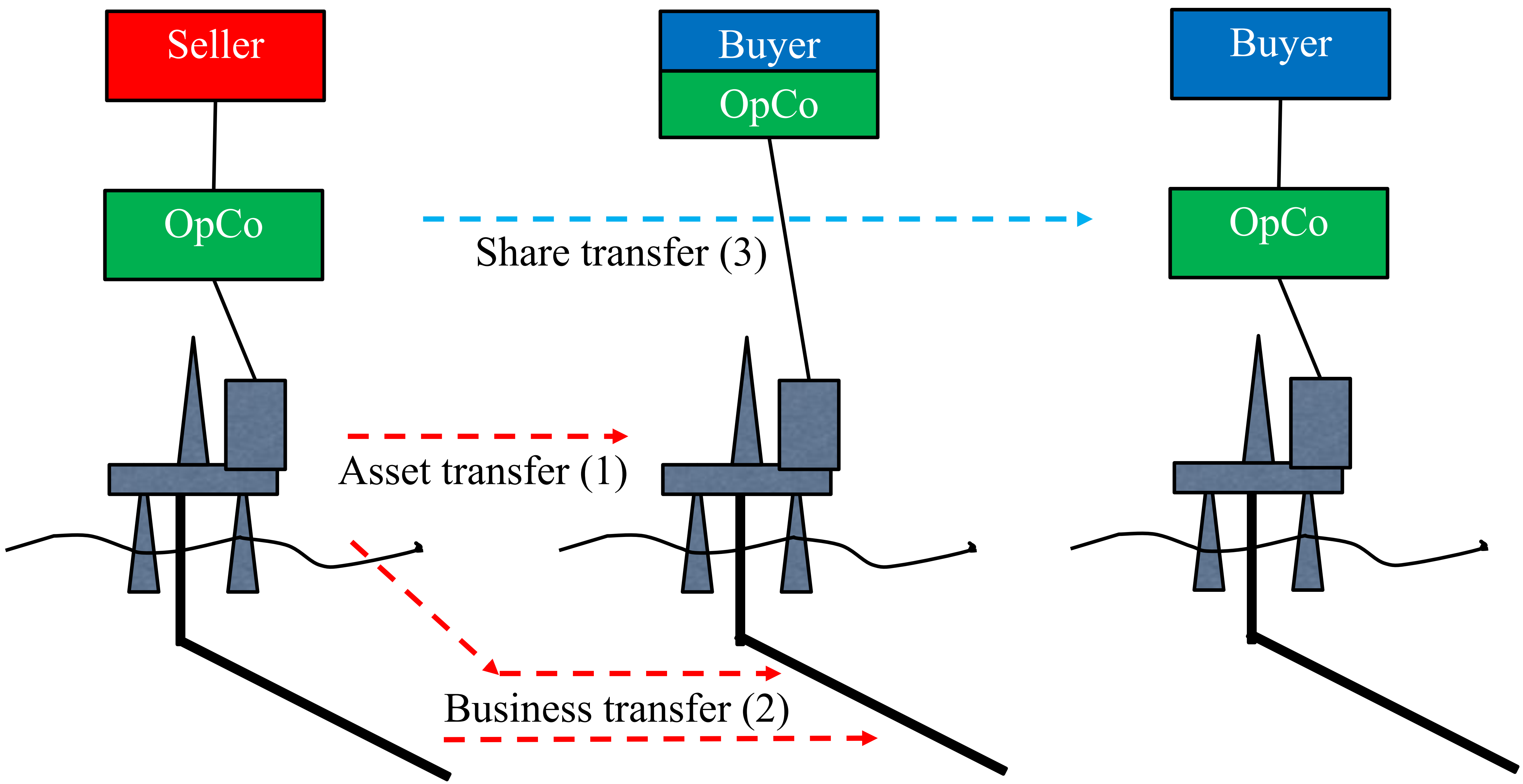
Source: Ministry of Finance, Fact sheet.- The state's income and expences 2019: https://www.regjeringen.no/contentassets/fada85d4686f486ebc31dd278a7a7778/faktaark_inntekter_utgifter.pdf

