Tax manual

AKER BP ASA

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Introduction to Norwegian petroleum tax

The Norwegian petroleum taxation system is based on the rules for ordinary corporate taxation and are set out in the Petroleum Taxation Act, adopted in 1975. In addition to the ordinary corporate tax, oil companies are subject to a special petroleum tax. The total tax rate is 78 percent.

Exhibit 1 – Norwegian petroleum tax rates 2013-2019

Petroleum tax	2013	2014	2015	2016	2017	2018	2019
Company tax	28%	27%	27%	25%	24%	23%	22%
Special petroleum tax	50%	51%	51%	53%	54%	55%	56%
Total tax rate	78%	78%	78%	78%	78%	78%	78%

Net profit

In general, only the company's net profit is taxable. Deductions are allowed for all relevant costs, including costs associated with exploration, research and development, financing, operations and decommissioning. Consolidation between fields is allowed. This means that losses from one field, or exploration costs, can be written off against the company's income from operations elsewhere on the Norwegian shelf.

Capex deductions

When the taxable income is calculated, investments are written off using straight-line depreciation over six years from the year the expense was incurred. An additional uplift is granted on capital expenditure. This uplift represents an additional depreciation spread over four years, and is deductible under the special petroleum tax only.

Exhibit 2 – Norwegian petroleum tax – nominal uplift rates 2013-2019

Uplift	2013	2014	2015	2016	2017	2018	2019
Uplift per year	5.5%	5.5%	5.5%	5.5%	5.4%	5.3%	5.2%
Total uplift over four years	22%	22%	22%	22%	21.6%	21.2%	20.8%
Special petroleum tax	50%	51%	51%	53%	54%	55%	56%
After tax value of uplift	11.0%	11.2%	11.2%	11.7%	11.7%	11.7%	11.6%

Norm price

When calculating taxable income, all crude oil sales are recorded using a “norm price”. The norm price is set by the authorities based on market prices, and is applied regardless of whether the transactions are between related or unrelated parties. The norm price system applies to various types and qualities of petroleum. For natural gas and NGL, the actual sales prices are used.

Loss carry forward

Companies that do not have any taxable income may carry forward losses and uplift to subsequent years, with interest. Such losses can be transferred to a buyer together with the entire business activity (all licences) in which the loss originated. If a company ceases all petroleum activities on the Norwegian Continental Shelf, the tax value of any remining losses will be reimbursed by the state.

Companies that are not in a tax-paying position may also apply for a refund of the tax value of exploration costs. These rules are intended to ensure equal incentives regardless of the company’s tax position.

Aker BP – tax overview

The tax expense in the income statement is principally made up of two components; *current tax* and *change in deferred tax*. In addition, the tax expense may include adjustments related to prior periods.

Exhibit 3 – Tax overview

Tax for the period	2017	2018
Current tax	332	803
Change in deferred tax	203	527
Prior period adjustments	2	-2
Total tax in income statement	536	1 328

