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Norwegian tax regime for petroleum exploration - Case No 81036

1. INTRODUCTION

We refer to the letter of 7 December 2017 from the EFTA Surveillance Authority (hereafter “the Authority”) (Case No 81036, Document No 880791) in which the Authority requests additional information regarding the complaint against the Norwegian tax rules on the reimbursement of the tax value of explorations costs in Section 3 litra c sub-paragraph 5 of the Norwegian Petroleum Tax Act. We also refer to our letter of 22 September 2017 and the meeting in Brussels on 12 January 2018.

The Norwegian Ministry of Finance (hereafter the “Ministry”) maintains that the Norwegian rules on reimbursement of the tax value of exploration costs and on loss carry forward with interest in the Norwegian Petroleum Tax Act do not constitute state aid under Article 61 of the EEA Agreement. The rules are hence in compliance with the EEA law.

In the following, the Ministry will describe the fundamental features of taxation of petroleum activity and the principles behind the Norwegian petroleum taxation system (section 2), the activities on the Norwegian Continental Shelf (section 3) and the objectives of the Norwegian Petroleum Tax Act (section 4). Section 5 gives a brief overview of the petroleum tax system. Finally, section 6 contains the Ministry’s response to the Authority’s questions in the letter of 7 December 2017.

The petroleum tax system, with a tax rate of 78 pct., is designed to capture a large part of the considerable excess return from the petroleum activity without distorting investments to the benefit of the Norwegian people.

As will be further elaborated below, the Ministry holds that the *petroleum tax system* (78 pct. tax rate) is the correct *reference system* when assessing the reimbursement rules for exploration costs and the loss carry forward with interest under Article 61 of the EEA Agreement. Since the introduction in 1975, the petroleum tax system has consisted of two interlinked elements - the ordinary corporate tax and the special tax. It is essential, however, to underline that these two elements *in combination* constitute the petroleum tax system. For instance, the total petroleum tax rate has been unchanged at 78 pct. since the general tax reform in 1992, despite several reductions in the ordinary tax rate. The total tax system is also relevant when evaluating the petroleum tax system's effect on the investment decisions.

The rules on reimbursement of the tax value of exploration costs and on loss carry forward with interest in the petroleum tax system are integrated parts of the petroleum tax system that applies to the petroleum activity (extraction and pipeline transportation) on the Norwegian Continental Shelf (NCS).

The introduction of the reimbursement of the tax value of exploration costs in 2005 equalised the tax treatment of exploration costs for companies covered by the petroleum tax system. The objective of neutrality also underpins the introduction of the rules on loss carry forward with interest in 2002. The rules do not favour certain undertakings compared to other undertakings in a similar situation within the petroleum tax system. As will be explained below, the Ministry cannot see that the rules imply any selective advantages under the state aid rules.

2. FUNDAMENTAL FEATURES OF PETROLEUM TAXATION AND THE NORWEGIAN PETROLEUM TAXATION SYSTEM

2.1 Introduction

There is a potential for a considerable excess return (resource rent) associated with the extraction of a limited, non-renewable resource such as petroleum. The petroleum resources are often owned by the state and petroleum-rich countries normally have special systems or instruments designed to capture a large part of the resource rent (Government take). Two of the most common instruments world-wide are royalty

(taxation based on *gross income* from the petroleum production) and *net income* tax (where relevant costs are deductible before arriving at the tax base)¹.

Thus, the state revenue from petroleum activity can potentially be large. This will depend on the profitability in the petroleum sector and the share of the return the state collects through the Government take system. The design of the total Government take system will affect the profitability and the value creation in the sector. The question of how the state can facilitate the highest possible value creation and at the same time collect a large revenue, have therefore been important considerations when designing the Norwegian petroleum tax system. As described in economic literature², a specially designed resource rent tax may secure the state a large share of the net profit without distorting incentives for companies to explore and invest, see section 2.3.

Moreover, petroleum activity is characterised by high risk and high capital requirements. In addition, it normally takes several years from exploration starts to a potential discovery is made. If petroleum is found, it will take additional years before a field can be developed and production can begin. The very high marginal tax rate and the special features of the petroleum activity, imply that it is important that the tax system is neutral; i.e. that it does not distort the companies' decisions and that it makes investments equally profitable for all petroleum companies.

Below, the Ministry provides an overview of the main instruments for the government take in Norway (section 2.2) and the importance of the neutrality principle in the petroleum tax system (sections 2.3 and 2.4).

2.2 Government take in Norway – main instruments

The petroleum resources on the Norwegian Continental Shelf are owned by the state, cf. Section 1-1 of the Petroleum Act. The exploitation of the petroleum resources shall be to the benefit of the Norwegian people. Through the licencing rounds, cf. section 3 and 6.4, the petroleum companies are awarded *exclusive rights* (production licenses) to explore, develop and produce the petroleum resources *free of charge*.

The PTA, cf. section 4, sets out the *petroleum tax system* based on net income, specially designed to ensure the state a large part of the excess return from the petroleum activity. At the beginning of the petroleum era in Norway, the royalty was an important taxation instrument in combination with the net income tax. Over time, the royalty was phased out because it could hamper profitable investments (*i.e.* investments that were profitable before tax, could become unprofitable after tax, see section 2.3). Today, the

¹ Another common Government take instrument is a Production Sharing Agreement (PSA), which is a contract signed between the government and a company (or group of companies) concerning how much of the petroleum extracted from the country each will receive. A PSA may have some elements with similar features as royalty, and other elements with features similar to net profit taxation. Norway has not used PSAs.

² See Fane (1987), Summers (1987), Bond & Devereux (1995) and IMF (2012).

two main government take instruments in Norway are the petroleum tax system and the State Direct Financial Interest (SDFI), both based on net income. In addition to being a tax collector, the state is thus a direct investor in the petroleum activity through the SDFI.

Over the last 10 years, the annual investments in the petroleum sector have been around 170 billion NOK on average. In the national budget for 2018, the present value of the future cash flow from the petroleum sector is estimated to 4 500 billion NOK in 2017-values. The state's revenues are estimated to 3 900 billion NOK, or almost 87 pct. of the estimated future cash flow from the sector.

2.3 The Norwegian petroleum tax system - neutrality

Petroleum activity is, as described above, characterised by high risk, high capital requirements and a very long investment horizon as it takes many years from exploration starts to a potential discovery is made. If petroleum is found, it will take time before a field can be developed and production begins. The special features of the petroleum activity, combined with a high marginal tax rate, emphasise the importance of a tax system that does not distort petroleum companies' decisions (neutrality).

A *neutral* tax system will ensure that petroleum resources that are profitable to develop before tax, are profitable for companies after tax, and vice versa. A neutral tax system requires *symmetrical* treatment of costs and income, *i.e.* that all relevant costs can be deducted *against the same tax rate* as the income is taxed. This means that if income derived from petroleum activity is taxed at a rate of 78 pct., the state, through the tax system, should cover a corresponding share (78 pct.) of the costs incurred to earn this income. This applies to exploration costs as well as to other costs related to the petroleum activity.

