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Taxation of E&P activity on the Norwegian Continental Shelf

Main elements as of December 2022

7 January 2023

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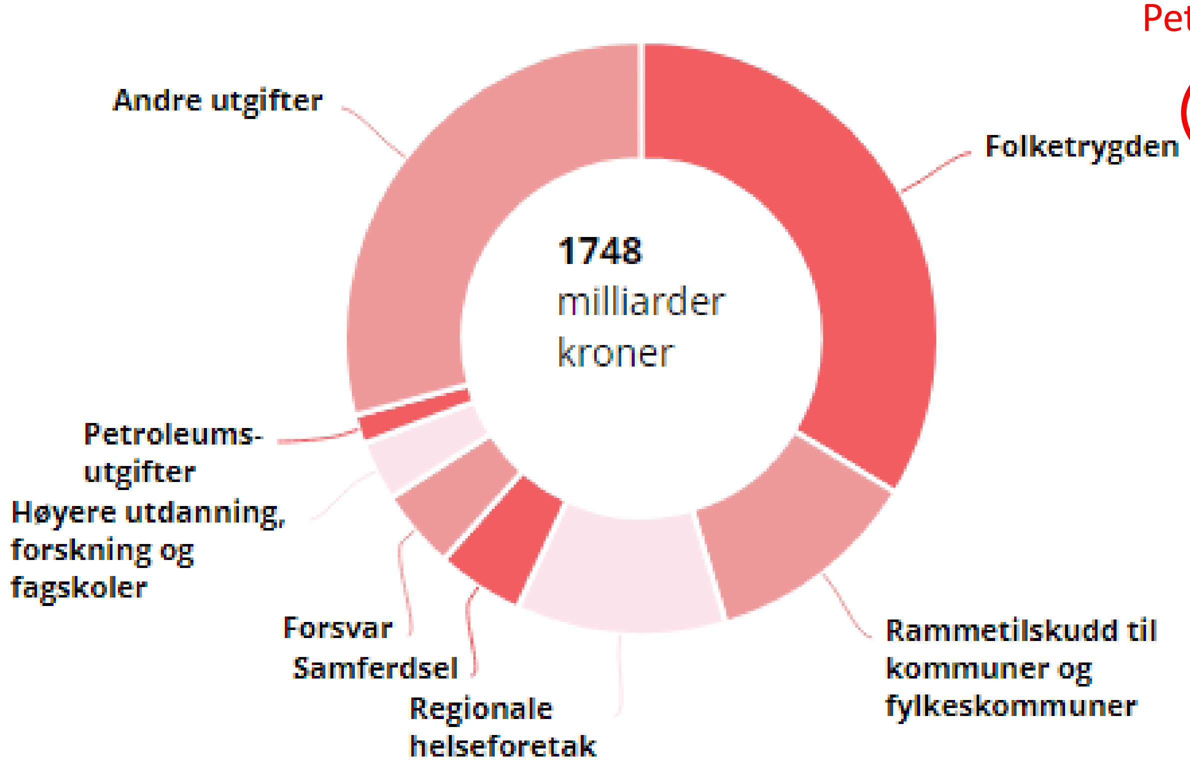
Main Features

1. Introduction
2. The NCS is one tax area – The Offshore Area
3. Tax (Corporate Tax and Special Tax) based on net income with some modifications
4. Special Tax on exploitation, processing and pipeline transport of petroleum
5. Investments
6. Interest costs – Other financial items
7. Risk reducing elements
8. Withholding tax on dividends and certain interest, royalty and lease payments
9. Transfer of licenses – PTA Section 10
10. Transfer pricing
11. Related activity: Wind power generation – CO2 storage – Hydrogen/Ammonia production
12. Tax payments and tax assessment
13. Onshore elements
14. Indirect taxes and property tax