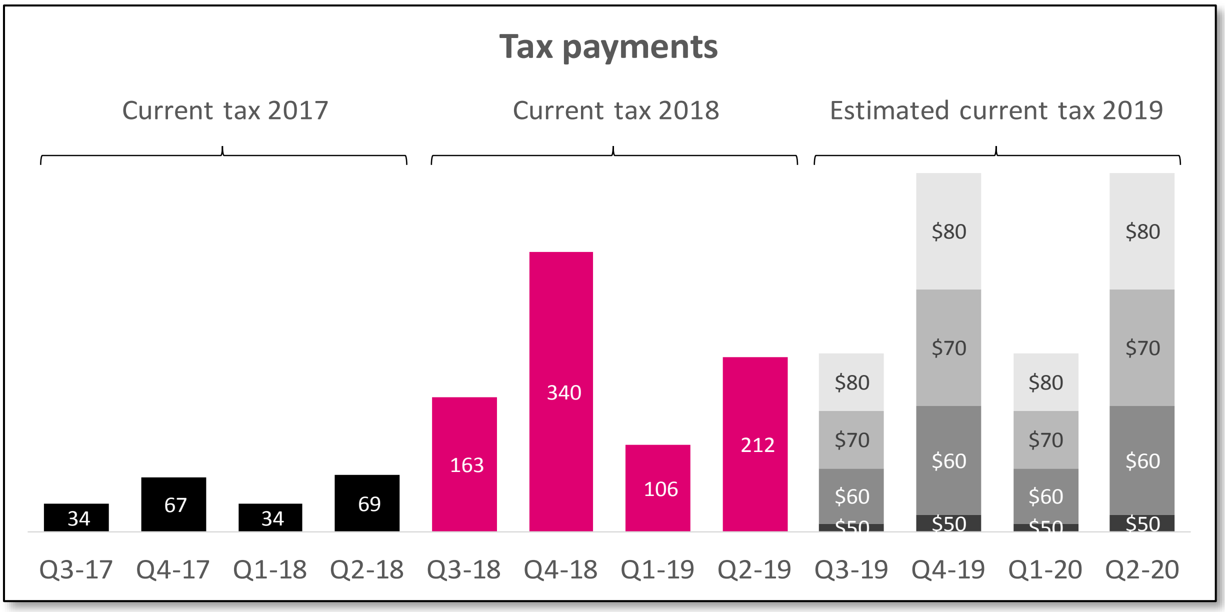
Current tax represents the payable tax related to the respective accounting period. The current tax is paid in six bi-monthly instalments, starting in August in the fiscal year and ending in June the following year. The first three instalments are based on the company's estimated tax for the year. After the end of the fiscal year, the size of the remaining instalments may be adjusted if the actual results differ from the initial estimate. When the tax assessment is finalized, the difference between actual tax and the instalments paid is settled, normally in November.

Deferred tax is the calculated tax liability on the temporary differences between book values of assets and liabilities in the financial statements, and the values of the same items in the tax returns. For Aker BP, there are four main sources of such temporary differences:

- Property, plant and equipment
- Capitalized exploration expenditures
- Other intangible assets
- Abandonment provisions

Exhibit 4 shows the payment cycle for current tax, and shows Aker BP's estimated payments of current tax for 2019 at various oil price scenarios (based on USDNOK of 8.50).

Exhibit 4 - Tax payment schedule



Current tax

The calculation of current tax is set out in Exhibit 5. The calculation of taxable income is slightly different for corporate tax and special petroleum tax. These differences are mainly related to financial items and uplift.

Exhibit 5 – Current tax 2018

USD million	Taxable income	Corporate Tax	Special Petroleum Tax	Total
Revenues	3 750			
Production cost	-689			
Other opex	-17			
EBITDAX	3 044			
Exploration spend	-359			
Abandonment spend	-243			
Capex depreciation	-1 025			
Tax EBIT	1 417	1 417	1 417	
<u>Financial items for corporate tax:</u>				
Net financial items from income statement		-171		
Foreign currency translation of NOK monetary items		-44		
Foreign currency translation of USD monetary items		-143		
Capitalized interest		-110		
Accretion		129		
<u>Special petroleum tax deductions:</u>				
Uplift			-238	
Interest expenses and currency gain/loss			-129	
<u>Other:</u>				
Other adjustments and non-taxable items		7	-44	
Taxable income		1 086	1 007	
Tax rate		23%	55%	
Current tax		250	554	803

Most of the line items in Exhibit 5 can be found in the company's financial statements, directly or indirectly. In the following pages, these items are described in detail. The examples used are from Aker BP's fourth quarter 2018 report.

Exploration spend

Exploration expenses are recorded in the financial statements according to the successful efforts method, where drilling costs related to discoveries are capitalized in the balance sheet. For tax purposes however, all cash spend on exploration activities is immediately deductible, regardless of capitalization. A simple method to calculate the exploration spend is illustrated in Exhibit 6. Note that *Dry well expenses* are deducted, as these costs are also included in the *Additions*.

Exhibit 6 - Exploration spend calculation

Note 3 Exploration expenses

Breakdown of exploration expenses (USD 1 000)	**2018**	**2017**
Seismic	95 458	53 283
Area fee	13 822	16 589
Field evaluation	79 323	40 162
Dry well expenses	65 852	75 401
Other exploration expenses	41 453	40 267
Total exploration expenses	**295 908**	**225 702**

Note 5 Tangible fixed assets and intangible assets

Exploration wells	**2018**	**2017**
Additions	128 794	111 569

Exploration spend calculation

	2018
Total exploration expenses	295 908
Dry well expenses	-65 852
Additions	128 794
Exploration spend	**358 850**

Abandonment spend

Costs related to abandonment are deductible when incurred. In the financial statements, these costs are disclosed in the cash flow statement as shown in Exhibit 7.