The economic costs (distortions) associated with a non-neutral tax system will increase with the tax rate. The economic costs resulting from distortionary taxes (such as the ordinary corporate tax) should be kept as low as possible. In order to reduce distortions, the guiding principle of the major general tax reform in Norway in 1992 was to enhance neutrality. The tax system has thus been based on the principles of broad tax bases, low rates and symmetrical treatment of income and expenses.

A neutral petroleum tax system on the other hand, allows for a high marginal tax rate, at the same time as it allows companies to maximise the production value of the resources. Without a neutral tax base, the high tax rate of 78 pct. could hinder profitable investments, and the total value creation and the tax revenues from the petroleum activity would be reduced.

As pointed out in section 2 of our letter dated 22 September 2017, the Norwegian petroleum tax system has been developed towards a more neutral tax system over time, cf. also section 2.4 below.

2.4 The Norwegian Official Report on Taxation of petroleum activity (NOU 2000: 18)

The expert committee that considered the Norwegian petroleum tax system in *NOU 2000: 18 Taxation of petroleum activity* emphasized that the main question was how the state can maximise value creation and at the same time tax revenues³. The committee identified several non-neutralities in the petroleum tax system then in place. One such non-neutrality was that exploration and investment incentives depended on whether petroleum companies were in a tax paying position or not⁴. The committee advised to introduce special measures, such as carry forward with interest⁵ and tax rules to ensure security for the full value of the tax deductions⁶, to correct the lack of equal treatment between petroleum companies.

For an established petroleum company recording a profit, all relevant costs can be deducted each year and reduce the taxable net profit. Petroleum companies that are at present not in a tax paying position, have to wait for a possible positive net profit before they can take advantage of deductions. Without the opportunity to carry forward loss with interest, the value of the deductions would decline over time. Indeed, this is also true for other business activities. However, the high tax rate of 78 pct. combined with the particular features of the petroleum activity as described above, substantiated the recommendation of a loss carry forward *with* interest within the petroleum sector. In the report, the committee illustrated that an investment would be more profitable for a petroleum company in a tax paying position than for a petroleum company not in a tax paying position.

The expert committee recommended introducing the special measures in the petroleum tax system as a whole (*i.e.* both in relation to the ordinary corporate tax element and the special tax element)⁷. The committee argued that this was necessary to give the same investment incentives for all petroleum companies. When the committee considered the impact of the tax system on companies' investment decisions, they evaluated the effect of the petroleum tax system as a whole – not the Norwegian General tax act (GTA), or the corporate income tax (CIT) separately, cf. section 6.2 on the identification of the reference system.

The committee also considered arguments in favour of and against taxing the normal return from the petroleum sector through the ordinary tax element. They pointed out that the ordinary taxation aims to tax all capital income, including the normal return, with the same effective tax rate in all sectors. In addition, it can be difficult to separate the normal return from the excess return. The committee also pointed out that there could be arguments for not taxing the normal return, for example if the state needs to

³ See NOU 2000: 18 *Skattlegging av petroleumsvirksomhet*, section 1.5.1.

⁴ See NOU 2000: 18 *Skattlegging av petroleumsvirksomhet*, section 6.5.2.

⁵ See NOU 2000: 18 *Skattlegging av petroleumsvirksomhet* section 9.5.5.

⁶ See NOU 2000: 18 *Skattlegging av petroleumsvirksomhet* section 9.5.6.

⁷ There was one dissenting member of the committee on this point.

attract (Norwegian and foreign) capital for investments on the NCS. However, the committee concluded that the strongest arguments were in favour of taxing the normal return and uphold two tax elements in the petroleum tax system.

Finally, the committee argued that non-neutralities in the ordinary corporate tax system should not be extended to the petroleum tax system.⁸ As the ordinary corporate tax element (today 23 pct.) in the petroleum activity is *also* a tax on the resource rent, the committee argued that special considerations should be made in the design of also this element of the petroleum tax on not only as regards the special tax element (today 55 pct.). The committee underlined that ensuring neutrality in the petroleum tax system was decisive for this recommendation.

As explained in our letter of 22 September 2017, the legislator followed the recommendations of the expert committee and introduced special rules⁹ to ensure equal tax treatment of all petroleum companies, *i.e.* both companies in a tax paying position and companies not in a tax paying position. As the expert committee advised, these rules were introduced for the total petroleum tax system.

3. ACTIVITIES ON THE NORWEGIAN CONTINENTAL SHELF

Petroleum extraction can be divided into different phases, as illustrated in figure 1. The first four phases may be referred to as pre-production phases and the last two phases as production phases.

Figure 1 Phases in upstream petroleum activity



3.1 Prospecting

Before any operations are permitted, an area must be opened for petroleum activity by Parliament. After an area has been opened, companies may, subject to approval, start to collect seismic data. Seismic data acquisition is used to map potential petroleum resources in the subsurface. The petroleum companies either collect seismic data themselves, or purchase the data from a specialised seismic collecting company.

Seismic surveys in connection with petroleum activities on the Norwegian Continental Shelf must be authorised either by an *exploration* license or a *production* license (see section 3.2 below). If seismic companies acquire marketable seismic data to sell to the petroleum companies, they need an exploration license awarded by The Norwegian

⁸ See NOU 2000: 18 *Skattlegging av petroleumsvirksomhet* section 9.5.5.

⁹ The loss carry forward with interest was introduced in 2002. The tax reimbursement for losses at termination of activity and the tax reimbursement of the tax value of exploration costs were introduced in 2005.

Petroleum Directorate (NPD). An exploration license entitles the holder to explore for petroleum, i.e. geological, petrophysical, geophysical, geochemical and geotechnical activities, including shallow drilling, as well as the operation and use of facilities to the extent they are used for exploration. The exploration license is not exclusive and several companies may be entitled to conduct surveys in the same area. Nine seismic companies have an exploration license from the NPD in 2018.

3.2 Awarding of production licenses

Petroleum companies who wish to acquire seismic data usually do such according to a *production license*. A production license is issued to a group of petroleum companies, and gives the group of licensees an exclusive right to survey and carry out exploratory drilling and production of petroleum resources in the area covered by the license. This means that only the licensees may conduct petroleum activities within the area covered by the license. The production license thus provides more extensive rights than an exploration license. Production licenses are awarded by the Ministry of Petroleum and Energy through the regular licensing rounds. See further details about the process of awarding licenses in section 6.4.

3.3 Exploration phase

In the exploration phase of the production license, subsea petroleum resources are mapped and proved. Exploration typically involves detailed data collection and seismic surveying in specific areas. The production licenses are awarded with work-programme commitments outlining the required work to be undertaken year by year in the initial period, and the accompanying decision points/milestones, thus ensuring sufficient progress in maturing knowledge about the prospectivity in the licensed area. If, having conducted the relevant section of the work commitment, the group of licensees decide that there is no commercial rationale for maturing the licensed area further, they may at each decision point decide to relinquish the license.