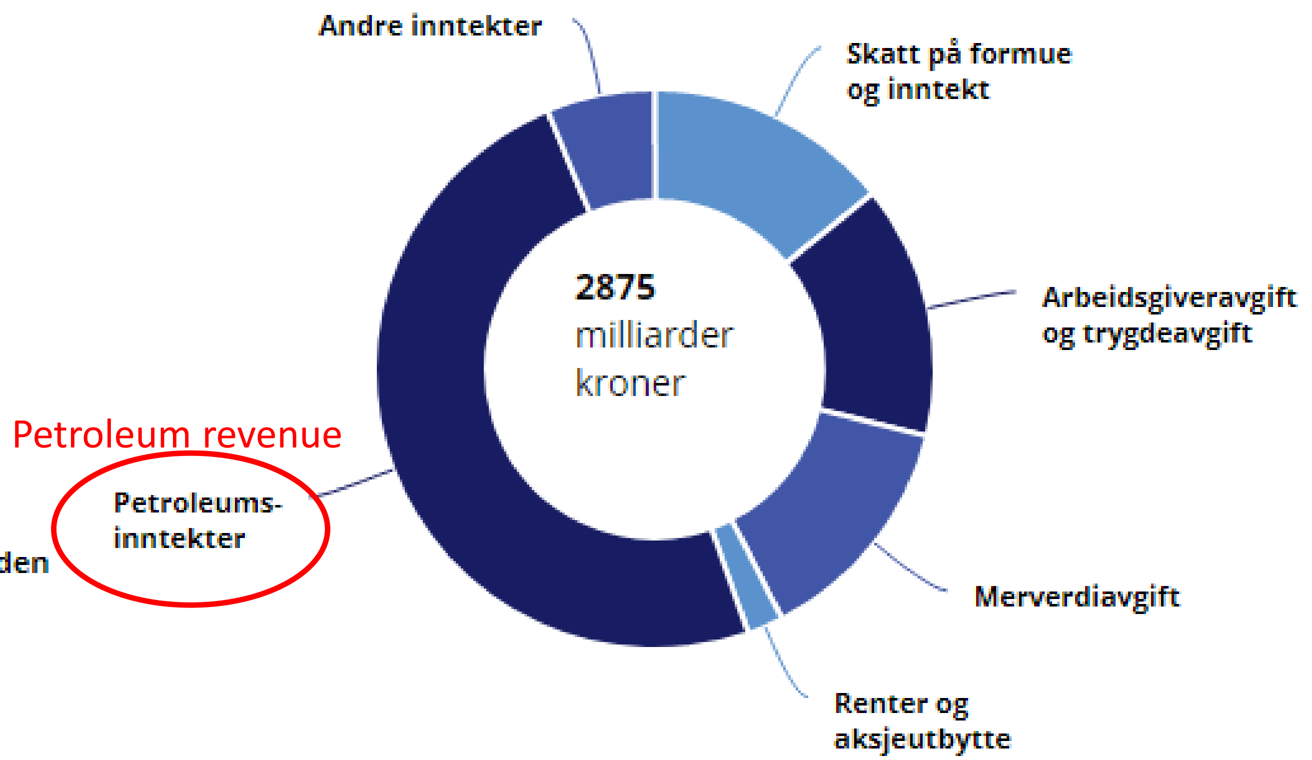
This paper is a general, high level introduction to upstream taxation on the NCS. It does not pretend to be complete and it does not include details which may have significant impact on taxation of any specific company, business, activity or transaction

1.1 Importance of the E&P industry

Expenses (BNOK) in the National Budget, 2023 (excluding loan transactions)



Income (BNOK) in the National Budget, 2023 (excluding loan transactions)



Relative importance of petroleum industry:

- GDP: 33%
- State's revenue: 49%
- Total investments: 17%
- Total export revenue: 64%

Source: https://www.norskpetroleum.no/okonomi/statens-inntekter/(November 2022)

Source: Ministry of Finance, Fact sheet.- The state's income and expences, Dec. 2022: https://www.regjeringen.no/no/statsbudsjett/2023/statsbudsjettet-2023-statens-inntekter-og-utgifter/id2931252/

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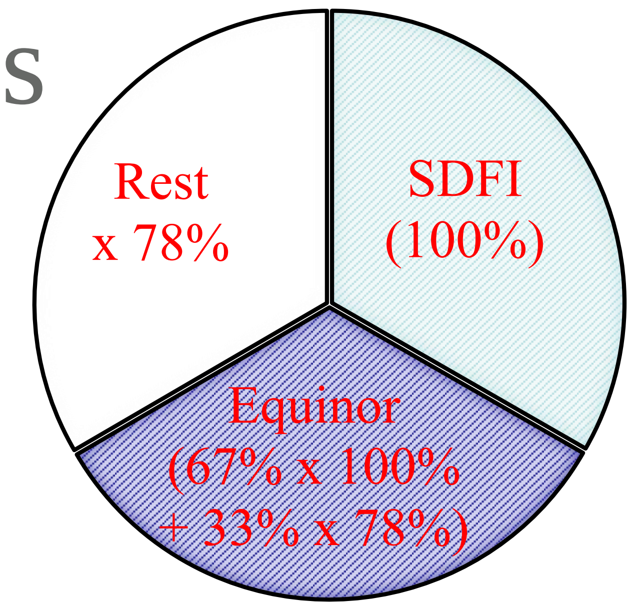
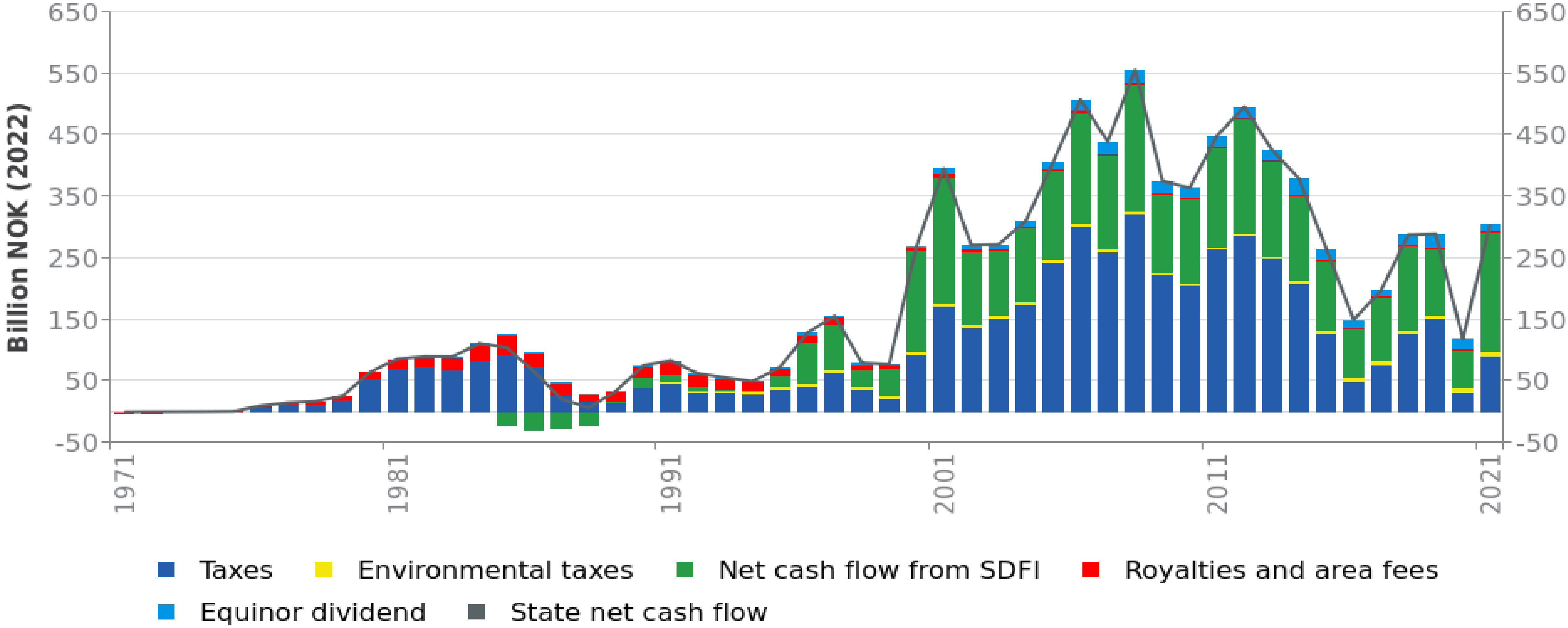
Rough, private illustration