Exhibit 7 - Cash flow from investment activities

STATEMENT OF CASH FLOW

(USD 1 000)	**2018**	**2017**	
CASH FLOW FROM INVESTMENT ACTIVITIES			
Payment for removal and decommissioning of oil fields	-242 545	-85 733	← Abandonment spend
Disbursements on investments in fixed assets	-1 312 697	-977 462	
Acquisitions of companies (net of cash acquired)	-	-2 055 033	
Cash received from sale of licenses	-	170 959	
Disbursements on investments in capitalized exploration	-128 795	-111 569	
Disbursements on investments in licenses	-463 049	-156	
NET CASH FLOW USED IN INVESTMENT ACTIVITIES	**-2 147 085**	**-3 058 994**	

Foreign currency translation effects

Aker BP's functional currency in the financial statements is USD. The tax returns are however denominated in NOK, hence only currency movements relative to NOK are relevant for tax. When using the financial statements as a starting point, the translation effect on NOK monetary items should therefore be excluded, while the translation effect on USD monetary items should be included, when calculating taxable income. The actual effects for both NOK and USD items can be found in the Tax note, see Exhibit 8. The NOK effect can also be found in the Financial items note, see Exhibit 10. An analytical approximation of the USD effects is presented in Exhibit 9.

Exhibit 8 - Foreign currency translation effects

Note 7 Tax

Reconciliation of tax expense (USD 1 000)	**2018**	**2017**		**Foreign currency translation effect calculation:**	
78% tax rate on profit before tax	1 407 829	632 680			
Tax effect of uplift	-130 767	-123 057			
Change in tax rates	-2 047	-1 894			
Permanent difference on impairment	0	22 813			
Tax effect on OCI reclassification	37 053	0		**Divided by 78%**	**2018**
Foreign currency translation of NOK monetary items	-34 002	-12 955	←	NOK items	-43 592
Foreign currency translation of USD monetary items	-111 806	120 113	←	USD items	-143 341
Tax effect of financial and other 23%/24% items	50 578	-19 592			
Currency movements of tax balances	113 147	-84 676			
Other permanent differences, prior period adjustments and change in estimate of uncertain tax positions	-1 498	2 908			
Total taxes (+)/tax income (-)	**1 328 486**	**536 340**			

Exhibit 9 - Estimating USD forex effects

Taxable FX losses 2018	USDm	From	USDNOK	To	USDNOK	NOKm	USDm
USD400m bond	400	2017-12	8.20	2018-12	8.64	175	21
USD500m bond	500	2018-03	7.84	2018-12	8.64	400	49
USD 1.5bn bank loan	1 500	2017-12	8.20	2018-11	8.62	622	76
Estimated taxable FX losses, USD million							147
Actual taxable FX losses, USD million							143

Capitalized interest

Parts of the interest expenses are capitalized. For tax purposes, such interest is immediately deductible. The capitalized amount is specified on a separate line in the Financial items note in the company's financial statements, see Exhibit 10.

Exhibit 10 - Financial items

Note 6 Financial items

(USD 1 000)	**2018**	**2017**	
Interest income	**25 976**	**7 716**	
Realized gains on derivatives	141 823	18 428	
Change in fair value of derivatives	-	40 971	
Net currency gains	-	16 107	
Total other financial income	**141 823**	**75 507**	
Interest expenses	200 524	156 704	
Capitalized interest cost, development projects	-110 213	-89 977	← Capitalized interest
Amortized loan costs	29 722	36 900	
Total interest expenses	**120 033**	**103 627**	
Net currency loss/gain (-) before reclassification from OCI	-43 592	-	← Foreign currency translation of
Reclassification from OCI	47 504	-	NOK monetary items
Realized loss on derivatives	45 993	9 331	
Change in fair value of derivatives	36 503	-	
Accretion expenses	128 737	129 619	← Accretion
Other financial expenses	3 128	36 746	
Total other financial expenses	**218 272**	**175 696**	
Net financial items	**-170 505**	**-196 100**	← Net financial items

Accretion

Accretion is a non-cash cost which reflects the increasing present value of the abandonment liabilities over time, and which is not tax deductible. The accretion expenses are specified on a separate line in the Financial items note in the company's financial statements (see Exhibit 10).