3.4 Development phase

If a commercially viable discovery is made, activities enter a new phase with the aim of developing the field. Following a decision to develop an asset, companies must submit a Plan for Development and Operation (PDO) to the Ministry of Petroleum and Energy. The PDO describes both the development of the petroleum deposit and operation (production) phase, including a production plan. If the project includes pipelines or onshore terminals, a separate plan for installation and operation (PIO) of these must also be submitted. The plans must be approved by the Ministry of Petroleum and Energy (MPE) before development is initiated. Major and/or important projects are put before the Parliament before the Ministry gives its approval.

During the field development phase, the production of a discovery is planned and the installations, infrastructure etc. is designed and built. Subsea equipment and installations are typically procured from the supplier industry.

3.5 Production phase

After developing a field, the production phase begins. The life span of a field may vary greatly. On the Norwegian Continental Shelf, some of the first discoveries are still in production after more than 40 years, while smaller fields may have a commercial life span of only a few years. During the production phase, the petroleum companies will normally procure services from a wide range of suppliers. Each year, the license holders need an annual production permit from the MPE.

3.6 Closure

When it is no longer possible to maintain profitable production from a field, operations must be closed down and the installations decommissioned following the approval of a decommissioning plan by the MPE. As for the earlier phases, the licensees may procure services from non-petroleum companies during the closure of a field. Licensees are required to remove and dispose of offshore facilities in line with relevant national and international legislation, and the petroleum companies carry the costs of decommissioning. As other related costs, decommissioning costs are deductible against income from the petroleum activity.

4. THE NORWEGIAN PETROLEUM TAX ACT (PTA) – OBJECTIVES

4.1 Introduction

The Petroleum Tax Act (PTA) was introduced in 1975.

The PTA has two objectives:

- i) to provide the legal basis (jurisdiction) on the NCS for taxing activity covered by the special petroleum tax system *and* for taxing related activity and work covered by the ordinary corporate income tax system, cf. section 4.2.
- ii) to set out the specific, substantive rules under the petroleum tax system, that apply to the *petroleum activity* only (extraction and pipeline transportation) on the NCS, cf. section 4.3.

As the PTA serves this double purpose, the listing of the activities in Section 1 does not mean that all the listed activities fall within the special petroleum tax system. Only the petroleum activity as such (extraction and pipeline transportation of extracted petroleum) is covered by the petroleum tax system, while the other activities are covered by the ordinary corporate tax system.

4.2 Legal basis for taxation of the petroleum activity and related activity and work on the NCS

The Norwegian General Tax Act (GTA) provides the legal basis for taxation of individuals and companies that are tax resident in Norway, cf. GTA Section 2-1 and 2-2. Norwegian residents are subject to tax in Norway for income earned world-wide (the world-wide income principle).

The GTA also provides the legal basis for taxation of activity and work that is carried out within the Norwegian territory by individuals and companies that are resident abroad, cf. GTA Section 2-3.

However, the GTA does *not* provide a legal basis for taxation of activity and work carried out on the NCS by companies and individuals that are resident abroad (and thus not subject to the world-wide income principle that applies to Norwegian residents).

Therefore, the PTA extends the legal basis for taxation beyond the scope of the GTA. Consequently, it is the PTA that provides the legal basis for the taxation of foreign companies' activities on the NCS. Without the PTA these foreign companies would not have been subject to income tax to Norway at all.

This legal basis for taxation applies to "*exploration for and extraction of subsea petroleum deposits, and activities and work relating thereto, including pipeline transportation of extracted petroleum*" on the NCS, cf. PTA Section 1.

Thus, the legal basis for taxation applies to both the *petroleum activity* as such (extraction and pipeline transportation, see section 4.3), and to *related activity and work* on the NCS.

However, different tax rules apply to the petroleum activity (extraction and pipeline transportation of extracted petroleum) and activities and work related thereto, respectively. Only the petroleum activity as such is subject to the petroleum tax system (78 pct.), see section 4.3. Other activities and work on the NCS related to the petroleum activity, are taxed under the rules of the ordinary tax regime in Norway (the GTA). The complaint addresses an element which only applies within the petroleum tax system.

4.3 The tax regime for “extraction” and “pipeline transportation” (78 pct. tax rate)

In addition to providing the legal basis for taxation of all the activities and work on the NCS, see section 4.2, the other main objective of the PTA is to set out the petroleum tax system with a marginal tax rate of 78 pct. that applies to extraction and pipeline transportation of petroleum (“the petroleum activity”) on the NCS, cf. Sections 3 to 10 of the PTA. For a brief overview of the petroleum tax system, see section 5 below.

A number of companies supply products and services to the petroleum activity, see section 3. The service and supplier industry, *e.g.* companies that collect seismic data and catering suppliers, serve as input providers to petroleum extraction. These companies are not subject to the petroleum tax system (78 pct.). Income from these activities is liable to ordinary corporate tax at a rate, in 2018, of 23 pct., and correspondingly, costs incurred in these activities are deductible against a tax rate of 23 pct.

5. THE PETROLEUM TAX SYSTEM – A BRIEF OVERVIEW

5.1 “Extraction” and “pipeline transportation”

The “petroleum tax system”, cf. Sections 3 to 10 of the PTA, apply only to the activities that consist of “*extraction*” and “*pipeline transportation of extracted petroleum*”¹⁰ (the petroleum activity) on the NCS.

“*Extraction*” also includes exploration for petroleum conducted by the petroleum companies, see section 3 on the different phases of the petroleum activity.

Income from “*pipeline transportation*” of extracted petroleum (*i.e.* tariffs to the owners of pipelines for transportation of petroleum) normally does not have a potential for extraordinary profits (resource rents) in the same way as extraction of limited non-renewable petroleum resources, see section 2. However, pipeline transportation was also covered by the petroleum tax system of the PTA in 1975. The background was that licensees in a developed petroleum field usually owned the connected pipeline that transported the petroleum to the shore. Pipeline transportation was comprised by the petroleum tax regime to eliminate the risk that the licensees would *shift profit* from the extraction of petroleum to the pipeline transportation by stipulating high tariffs, and thereby reducing the tax base subject to petroleum tax (78 pct.).

5.2 “Ring fencing” of the petroleum activity

A company that carries out petroleum activity (petroleum company) on the NCS, may also be engaged in other activities on the NCS, or activities onshore (or abroad). For companies that carry out both petroleum activity and other activities, Section 12 of the Regulations to the PTA sets out that income and costs shall be attributed “so that income of production¹¹ and pipeline transportation shall be stipulated as if this activity was carried out by an independent enterprise.”