1.2 Government take – 3 main sources



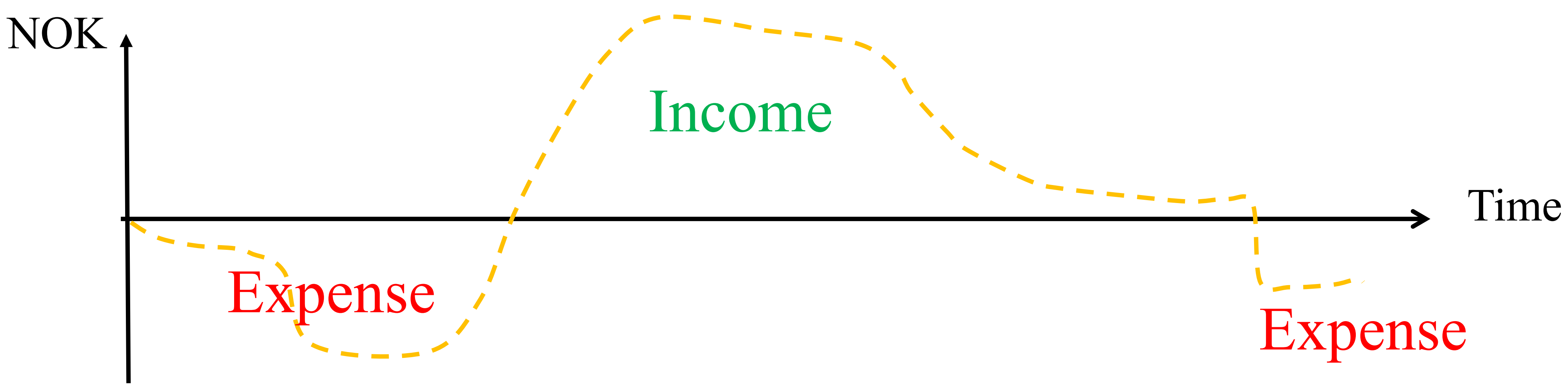
The State's share of remaining petroleum resources (National Budgets, estimates:)

2019 – Meld. St. 1 (2018-2019) chapter 2.6: BNOK 5.100 of BNOK 6.000 (85%)
2020 – Meld. St. 1 (2019-2020) chapter 2.6: BNOK 4.900 of BNOK 5.700 (86%)
2021 – Meld. St. 1 (2020-2021 chapter 2.6: BNOK 4.500 of BNOK 5.600 (80%)
2022 – Meld. St. 1 (2021-2022 chapter 2.6: BNOK 3.200 of BNOK 3.700 (86%)
2023 – Meld. St. 1 (2020-2021) chapter 2.5: No estimat after 2024



1.3 Characteristics of E&P activity

Phase	Income/expense
Exploration	Expense
Development	Expense
Production	Income
P&A – Decommissioning	Expense



