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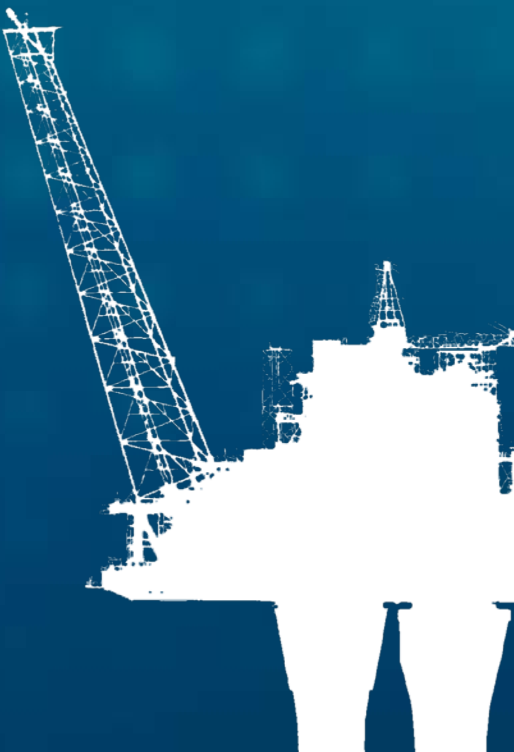
# Taxation of upstream activity on the Norwegian Continental Shelf

## Main elements as of 1 June 2018

*June 2018*



# Main Features

1. The NCS is one tax area
2. Taxable income based on net revenue with some modifications
3. 55% Special Tax on exploitation, processing and pipeline transport of petroleum on the NCS
4. Restriction on interest deduction against Special Tax
5. Transfer pricing
6. Tax incentives for new participants on the NCS
7. Special tax treatment of transfer of licenses – the PTA Section 10
8. Tax payments
9. Onshore elements

# 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)
- Advance rulings for inter company gas sales
- Achieved prices (FMV)
- 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/offshore
- 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 55% (+ 23% on Ordinary Income = all income)
2. Uplift = deduction: 4 years x 5,3% (total 21.2%) on ”fixed” installations against Special Tax base only (works like an additional tax depreciation)
   - 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

# 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 ordinary tax base (23%) and Special Tax base (55%)

- 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** |

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# 3. Uplift - 4 years

- Ref. example for deprecation: similarly, uplift starts each year, and is granted at 5.3%* over 4 years (only against Special Tax base)
- Example:

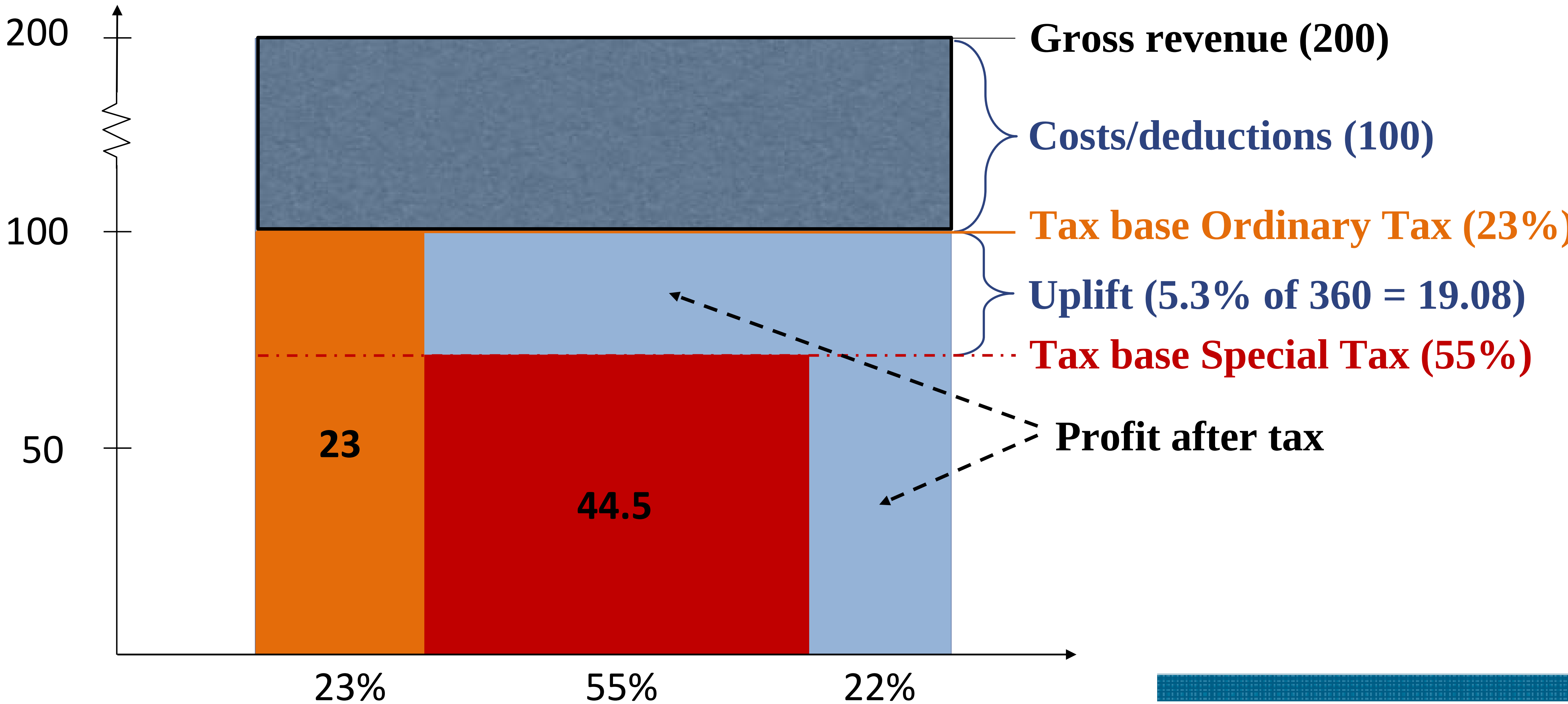
| | Investment | Uplift | | | | |
|---|---|---|---|---|---|---|
| | | Per asset | | | total | |
| Year 1 | 60 | 3,18 | | | 3,18 | |
| Year 2 | 180 | 3,18 | 9,54 | | 12,72 | |
| Year 3 | 120 | 3,18 | 9,54 | 6,36 | 19,08 | |
| Year 4 | | 3,18 | 9,54 | 6,36 | 19,08 | |
| Year 5 | | | 9,54 | 6,36 | 15,9 | |
| Year 6 | | | | 6,36 | 6,36 | |
| Year 7 | | | | | | |
| Year 8 | | | | | | |
| **Total** | **360** | **12,7** | **38,2** | **25,44** | **76,32** | (= 360 x 21,2%) |