¹⁰ The scope is defined *i.a.* in the introduction of Section 3 and 5 of the PTA: “*extraction, processing and pipeline transportation*”. “*Processing*” relates to a specific situation, and is not commented any further in this document.

¹¹ *i.e.* “*extraction*” of petroleum

This implies that income from the petroleum activity is “*ring fenced*” against income from other activities. The “ring fencing” of the petroleum company’s tax base for income from the petroleum activity, applies to all income relevant for the 78 pct. tax rate.

The petroleum tax system at a rate of 78 pct. is applicable only to the petroleum company’s *petroleum activity* (extraction and pipeline transportation). Other activities that the petroleum company may carry out, are only subject to ordinary corporate tax at a rate of 23 pct. (or taxed abroad). For companies that are engaged in petroleum activity and other activities, the income and costs must be allocated between the different activities to arrive at the tax base liable to petroleum tax (78 pct.) and ordinary corporate tax (23 pct.), respectively.

5.3 Consolidation within the petroleum activity

The petroleum activity on the NCS is not taxed on a “field by field” basis. Instead, under the PTA a petroleum company may deduct costs related to one license (for instance exploration or development costs) in sales income from other licenses with producing fields (*i.e.* against 78 pct. tax rate). This means that there is *full consolidation* of income and costs within the company’s petroleum activities on the NCS.

The group of licensees (“joint venture”) that is awarded a production license from the Ministry of Petroleum and Energy, is exempted from the general rules of the Company act, see fourth paragraph of Section 1-1 of the Company act, and the general rules of the GTA on taxation of partnerships, see second paragraph of Section 10-40 of the GTA. Thus, each individual petroleum company is the taxable unit (tax subject), and not the license group.

5.4 The tax rules of the PTA applicable to extraction and pipeline transportation

The special tax rules for the petroleum activity (extraction and pipeline transportation), are laid down in the PTA Sections 3 to 10.

The rules comprises *i.a. depreciation* rules (linear depreciation over six years starting the year of the investment), cf. PTA Section 3 b, *norm prices* for sales of petroleum for tax purposes, cf. PTA Section 4, special rules on *tax treatment of losses* (*i.a.* interest on losses carried forward and reimbursement of the tax value of exploration costs and losses upon cessation of petroleum activity), cf. PTA Section 3 c, *tax neutrality* upon *disposal of production licenses or the petroleum activity*, cf. PTA Section 10.

These special rules of the PTA apply to both tax elements of the total tax rate of 78 pct.

The PTA Section 5 governs the special tax (55 pct.) and the special tax base (*i.a* the uplift allowance).

The special rules of the PTA on the determination of net taxable income from the petroleum activity, are supplemented by reference to the general rules and principles of the GTA, cf. the reference to the general tax framework in Section 8 of the PTA. This applies to both elements of the petroleum tax system, which further underpins that the relevant point of reference within the petroleum tax system is the 78 pct. tax rate.

As a main rule, all costs that are incurred to earn taxable income, are deductible. For the petroleum activity this means that all costs that are incurred to earn income subject to petroleum tax at a rate of 78 pct. (income from extraction and pipeline transportation of petroleum), are deductible against a tax rate of 78 pct.

A petroleum company may incur *exploration costs* from acquisition of seismic data (purchased from a seismic company or incurred by the petroleum company itself) or drilling of wells *etc.*, see section 3. Exploration is a necessary step to find and later develop and produce the petroleum resources. For a petroleum company, exploration costs are thus deductible against a tax rate of 78 pct. According to Section 3 of the Regulations to the PTA, exploration costs may be deducted *immediately* in the income year in which they are incurred.

5.5 Tax rates for extraction and pipeline transportation

The tax rates that apply to income deriving from the petroleum activity are decided by the Parliament annually, cf. chapter 4 of the Parliament's annual tax resolution (Stortingets skattevedtak). The 78 pct. total petroleum tax rate has been unchanged since 1992.

6. THE AUTHORITY'S QUESTIONS IN THE LETTER OF 7 DECEMBER 2017

6.1 Introduction

In the following, the Ministry will respond to the Authority's questions in the letter of 7 December 2017. In the letter, the Authority has addressed both the rules on reimbursement of the tax value of exploration costs and the rules on loss carry forward with interest under the petroleum tax system. Below, the Ministry will comment on both elements.

In question 1 in the Authority's letter of 7 December 2017, it is stated : "On the assumption that the PTA (*i.e.* the 54 % tax rate) would be the correct reference system, as you argue in your comments, for the reimbursement rules for exploration costs.....". As it seems that this assumption motivates the Authority's following questions, the Ministry will begin by clarifying this point, which seems to rest on a misunderstanding.

The petroleum tax system for the petroleum activity comprises *both* the ordinary corporate tax, currently at a rate of 23 pct., *and* the special tax, currently, at a rate of 55 pct. The two elements are interconnected and form a unity, *i.e.* the petroleum tax system laid down in the PTA¹². This has been unchanged since the PTA was introduced in 1975, and the tax rate of 78 pct. has been unchanged from 1992. It is thus the Ministry's opinion that it is the PTA as a whole, and not the one element (the special tax rate element of 55 pct.) only, that compromises the reference system under the state aid rules. Further, the ordinary tax element in the petroleum tax system has always had special features that has not applied to the ordinary corporate taxation.

6.2 Identification of the reference system

Question 1:

*"On the assumption that the PTA (*i.e.* the 54% tax rate) would be the correct reference system, as you argue in your comments, for the reimbursement rules for exploration costs: why do you consider the reimbursement rules non-selective, given that these rules include also the part that would arguably be subject to a separate corporate income tax (CIT) reference system (*i.e.* the 24% tax rate), which applies to companies in all economic sectors?"*

The premise for the question above, is that "the PTA (*i.e.* the 54 pct. tax rate) would be the correct reference system". As already indicated, and further elaborated below, that premise is incorrect.

In Norway, the petroleum tax system is generally viewed as a separate tax system, as illustrated also by section 6.2 in Bellona's complaint.

The Ministry holds that the correct reference system is the petroleum tax system, with a total tax rate of 78 pct. It is therefore incorrect that the point of reference is merely the 55 pct. tax rate, and the Ministry has not argued to that effect. In the following we will point to certain main factors that support this view.

First, the Ministry would like to emphasise that the petroleum resources are owned by the state. The petroleum tax system was introduced to capture a large share of the extraordinary return from the extraction of these resources without distorting investment incentives. When considering the effect of the tax system on companies' investment decisions, one has to take into account the total petroleum tax of 78 pct. The fact that the petroleum tax system consists of two tax elements, rather than one, does not have any material effect on the substantive parts of the petroleum tax system.

Second, it should be emphasised that the two tax elements in combination have constituted the petroleum tax system since the petroleum tax system was introduced in

¹² As explained in section 4, the PTA also provides the legal basis (tax jurisdiction) for taxation of activity related to the extraction and pipeline transportation on the NCS. Such related activities are not subject to the petroleum tax system, but taxed according to the ordinary rules of the GTA (23 pct.).