2.1 The NCS is one tax area – The Offshore Area

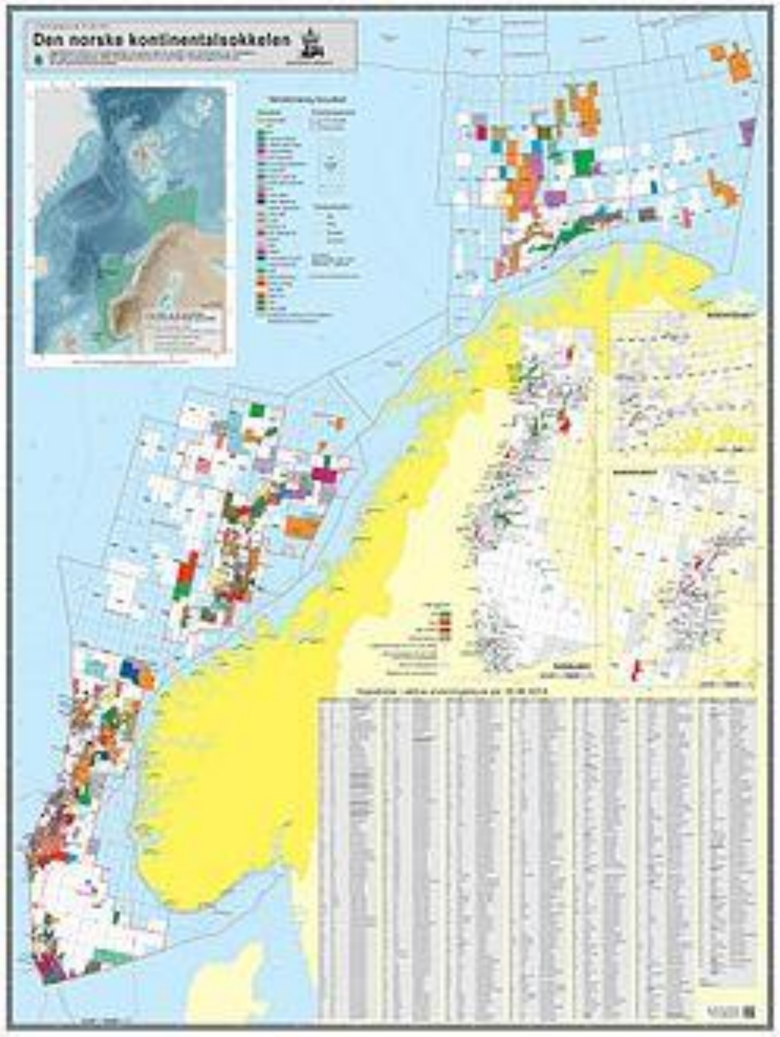
- Special tax regime for exploitation, processing and pipeline transport of petroleum on/from the NCS
- No ring fence per field – All upstream activity on the NCS is tax consolidated per company (Corporate Tax and Special Tax)
- Very limited tax consolidation with other activity
- Special Tax (71.8% nominal, 56% effective) on top of ordinary Corporate Tax (22%)
- Corporate Tax is deducted against the Special Tax base

2.2 The Offshore Area

The Geographical Scope of the PTA

1) All salt water areas between the shores of Norway and the end of the continental shelf / boarder lines towards other countries' continental shelves, and

2) Some designated terminal areas onshore



3.1 Tax (Corporate Tax and Special Tax) based on net income with some modifications

Revenue

- Crude oil:
  - Norm Price (most crude oil and NGL during some periods)
  - If no Norm Price - Achieved prices (Fair Market Value)
- Gas:
  - Achieved prices (Fair Market Value)
  - May request advance binding rulings for inter-company sales
  - Gas Trading (not Special Tax) vs. equity sales (Special Tax) – An issue for many disputes
- Timing is an area of focus

3.1 Tax (Corporate Tax and Special Tax) based on net income with some modifications

Norm Price:

- Substitutes actual sales price with a deemed market price set by the Norm Price Board
- The Norm Price Board is organized by the MPE
- Valuation at the Norm Price Point
- No costs downstream the Norm Price Point are tax deductible (such costs are deemed to be included in the Norm Price)
- Normally set after each quarter
- Separate Norm Price for each day
- Adjustments for differences in quality between different fields
- Based on standard terms of payment (30 days), etc.

3.2 Tax (Corporate Tax and Special Tax) based on net income with some modifications

Costs

- Exploration costs: Deductible as incurred (Corporate and Special Tax bases)
- Development costs: “Fixed” (permanently located) installations on the NCS (production facilities and related items, including pipelines for transport of NCS petroleum):
  - Corporate Tax base (22%): Depreciated over 6 years linear
  - Special Tax base (71.8% nominal, 56% effective): Deductible as incurred
- Opex: Deductible as incurred (operation, maintenance, taxes & duties (CO2 duty, NOx-duty, property tax, etc.)) (Corporate and Special Tax bases)
- Net finance (income and cost) allocated onshore (22%)
- Plugging and Abandonment (P&A) cost and decommissioning cost deductible when actual P&A/decommissioning takes place (Corporate and Special Tax bases)

4.1 Special Tax on net income

from exploitation, processing and pipeline transport of petroleum

1. Special Tax rate*:
   - Nominal: 71.8%
   - Effective, after deduction of Corporate Tax: 56% (71.8% x (1 – 0.22))
2. Total marginal tax rate: 78% (22% + 56%) Corporate Tax + Special Tax
3. Uplift – According to transitional and preliminary** rules, only
   - Transitional rules for investments up to and including 2019: 4.06% x 4 years (applicable rate in 2022)
   - Preliminary rules introduced for (i) investments made in 2020 and 2021, and (ii) investments made according to PDO approved by the MPE between 12 May 2020 and 1 January 2024: 12.4% first year