7. Withholding Tax (WHT)

- Dividends (the lowest WHT rate shall apply):
  - Domestic rate: 25%
  - Tax treaties: Normally 15% or lower
  - Shareholder (company) resident within the EEA: 0%
  - The Parliament's Annual Tax Decree: 0% to the extent dividends are paid from income subject to Special Tax for the distributing company to a shareholder (company) owning directly at least 25% of the distributing company
- Interest, royalty and lease payments for rigs, vessels, helicopters and airplanes:
  - 15% on gross payment if recipient is (i) an affiliated party *and* (ii) not resident within the EEA (effective from 1 July 2021)

8. Transfer of licenses – PTA Section 10

Alternative transfers – 3 alternative main structures



8. Transfer of licenses – PTA Section 10

Legal basis

- The PTA Section 10 – Consent from the Ministry of Finance
- Co-ordinated with the Petroleum Act Sec. 10-12 (MPE)
  - Direct transfer of license
  - Indirect transfer of license
    - Transfer of shares or participating interests in a company holding licenses that *"... may give decisive influence ..."*
    - Applies to parent companies at all levels (up to and including ultimate parent company)
    - Merger

8. Transfer of licenses – PTA Section 10

The concept of "tax neutrality"

- Standardized terms through Regulations of 1 July 2009 # 956
- Three main elements:
  - After tax consideration
  - Tax positions (base and profile for depreciation and uplift, and provisions for P&A costs deducted prior to 2005) follow the license and installation (continuity)
  - Effective date for tax purposes: normally 1 January in year of approval from MPE or 1 January in the following year

8. Transfer of licenses – PTA Section 10

The purchase price on an after-tax basis

- Seller: no tax on gain (no deduction of a loss)
- Purchaser: no tax depreciation on the purchase price
- Exceptions: "only if exceptional circumstances"
- Effects:
  - Reduces purchase price (funding requirements)
  - Allocation of purchase price between license and installations for tax purposes is no issue

8. Transfer of licenses – PTA Section 10

Seller's tax positions to be transferred to Buyer - Continuity

- Tax book values for depreciation
- Tax book values for uplift
- Deductions made for future P&A (closing down) costs:
  - Seller: take deducted amount to income in year of transfer
  - Buyer: deduct the amount as cost in year of transfer
- Exceptions: "if special circumstances"

9. Tax payments and tax assessment

- Estimated tax paid in 6 instalments:
  - 1 Aug, 1 Oct and 1 Dec in the tax year (Income Year) and
  - 1 Feb, 1 Apr, and 1 June in the following year
- Tax filing by 30 April in the year after the Income Year
- Tax assessment finished around October in Assessment Year
- Payable tax balance to be paid or received three weeks after the tax assessment is finished

10. Onshore elements

- Tax rate: 22%
- Tax consolidation between business activities and between group companies – Group Contribution (“Konsernbidrag”) – if joint ownership is more than 90%
- Depreciation:
  - Machinery: 20% declining balance
  - Buildings and constructions: 4% declining balance
  - Office buildings: 2% declining balance
  - Technical installations in buildings: 10% declining balance
  - Assets for transmitting, distributing and producing electricity: 5%
  - Improvements on leased assets: linear depreciation over the lease period
  - Property/land: no depreciation

10. Onshore elements

- Loss:
  - Only 50% may be applied against 22% tax base offshore
  - No offset against Special Tax base
  - No tax consolidation between group companies (Group Contribution/“Konsernbidrag”) with effect for income/loss subject to Special Tax
  - Onshore loss due to interest cost (and net exchange gain & loss on interest bearing debt) may be applied against 22% tax base offshore
- Tax payments:
  - 15 February and 15 April in year after the Income Year

11. Indirect Tax

- The geographical scope of the VAT Act is limited to the Norwegian mainland and the area within the territorial boarder (12 n. miles)
- The general VAT rate for delivery of goods and services against a consideration is 25%
- VAT exemption applies (with right to deduct input VAT) for a wide range of supplies within the petroleum sector
- The NCS is outside the geographical scope of the VAT Act
- Emission duties (CO_2, NO_x) are tax deductible against the 78% tax base

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