1975, *i.e.* the special net income tax system (“Government take instrument”) designed to collect the resource rent deriving from the extraction of petroleum and pipeline transportation on the Norwegian continental shelf.

In the general tax reform in Norway in 1992, the ordinary corporate tax base was broadened and the general corporate tax rate was reduced from 50.7 pct. to 28 pct. At the same time, the special tax rate for the petroleum activity was increased from 30 pct. to 50 pct. The Norwegian government then stated that the general broadening of the tax base liable to CIT did not have material effect for the petroleum companies due to the special rules of the petroleum tax system. To maintain the total tax revenues from the petroleum activity, the special tax rate was increased.

Similarly, in the latest tax reform in Norway, the ordinary corporate tax rate was reduced from 28 pct. in 2013 to 23 pct. in 2018. During the same period, the special tax rate was increased from 50 pct. to 55 pct. The marginal tax rate for the petroleum activity has thus remained unchanged at 78 pct. The objective has been to maintain the total government take from the petroleum sector.¹³ This demonstrates that the PTA constitutes a distinctive and indivisible system in which the relevant point of reference is the total tax rate of 78 pct., regardless of the rates applicable at different times under the ordinary corporate tax system.

Third, there are several special rules that applies to all the income relevant for the 78 pct. tax rate, which also underlines the fact that it is the total tax rate of 78 pct. that is the relevant point of reference within the petroleum tax system.

As mentioned in section 5, a petroleum company’s net income from the petroleum activity is “*ring fenced*” against income from other activities. The total income base for calculating the 78 pct. tax is subject to this “ring fencing”, *i.e.* both the two elements of the petroleum tax system.

Moreover, the *special tax rules* for the petroleum activity (extraction and pipeline transportation) laid down in the PTA (cf. Sections 3, 4 and 7 to 10 of the PTA), apply to both tax elements at a total tax rate of 78 pct.

Further, a *special petroleum tax administration* was established in 1975 to assess the petroleum companies. The Oil Taxation Office (OTO) and the Appeals Board on Petroleum Tax assess total tax imposed on the petroleum activity, see section 6.4.

And finally, the Norwegian state, exclusively, is the creditor of both the tax elements from the petroleum activity. The government’s *total* tax revenues from the petroleum activity are transferred into the Pension Fund Global.

¹³ See to that effect e.g. a, Prop. 1 LS (2017-2018) section 3.2.

Reference should also be made to the expert committee's considerations in NOU 2000:18. As noted in section 2 above, the expert committee considered the neutrality principle from the same point of reference as the Ministry argues here, i.e. the petroleum tax system with a total tax rate of 78 pct. In fact, the majority of the expert committee was of the opinion that non-neutralities in the ordinary corporate tax system should not be extended to the petroleum tax system, also with regard to the tax base of 23 pct. This further supports the fact that the petroleum tax system, with a total tax rate of 78 pct., constitutes a separate system of reference.

The premise for the Authority's question, according to which the point of reference would seem to partly be the petroleum tax system and partly the CIT, does not therefore mirror the correct point of reference. Moreover, as the premise for the question is incorrect, the question would no longer seem relevant.

For the sake of good order, however, the Ministry would like to stress that, on the basis that the correct reference system is the petroleum tax system, with a total tax rate of 78 pct., the reimbursement rules for exploration costs are not selective.

As stated in section 3.3 in our letter of 22 September 2017 to the Authority, the reimbursement rules are an integrated part of the petroleum tax system and a genuine tax element.

The Ministry argues that the reimbursement rules are not "*liable to favour certain undertakings or the production of certain goods as compared with other undertakings which are in a similar factual and legal situation, in the light of the intrinsic objective of the system of reference.*" (ref. The Authority's Guidelines on the Notion of State aid paragraph 5.2.3.2.)

The rules do not differentiate between companies within the petroleum tax system. All petroleum companies that are not in a tax paying position (both new entrants and established petroleum companies), may claim refund from the state of the tax value of the exploration costs.

Before the reimbursement rules for exploration costs were introduced, petroleum companies that were not in a tax paying position could have a *liquidity disadvantage* compared to companies with a tax surplus. The reimbursement rules for exploration costs equalised the tax terms and increased the neutrality of the petroleum tax system, see section 2. Consequently, it does not favour certain undertakings or the production of certain goods. On the contrary, it is an instrument to give the same value and timing of tax deductions for exploration costs for all petroleum companies.

The Ministry holds that the reimbursement rules are not *prima facie* selective.

The Ministry further holds that the considerations above are valid also as regards the rules on interest on carry forward of tax losses for petroleum companies that are not in a tax paying position, cf. Section 3 c second paragraph of the PTA. Within the petroleum tax system, the rules on interest on carry forward of tax losses for petroleum companies do not favour certain undertakings compared with other undertakings which are in a similar situation.

As the expert committee illustrated in NOU 2000: 18, see section 2, petroleum companies not in a tax paying position were in a less favourable situation than petroleum companies in a tax paying position. Petroleum companies not in a tax paying position have to wait for a possible positive net profit before they can take advantage of deductions. Without the opportunity to carry forward loss with interest, the value of the deductions would decline over time. The introduction of the interest on carry forward of losses, reduced the tax inequality between the companies within the petroleum tax system. The rules are therefore not *prima facie* selective.

Question 2:

“Following up on the above question, if the measure would be found to be prima facie selective, how do you justify the inclusion of the 24% tax rate in the reimbursement rules, by the nature and logic of the petroleum tax system?”

As stated above, the Ministry's view is that the rules on reimbursement of the tax value of exploration costs and carry forward of losses with interest within the petroleum tax system (78 pct. tax rate), are not *prima facie* selective. Indeed, it is the petroleum tax system as a whole that should be regarded as the relevant reference system. It cannot, therefore, be a question of assessing whether one element of this system – the element now at 23 pct. – represent a derogation from a reference system and whether such a derogation in turn would be within the nature and logic of the tax system.

Nevertheless, the Ministry will, based on the Authority's question, provide its views on why it is *logical* that the 23 pct. tax is included in the reimbursement of the tax value of the exploration costs. It is therefore also within the nature and logic of the petroleum tax system.

A *neutral* resource rent tax requires that all relevant costs can be deducted at the same rate as the income is taxed, *i.e. symmetrical* treatment of costs and income. The petroleum companies face a tax rate of 78 pct. on the net profit. For an established petroleum company recording a profit, all relevant costs can be deducted each year and reduce the taxable net profit. This means that through the petroleum tax system, the state annually covers 78 pct. (*i.e.* the tax value) of the costs that are incurred in the income year. Reimbursement of the tax value of exploration costs for petroleum companies not in a tax paying position, implies that the state also for these companies covers the tax value (78 pct.) of exploration costs annually through the tax system (the

reimbursement rules). This eliminates a liquidity disadvantage for companies that are not in a tax paying position.