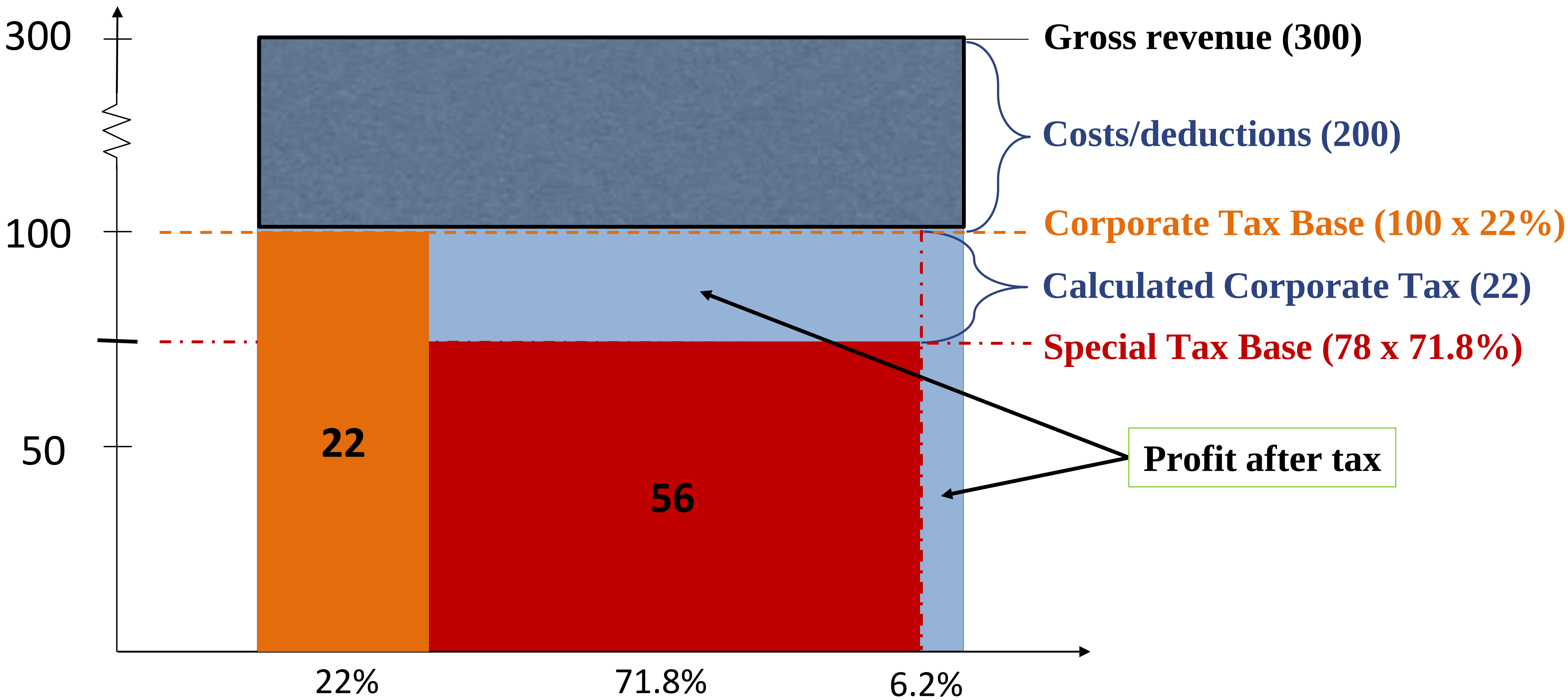
* All tax rates referred to in this presentation are those announced for the income year 2023 as of the date of this presentation.