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

# 3. Taxable income: summary

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

| | | |
|---|---|---|
| Ordinary Tax: 100 x 23% | = | 23.0 |
| Special Tax: (100-19.08) x 55% | = | 44.5 |
| Total tax: | = | 67.5 |



# 4. Interest cost

## Restrictions on interest deduction

- Restrictions on deduction against Special Tax
  - Interest and exchange gains/losses on interest bearing debt allocated offshore
  - All other exchange gains/losses subject to onshore taxation
  - Financial items to be allocated onshore (23%)
    - Interest income
    - Financial instruments (gain & loss)
    - Currency gain/loss (except on interest bearing loans)
    - Etc.
- General restrictions on interest deduction
    - Announced by the Ministry of Finance in 2013, but not yet proposed for companies subject to Special Tax

# 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 capitalisation

- Insufficient income onshore

  ⇨ loss from financial items returned offshore, but only 23% 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 23% tax base

  ⇨ Next: 50% of loss from other onshore deducted against offshore 23% income

- Thin capitalisation
  - 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. Tax incentives

## for new participants on the NCS

- 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 tax payers 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 tax payer ceases upstream activity on the NCS

# 6. Interest on loss and unused uplift carried forward

- Set annually by the MoF in January after income year
- "Normal borrowing cost after tax for investments with high security"
- For income year 2017 (balance at 31 December 2017): 0.7%
- Compound interest
- Interest element tax free (fully deductible against future income)
- Separate interest calculation on Special Tax base (55%), Ordinary Tax base (23%) and unused uplift (55%), respectively
- No interest on onshore tax base (23%)
- 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 oil in the ground:
  - Seismic data collection/acquisition and processing
  - Interpretation of seismic data
  - Application fee to the MPE for licenses
  - Drilling
  - 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 MPE (Ministry of Petroleum & Energy)
  - 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 of 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 (excl. any finance cost), and
  - loss carried forward in Special Tax base (55%) and Ordinary Tax base (23%), respectively
- Amounts applied for tax refund may not be included in loss carried forward

# 7. PTA Sec. 10

## Legal basis

- The PTA Section 10 – consent from the MoF
- Co-ordinated with the Petroleum Law Sec. 10-12 (MPE)
  - Direct transfer of licence
  - Indirect transfer of licence
    - Transfer of shares or participating interests in a company holding licences that *”… may give decisive influence …”*
    - Applies to parent companies at all levels (up to and including ultimate parent company)
    - Merger

# 7. PTA Sec. 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 following year

# 7. PTA Sec. 10

## The purchase price on an after tax basis

- Seller: no tax on gain
- Purchaser: no tax depreciation on 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

# 7. PTA Sec. 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
- <u>Exceptions:</u> "if special circumstances"

# 8. 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 (Assessment Year)
- Tax filing by 30 April in Assessment Year
- Tax assessment finished around October in Assessment Year
- Tax balance to be paid or received three weeks after the tax assessment is finished

# 9. Onshore elements

- Tax rate: 23%
- Tax consolidation between business activities and between group companies ("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 and distributing electricity and electrotechnical equipment for electricity production
  - Property/land: no depreciation
  - Leased property, etc.: linear depreciation over lease period

# 9. Onshore elements

- Loss:
  - Only 50% may be applied against 23% tax base offshore
  - No offset against Special Tax base
  - No tax consolidation between group companies (“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 23% tax base offshore

- Tax payments:
  - 15 February and 15 April in year after the Income Year

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