As mentioned in section 2.4, the expert committee pointed out in NOU 2000:18 that exploration and investment incentives depended on whether petroleum companies were in a tax paying position or not. The rules introduced in 2002 and 2005 aimed to equalise the tax terms between companies. Thus, the neutrality and symmetry of the petroleum tax system was further increased, consistent with the overall recommendation of the expert committee to remove non-neutralities that could distort company decisions in the petroleum activity. As the expert committee advised, the rules were introduced for the total petroleum tax system, i.e. 78 pct.

The inclusion of the 23 pct. tax rate in the reimbursement rules is therefore in any case within the logic of the petroleum tax system, see also section 2 above.

6.3 Loss carry forward system with interest

Question 3:

“In view of the above, it can be argued that for the measure in question, the reference system could be the CIT and in particular, the rules on loss carry-forward. Please comment on the basis of the three-step selectivity analysis.”

We refer to our answers to questions 1 and 2 above. As explained, the Ministry's opinion is that the correct reference system for the rules on reimbursement of exploration costs and interest on carry forward of losses, is the petroleum tax system. Further, the rules on reimbursement and interest on carry forward of losses, are not selective. The rules equalised the tax terms for petroleum companies that were in a different factual and legal situation before the rules were introduced, consistent with the nature and logic of the petroleum tax system.

To apply the CIT as the reference system, would imply that one element of the petroleum tax system (tax treatment of companies with tax losses) is compared to the corresponding tax treatment for companies subject to the CIT (23 pct. tax rate), without taking into account the other elements and main features of the petroleum tax system.

One element of the petroleum tax system with a high tax rate that serves a specific function (see section 2.3), should not be compared to the tax treatment of losses in the ordinary corporate tax system that applies to business activities in general, and at a much lower tax rate.

The petroleum activity is characterised by a potential for extraordinary profit due to the exploitation of limited, non-renewable resources that are owned by the Norwegian state. Only companies awarded an exclusive license free of charge are permitted to extract the petroleum resources. This situation differs from ordinary business activity.

The special features of the petroleum activity motivate a tax system that captures a large part of the excess return without distorting companies' decisions, see section 2.2 and 2.3. Further, with a concession system in place, only a limited number of companies awarded a production license are permitted to carry out the petroleum activity. The petroleum tax system is "ring fenced" and applies only to petroleum companies operating on the NCS and to the profits from this activity. With a specialised and competent tax office and a limited number of petroleum companies to assess, it is possible for the tax authorities to audit the tax return thoroughly, and to control that only eligible exploration costs are reimbursed (and only eligible losses are carried forward with interest), see below.

Further, a general CIT system with loss carry forward with interest, and payment from the state of the tax value of costs, would give strong incentives to exploit the system, and a material risk of tax abuse. Taxpayers could for instance argue that a hobby, without potential to become profitable, was a start up of a business activity, and claim reimbursement from the state of costs that were incurred. The general tax authorities do not have the necessary resources to audit the tax returns thoroughly for all taxpayers subject to ordinary corporate tax. The result could be a substantial reduction of ordinary corporate tax revenues due to exploitation of the tax system.

The Ministry holds that it is incorrect to apply the CIT as the reference system, as assumed in question 3. Thus, the Ministry has not commented further on question 3 in this reply, but will revert to this aspect should the Authority wish to have a more thorough elaboration.

Question 4:

"If the measure would be found to be selective, are there any arguments in your view for claiming that the measure does not confer an advantage on the beneficiaries?"

The Ministry maintains that the correct reference system is the petroleum tax system.

According to the Guidelines¹⁴, "An advantage, within the meaning of Article 61 (1) of the EEA Agreement, is any economic benefit which an undertaking could not have obtained under normal market conditions, that is to say in the absence of State intervention.".

Further, according to the Guidelines¹⁵, only the effect of the measure on the undertaking is relevant. To assess whether a measure implies an advantage, it is necessary to determine the financial situation of the undertaking following the measure compared to its financial situation if the measure had not been taken.

¹⁴ Guidelines on the notion of State aid as referred to in Article 61 (1) of the EEA Agreement paragraph 66.

¹⁵ Guidelines on the notion of State aid as referred to in Article 61 (1) of the EEA Agreement paragraph 67.

A basic principle of a net income tax system is that all costs incurred to earn taxable income, are deductible. For the petroleum activity, this means that all costs (including exploration costs) incurred to earn income subject to petroleum tax at a rate of 78 pct. (income from extraction and pipeline transportation), are deductible against a tax rate of 78 pct.

“Normal market conditions” for exploration costs for petroleum companies are, in the Ministry’s view, that the state, through the petroleum tax system, covers 78 pct. of the exploration costs in the year in which the costs are incurred for companies in a tax paying position (see section 5.3 on consolidation within the petroleum activity).

As mentioned in section 2.4, without the opportunity to carry forward losses with interest, the value of the deductions would decline over time for companies not in a tax paying position. Further, carrying losses forward for years could potentially give petroleum companies with tax losses a liquidity disadvantage. The introduction of the interest on carry forward of losses in 2002, and the reimbursement rules in 2005, thus *equalised the tax terms* for petroleum companies that were in a tax paying position and the petroleum companies that were not. Compared to petroleum companies in a tax paying position, the rules did not confer an advantage on the petroleum companies not in a tax paying position.

6.4 The introduction of tax rules on reimbursement for exploration costs in 2005

Question 5:

“*A comprehensive description of the exploration rights in the petroleum sector:*”

See section 3 above, for an overview of activities on the Norwegian Continental Shelf.

Question 5 a.:

“*How are the exploration rights granted (i.e. public procurement, objective criteria)?*”

All seismic surveys in connection with petroleum activities on the Norwegian Continental Shelf must be authorised by an *exploration* license or a *production* license, see further description in section 3 above.

Exploration licenses are awarded by the Norwegian Petroleum Directorate for areas of the Norwegian Continental Shelf that are open for petroleum activities, but where no production license has been awarded, see section 3.1. They do not grant exclusive rights to petroleum activities in the specified area. *Production licenses* are awarded by the Ministry of Petroleum and Energy, normally through the regular licensing rounds (the “concession system”). As mentioned in section 3.2, a production license gives the licensee an exclusive right to survey and carry out further exploration activities,

exploratory drilling, development and production of petroleum resources in the area covered by the license. A production license also regulates other rights and duties of the licensees vis-à-vis the Norwegian state. Production licenses supplement the provisions of the petroleum legislation, and set out detailed conditions for activities in a particular area.

In the following, we will describe further the *production* licenses awarded to the petroleum companies under the concession system set out in the Petroleum Act.

Awards are made on the basis of fair, objective and non-discriminatory criteria that are published.