** See slide heading 5.3

4.2 Taxation of Net Income: Illustration

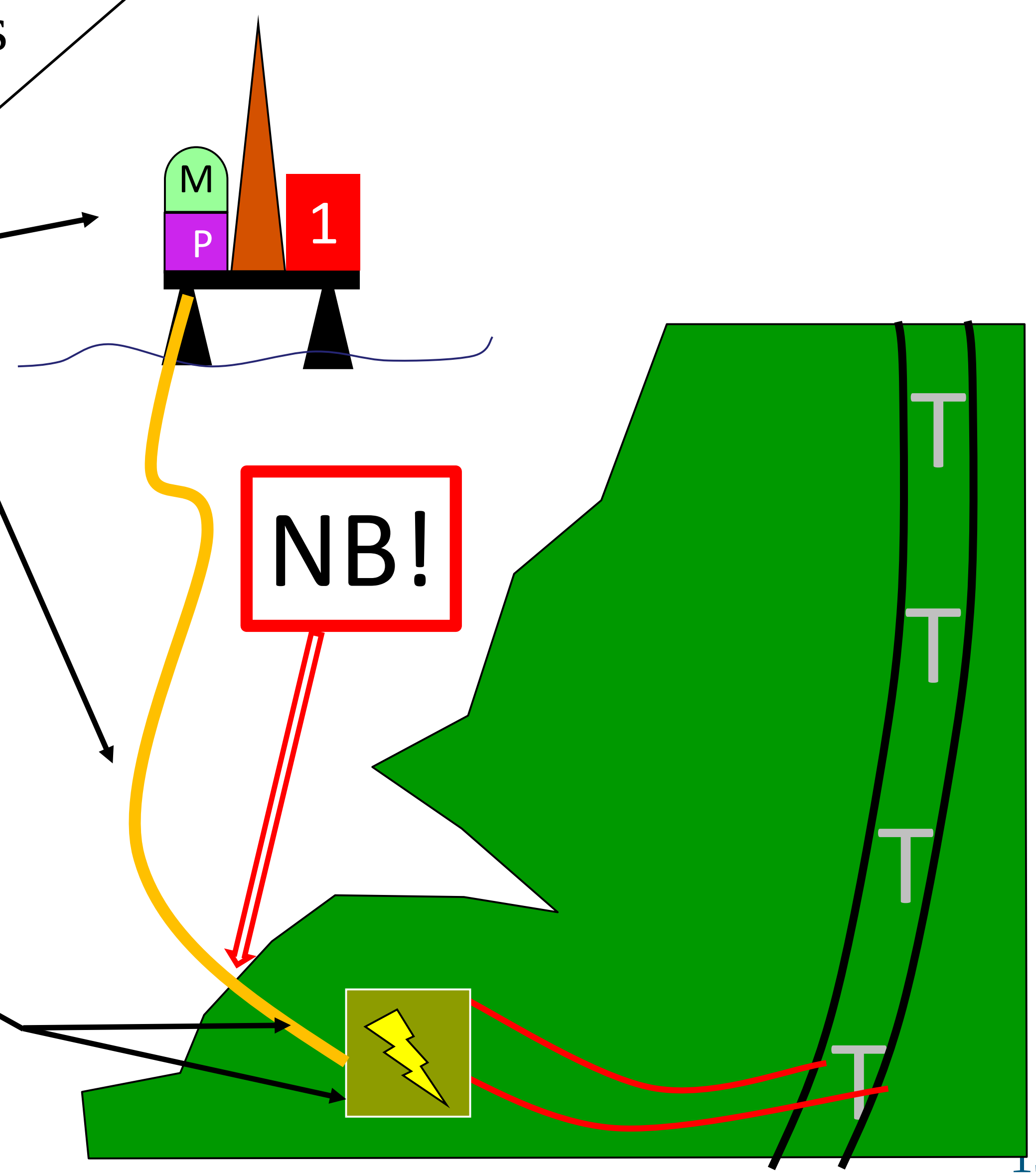
- Gross revenue: 300
- Costs, including depreciation/ expensing investments: 200

Corporate Tax: 100 x 22%	=	22.0
Special Tax: (100-22) x 71.8%	=	56.0
Total tax:	=	**78.0**



5.1 Investments – Location determines depreciation

- Production facilities “offshore” (PTA Sec. 3 b)
  - Acquisition of permanently located installations (including pipelines)
  - Corporate Tax base: 6 years linear
  - Special Tax base: 1 year
  - Start: As incurred



- Assets “onshore”
  - Declining balance (0 – 30%), ref General Tax Act/GTA Sec. 14-43
  - Start: When delivered/finished

5.2 Investments «offshore» (PTA Section 3 b)

- Corporate Tax Base (22%):
  - 6 years linear depreciation.
  - For investments made over several years, depreciation starts in each year
- Special Tax Base: Deduct as incurred (expense in year 1)
- Example:

		Corporate Tax Base					Special Tax Base			
	Investment	**Depreciation**					**Direct expensing**			
					Total					**Total**
Year 1	60	10			10		60			60
Year 2	180	10	30		40			180		180
Year 3	120	10	30	20	60				120	120
Year 4		10	30	20	60					0
Year 5		10	30	20	60					0
Year 6		10	30	20	60					0
Year 7			30	20	50					0
Year 8				20	20					0
Total	**360**	**60**	**180**	**120**	**360**		**60**	**180**	**120**	**360**

5.3 Preliminary rules for PTA Sec 3 b 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, ref PTA Sec. 3 b), plus 24% uplift, may be expensed directly against the Special Tax Base (56% effective), only (in addition to 6 years depreciation in the 22% tax base).

- Similar costs up to and including the year for *planned* production start, plus 12.4% uplift, 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

- Does not apply for investments onshore

6.1 Interest costs

Restrictions on interest deduction

- Restrictions on deduction against Special Tax
  - Interest and exchange gains/losses on interest bearing debt allocated onshore (22%)

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

  - Special Tax Value = Written down Special Tax values at end of income year (after depreciations/expensing that income year) => normally 0 – zero deduction against the Special Tax base because investments are expensed in Year 1
- All other exchange gains/losses subject to onshore taxation
- Withholding Tax (15%) on interest payments to related parties in low tax jurisdictions outside the EEA

6.2 Interest costs

- Insufficient income onshore
  - ⇨ loss from financial items returned offshore, but only in the 22% tax base

- 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)
  - Corporate Tax: no special provision, but the General arm’s length principle applies (General Tax Act/GTA Sec. 13-1)