In the licensing rounds the Ministry of Petroleum and Energy announces that companies can apply for production licenses in certain geographical areas (blocks). Two types of licensing rounds have been established to ensure exploration of both mature and frontier areas of the Norwegian Continental Shelf. All areas that are open and available for petroleum activities may be announced in numbered licensing rounds or through the system of awards in predefined areas (APA). Numbered licensing rounds are used for frontier areas, where there is limited knowledge of the geology, greater technical challenges than in mature areas and a lack of infrastructure. APA licensing rounds are used for mature areas, where petroleum activities have been in progress for many years. In such areas the geology is well known, there are fewer technical challenges, and there is well developed or planned infrastructure.

The main difference between numbered licensing rounds and APA rounds is in the stages before licensing rounds are announced; in the numbered licensing rounds, the companies are invited to nominate blocks. After this stage, the procedures and award process are very similar.

On the basis of the applications received, the Ministry of Petroleum and Energy awards production licenses to groups of companies (licensees).

Question 5 b.:

“What are the fees paid for these rights and how are the fees calculated?”

There is a fee payable for an *exploration license*. This is regulated in § 5 to the Regulation to the 1996 Petroleum Act, where it is stated that 65 000 NOK is to be paid for the exploration license. In the same regulation, it is stipulated that a fee of 33 000 NOK is to be paid for each seismic survey conducted.

Further, there is a fixed fee per application for a *production license*. This fee is meant to cover costs incurred by the State in processing the applications. This application fee is defined in § 9 in the Regulation to the 1996 Petroleum Act, and has since been adjusted for inflation. For 2017, the application fee was 123 000 NOK per application.

In addition, there is an *area fee*. This is an annual fee¹⁶ which the licensees on the Norwegian shelf pay the Government for each square kilometre of the acreage covered by a production licence in the production phase. The area fee was introduced to ensure efficient exploration of areas, and does not apply in the initial phase. In the production phase, the fee does not apply to the parts of the licensed area included in the PDO. Beyond this, exemptions from the area fee may also be granted if a sufficient level of work is carried out for the relevant area, or if further development of the area is limited by external factors beyond the control of the licensees.

Question 5 c.:

"What is the duration of these rights?"

Once awarded, a production license applies for an initial period of up to ten years, which is reserved for exploration activity. To ensure that the area to which the production license applies is explored properly, the group of licensee is obliged under the terms of the license to carry out a work programme. This is specified in point 4 (obligatory work commitment) of the production license, and may include geological and/or geophysical activities and exploration drilling. The license includes deadlines for carrying out the different activities.

If all the licensees agree, they may relinquish the production license once they have completed the obligatory work. Areas relinquished in this way can later be awarded to new licensee groups. This ensures that mapping of the petroleum resources in different parts of the Norwegian Continental Shelf is steadily improved. As a result, we now have extensive knowledge of the subsea resources in many areas.

If the licensees make a discovery and wish to continue work under the license after they have fulfilled their work obligation, they are entitled to an extension period for the license. The duration of the extension period is determined by the Ministry of Petroleum and Energy when the license is awarded. The duration of the extension period is in most cases 30 years, but may be adjusted in accordance with the production life span of the field as applied for through the plan for development and operation, see section 3.4.

Field development and operation take place during the extension period. If the licensees wish to develop a field, they are obliged to do this in a responsible way. The companies are responsible for planning and implementing development projects, but each project requires prior approval from the Ministry, see section 3.4. Major projects and/or projects of a principal nature and/or projects of particular interest to society are put before the Parliament before the Ministry gives its approval.

Question 5 d.:

"Please provide a copy of a standard agreement or other document granting the rights."

¹⁶ See the rates here: <http://www.npd.no/en/news/News/2013/Area-fees-Stipulation-of-new-rates>

See the following attachments:

1. Initiation to apply for petroleum production license (from APA 2017 announcement).
2. Model APA production license and attachments.

Question 5 e.:

"Please provide any other information you consider relevant concerning the granting of those rights."

Please let us know if you want further information on this topic.

Question 6:

"The reimbursement rules imply that the companies can receive a refund of the tax value of direct and indirect costs, excluding financial costs, for exploration activities. In your submission, it is stated that "the costs must be exploration costs in their nature". Please explain how the Norwegian authorities check the eligibility of those costs? If possible, please provide a spread sheet as an example."

Below, we will i) explain the key conditions that apply to petroleum companies claiming payment from the state of the tax value of exploration costs (direct and indirect exploration costs with the exception of financial expenses) incurred in the petroleum activity. Further, we will ii) describe how the relevant control and monitoring procedures are organized and carried out within the Oil Taxation Office.

The Oil Taxation Office (OTO) is the assessment office for the petroleum companies that carry out petroleum activity on the NCS. The OTO was established due to the importance of the petroleum tax revenues for Norway and the complex questions arising when taxing the petroleum extracting activity. To ensure a satisfactory control and an efficient assessment of the petroleum companies it was deemed necessary by the Norwegian authorities to establish a specialized body well equipped with staff of high expertise in the fields of accounting, law, finance and technology. Currently, approx. 70 petroleum companies are recorded in the tax list at the OTO. The OTO's assessments may be appealed to the Appeals Board on petroleum tax. The OTO and the Appeals Board assess both the ordinary corporate tax (23 pct.) and the special tax (55 pct.) imposed on the petroleum activity on the NCS.

i) Key conditions for reimbursement of exploration costs

The right to a reimbursement is an integrated part of the petroleum tax system, cf. the main provision in paragraph 5 in Section 3 c of the PTA. However, the eligibility for reimbursement must be construed in the light of the general conditions for tax deductions, *inter alia* in Section 6-1 of the GTA.

Only costs related to activities subject to the petroleum tax system, *i.e extraction* and *pipeline transportation* at a rate of 78 pct., will be eligible for a refund.

Companies subject to ordinary corporate tax under Section 2 of the PTA, but not to the petroleum tax system for petroleum activity (see section 4 on the two objectives of the PTA), may not claim a tax reimbursement, even if costs may be connected to exploration. An example of such a company with activities not eligible for a refund could be a pure seismic collecting company or drilling company, performing activities with the aim of selling data or services to petroleum companies.

To qualify for a reimbursement, the costs must relate to *exploration* for petroleum.

The Appeals Board has in its administrative practice stated that costs must be *exploration* costs "in their nature" to be reimbursable. Only (direct and indirect) costs sufficiently connected to the exploration activities of a petroleum company, with the purpose of finding petroleum reserves in a defined part of the Norwegian subsurface, are deemed to be exploration costs in their nature. More general assessments of the possibilities of finding petroleum on the Norwegian Continental Shelf will not be sufficient. Furthermore, other costs regarding activities of a more general nature, will not qualify for a refund.

Examples of non-eligible costs, according to administrative practice, include costs for marketing, costs for establishment of the company, costs for preparation of license applications, area fees, pre-qualification costs, costs related to acquisition of licenses and funding costs.