6.3 Other financial items allocated onshore (22%)

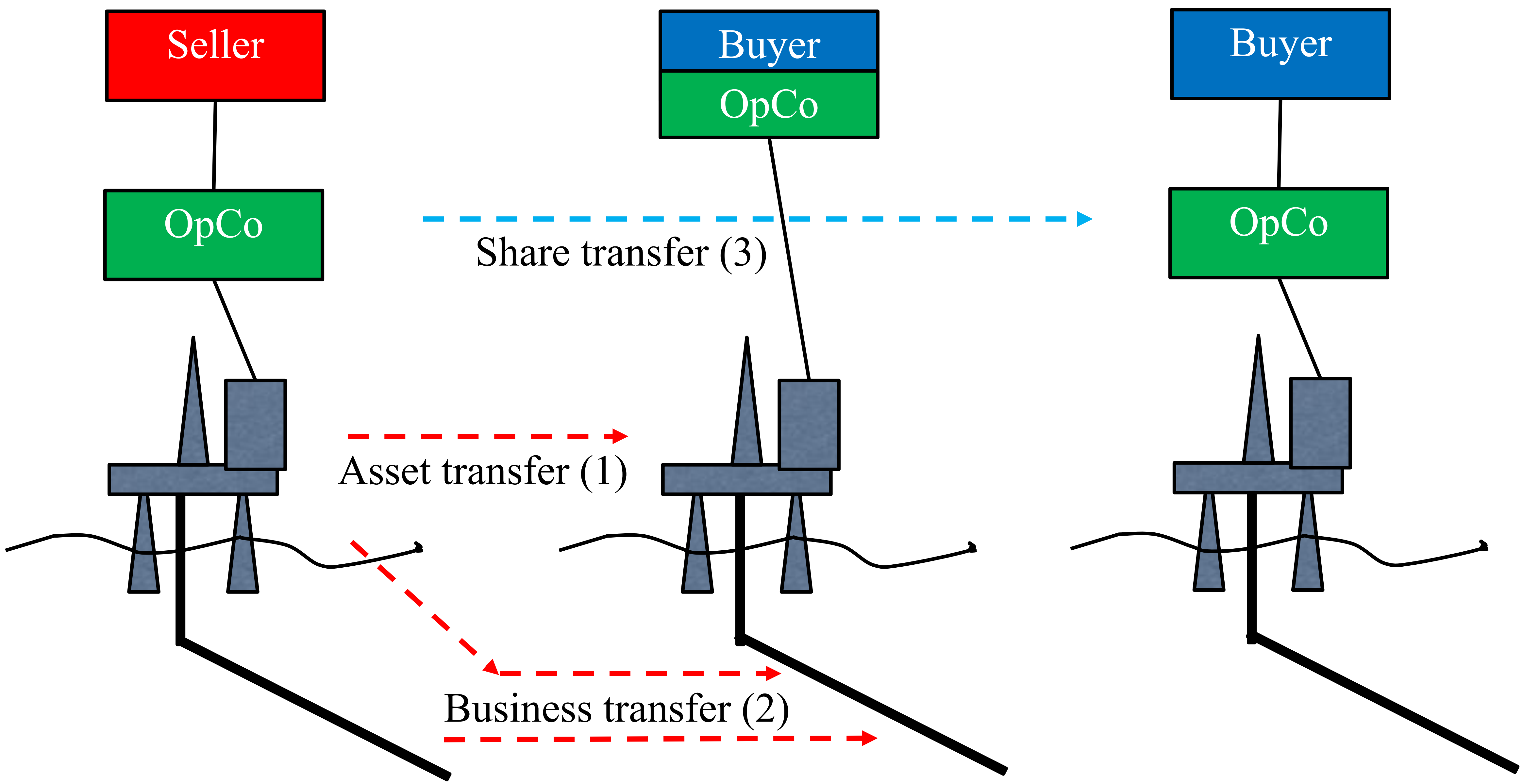
- Interest income
- Gain/loss on receivables
- Exchange gain/loss other than on interest bearing debt
- Gain/loss on financial instruments (most instruments used for hedging of currencies and sales)

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) resident in a low tax jurisdiction outside the EU/EEA

8.1 Transfer of licenses – PTA Section 10

3 alternative main structures



8.2 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

8.3 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
    - Seller: no tax on gain (no deduction of a loss)
    - Purchaser: no tax depreciation on the purchase price
  - Tax positions (base and profile for depreciation (and uplift), and provisions for P&A costs deducted prior to 2005) follow the license and installations (continuity)
  - Effective date for tax purposes: Normally 1 January in year of approval from MPE or 1 January in the following year
- The GTA Sec 13-3 might disallow loss carried forward in Corporate Tax base

9. Transfer Pricing

- Legal framework:
  - GTA Sec 13-1
  - OECD Transfer Pricing Guidelies
- TP issues frequently being raised by the Oil Taxation Office:
  - Gas pricing
  - Services
  - Insurance premiums (captive insurance)
  - Interest on loans and deposits
  - Guarantee fees
  - Thin capitalisation

10. Risk reducing elements (…. have been reduced)

- No deadline for loss carried forward
- Loss carried forward may be transferred to a buyer if merged into another E&P company on the NCS – unless tax reasons dominate (GTA Sec. 13-3)
- The government will pay out annually the tax value (”negative tax”) of a loss in the Special Tax base (only) – A claim on the government may be used as collateral for loan financing

11. Related activity

Wind power generation – CO2 storage – Hydrogen / Ammonia production

<u>Key question</u>:

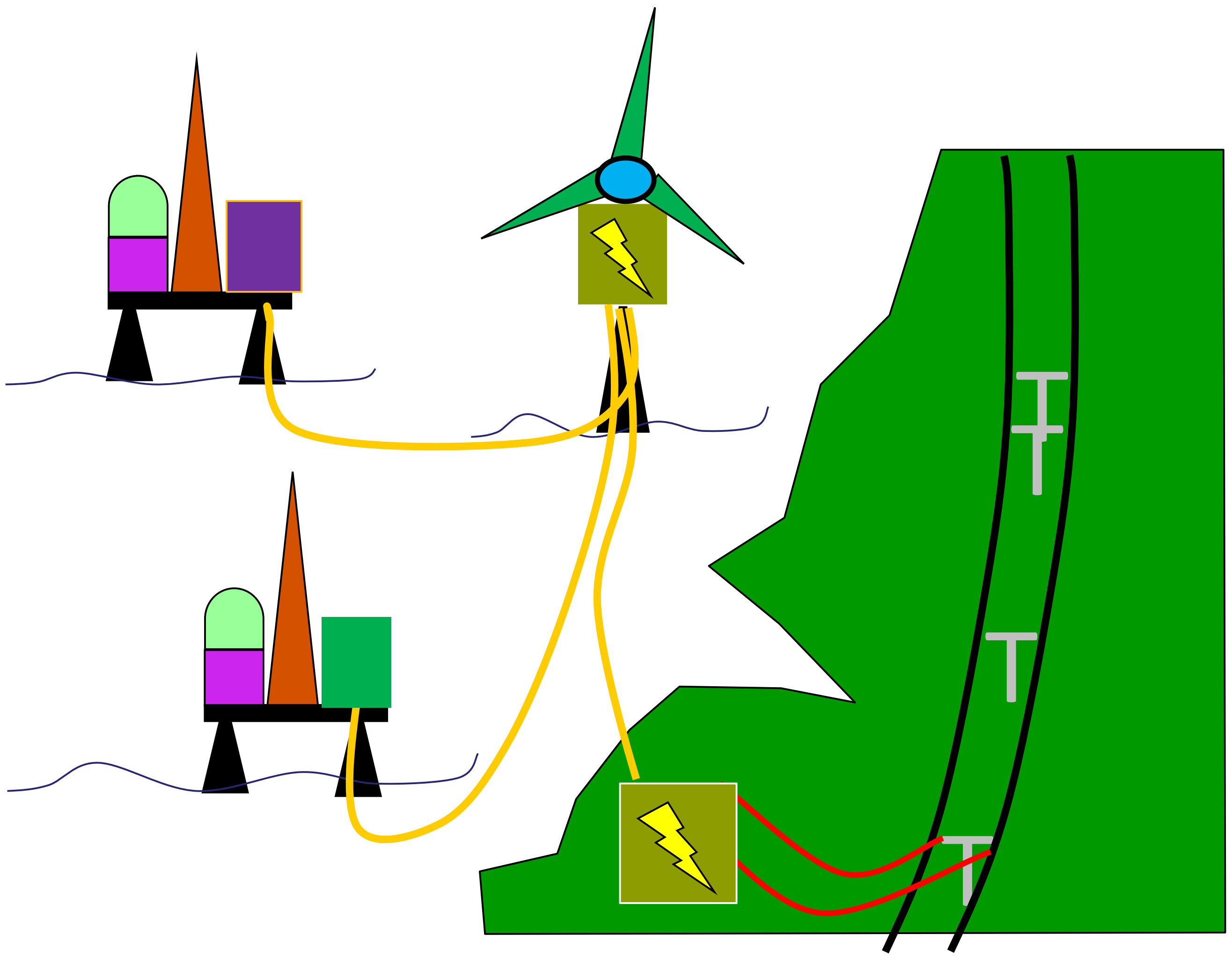
What is the main purpose?

- Support the company's E&P activity

  => Special Tax (78%) regime

- Produce and sell electricity, storage capacity, Hydrogen and/or ammonia

  => Onshore (22%) regime



12. 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 October/November in the year after the Income Year
- Payable tax balance to be paid or received three weeks after the tax assessment is finished

13.1 Onshore elements

- Tax rate: 22%
- Full tax consolidation:
  - Between different business activities within the same company
  - Between group companies if common ownership is more than 90% – Group Contribution ("Konsernbidrag")
- 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% declining balance
  - Improvements on leased assets: Linear depreciation over the lease period
  - Property/land: No depreciation

13.2 Onshore elements

- Loss:
  - Only 50% may be applied against 22% Corporate 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% Corporate Tax Base Offshore

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

14. Indirect taxes and property 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 NCS is outside the geographical scope of the VAT Act
- 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
- Property tax might be issued by each individual municipal on fixed property, plants and constructions at a rate between 0.1% – 0.7% of market value
- Emission duties (CO_2, NO_x) and property tax are tax deductible against the Corporate Tax base and the Special Tax base

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