To qualify for reimbursement, the basic criteria to claim tax deductions for costs under the GTA and PTA must also be fulfilled. This implies that there must be a true reduction in the taxpayer's assets, cf. Section 6-1 of the GTA. There must also be a close connection between the costs and the estimated future income (78 pct. tax rate).

If seismic data is purchased from an associated enterprise, the OTO audits whether the costs claimed eligible for a refund are in line with the "arm's length principle" according to the GTA Section 13-1. If not, the exploration costs will be adjusted in accordance with the arm's length principle, as in other transactions involving associated enterprises, with effect for the amount to be refunded. In addition, the Norwegian general anti-avoidance rule (GAAR) may also be relevant for costs claimed eligible for a refund.

The tax value (78 pct.) of the exploration costs is the maximum amount that may be reimbursed. In addition, the basis for the reimbursement may not exceed the tax loss of each year (cf. Section 3 c 5 paragraph first sentence).

The Ministry will emphasise that only exploration costs related to the petroleum activity subject to the petroleum tax at a rate of 78 pct., are eligible for refund of the tax value

from the state. This means that only costs that *would otherwise be deductible* in future income from the petroleum activity (against a tax rate of 78 pct.) and qualify for carry forward with interest, are comprised by the reimbursement rules for exploration costs.

ii) The Control and Monitoring Procedures within the OTO

The OTO has established its own unit responsible for questions regarding reimbursement of exploration costs. The designated unit is responsible for overseeing the monitoring and control tasks, hereunder undertaking risk assessments and general quality control related to the reimbursement of exploration costs.

As with other tax deductions, the refund of the tax value of exploration costs is claimed in the petroleum companies' annual tax returns. Hence, the audit of the costs is an integrated part of the ordinary assessment procedure. The tax value of the exploration costs eligible for a refund is paid out as part of the annual tax settlements with the petroleum companies.

The reimbursement claims concern large amounts. It is of great importance that only eligible costs form the basis for the refunds. The annual control actions begin with the OTO asking the companies to answer a standardized letter regarding exploration costs (see attachment 3). The standardized letter is a tool for checking the eligibility of the costs claimed and for identifying where there may be grounds for implementing more detailed control actions. Standardized letters are used also in other areas of particular importance for the control of the tax returns.

The standardized letter is sent to the companies every year, in due time before the deadline for delivering tax returns. In the letter, companies are asked, among other things, to specify the basis for the refund claim, how the costs of exploration are financed and whether the costs have been incurred via group transactions. Transactions between associated companies call for an increased level of scrutiny.

Based on the information given in the submitted tax returns and in the replies to the standardized letter on exploration costs, the responsible case handlers audit whether the costs are eligible for reimbursement. Should there be any factual doubts regarding the nature of the costs, further information will be requested or collected from the company, from the supplier or from any other relevant third party, as needed.

In case of doubt regarding the legal definition of exploration costs, the unit responsible for questions regarding reimbursement of exploration costs is to be consulted.

In addition to the annual assessments of the eligibility of the claimed exploration costs, the OTO also may perform risk-based tax audits. If an audit uncovers costs not eligible for a refund, the claimed reimbursements will be reversed through the normal procedures for auditing and reassessing tax cases.

Question 7:

"Please provide a comprehensive description of the conditions for receiving reimbursement of tax value of losses in termination of activities in Norway. Please refer to exact sections and paragraphs of respective legal acts."

According to the PTA Section 3 c fourth paragraph, a petroleum company may claim a reimbursement from the state of the tax value (78 pct.) of an uncovered tax loss upon cessation of the petroleum activity on the Norwegian Continental Shelf. The main criterion for reimbursement is that the petroleum activity is terminated according to the general tax legislation. The tax authorities (the Oil Taxation Office) assess that this criteria is fulfilled and that only eligible costs are included in the petroleum company's tax loss. The value of the tax reimbursement is based on the tax rates (78 pct.) applicable for the income year in which the petroleum activity is terminated. The size of the payment is set by the tax authorities and paid out as an integrated part of the assessment procedure and the tax settlement for the petroleum companies.

The rules on reimbursement of the tax value of uncovered losses upon the cessation of the petroleum activity, ensure that the state through the tax system covers 78 pct. of all costs that are incurred in the petroleum activity. Neutrality and symmetry of the petroleum tax system is thus achieved, consistent with the recommendations of the expert committee to remove non-neutralities that could distort company decisions in the petroleum activity.

Question 8:

*"According to the complaint (page 11), "other companies subject to the petroleum tax system that perform different activities are not granted similar advantages. Therefore, the system of cash grants to non-taxable persons appears also *prima facie* selective under the three-step test". Please provide your view on this allegation."*

We refer to Section 2 above on the two objectives of the PTA.

As described, only companies that carry out "extraction" and "pipeline transportation" of petroleum on the NCS, and thus are liable to the petroleum tax system at a rate of 78 pct., may claim reimbursement of the exploration costs, and carry forward tax losses with interest, according to the PTA Section 3 c.

Companies that carry out other activities than extraction and pipeline transportation on the NCS related to the petroleum activity, are liable to ordinary corporate tax at a rate of 23 pct. These companies are not subject to the petroleum tax system, and may not claim reimbursement of exploration costs, or carry forward of losses with interest. Costs that are incurred in such related activities, are deductible under the general rules of the GTA.

Question 9:

"According to the complaint (page 13), "the State, in its capacity as tax collector, cannot be viewed as a market operator that may trade benefits for future gain". Please provide your view on the applicability of the market economy investor principle for the measure in question."

The Norwegian state has different roles in relation to the petroleum activity (*i.e.* owner of the petroleum resources, regulator, tax collector, direct investor/SDFI).

In this reply the Ministry has assessed the rules from a tax collector point of view, and not addressed the market investor principle.

The Ministry maintains that the petroleum tax system is the reference system for the Norwegian tax rules for reimbursement of the tax value of exploration costs (and interest on carry forward of losses) under the Petroleum Tax Act, that these rules are not selective, and thus do not constitute state aid in the meaning of Article 61 of the EEA Agreement, see above.

Should the Authority disagree with the Ministry in its evaluation of the rules, the Ministry reserves the right to comment further on the market investor principle.

7. SUMMARY

In summary, the Ministry maintains that the Norwegian rules on reimbursement of exploration costs and interest on carry forward of losses in paragraphs 2 and 5 in Section 3 c of the Norwegian Petroleum Tax Act do not constitute state aid under Article 61 of the EEA Agreement, and are therefore in compliance with the EEA law.

We hope that the information provided is sufficient. Please do not hesitate to contact us if any further information is needed.

Yours sincerely,

Beate Bentzen
Director Legal

Kaja Stephensen
Senior Adviser

This document has been signed electronically and it is therefore not signed by hand.

Attachments:

1. Initiation to apply for petroleum production license (from APA 2017 announcement).
2. Model APA production license and attachments.
3. Fleet chart of the Oil Taxation Office' control of the eligibility of the exploration costs.