Tax balances, capex depreciation and uplift

Tax balances represent the remaining undepreciated asset values in the balance sheet of the tax returns. Such tax balances are based in NOK, while Aker BP's financial statements are reported in USD. The USD value of the tax balances will therefore fluctuate with the currency exchange rate.

Exhibit 11 shows the details of Aker BP's tax balance at the end of 2018. The time profile for future depreciation and uplift related to this tax balance is shown in Exhibit 12. Tax effects of future investments are not included.

Exhibit 11 - Tax balances per 31.12.2018

NOK million	Capex	2018 tax depreciation	Remaining tax balance end 2018	2018 uplift	Remaining uplift end 2018
2013	7 123	1 187	0		
2014	9 433	1 572	1 572		
2015	8 548	1 425	2 849	592	
2016	6 885	1 147	3 442	426	426
2017	7 616	1 269	5 077	415	830
2018	9 252	1 542	7 710	490	1 471
Other [1)]		188	1 261		
Total NOK million		8 331	21 912	1 924	2 727
NOK/USD		8.13	8.64	8.09	8.64
Total USD million		1 025	2 536	238	316

[1)] Investments subject to other tax depreciation schedules than six-year linear.

Exhibit 12 - Future tax depreciation and uplift from investments made before 2019

Year	Depreciation NOK million	Uplift NOK million	Tax effect NOK million	Tax effect USD million[2)]
2019	7 138	1 331	6 313	731
2020	5 542	905	4 830	559
2021	4 111	490	3 481	403
2022	2 949		2 300	266
2023	1 661		1 296	150
2024	55		43	5
2025 onwards	455		355	41
Total	21 912	2 727	18 618	2 155

[2)] Based on USDNOK exchange rate per 31.12.2018 of 8.64

Special Petroleum Tax and financial items

Interest expenses and currency losses are partly deductible from the Special Petroleum Tax, according to the formula in Exhibit 13. The exact data needed to calculate this deduction are not available in the company's financial reporting. One possible analytical approach to estimate the effect, and the actual numbers for 2018, are shown in Exhibit 14.

Exhibit 13 - Calculation of SPT deduction for financial items

$$0.5 * \left(\frac{Tax\ balances}{Avg.\ interest\ bearing\ debt}\right) * (Interest\ expenses + Taxable\ FX\ loss/(gain))$$

Exhibit 14 - Analytical approximation of SPT deduction for financial items

Tax balances per 31.12.2018, NOK million	**2018E**	**Actual**
Tax balances total (from specification of Tax Balances)	21 912	21 912
- tax balances excluded (related to investments in onshore assets)		431
= Tax balances subject to calculation of SPT interest deduction	**21 912**	**21 481**

Gross interest-bearing debt	**Interest**	**Q4-17**	**Q1-18**	**Q2-18**	**Q3-18**	**Q4-18**	**2018E**	**Actual**
USDNOK end of period (Bloomberg)		8.20	7.84	8.15	8.15	8.64		
USDNOK average for period (Bloomberg)			7.84	8.03	8.24	8.46	8.14	
Interest-bearing debt, USD million								
DETNOR02	7.50%	232	242	233	233	220		
USD400m	6.00%	400	400	400	400	400		
USD500m	5.875%	-	500	500	500	500		
USD1.5bn	4.00%	1 500	1 500	1 500	1 500	-		
RBL drawn	4.50%	1 330	515	450	400	950		
Total, USD million		3 462	3 157	3 083	3 033	2 070		
Average gross debt, USD million			3 309	3 120	3 058	2 551		
Average gross debt, NOK million			25 954	25 041	25 202	21 578	**24 444**	**24 868**
RBL undrawn, USD million	0.80%	2 670	3 485	3 550	3 600	3 050		
RBL undrawn average, USD million			3 078	3 518	3 575	3 325		

Interest expenses	**Q1-18**	**Q2-18**	**Q3-18**	**Q4-18**	**2018E**	**Actual**
Interest on average debt outstanding, USD million	39	38	37	33	148	
Commitment fee RBL, USD million	6	7	7	7	27	
Total interest expenses, USD million	46	45	45	39	175	167
Total interest expenses, NOK million	358	363	368	333	**1 422**	**1 376**

Taxable FX losses	**USDm**	**From**	**USDNOK**	**To**	**USDNOK**		**2018E**	**Actual**
USD400m bond	400	2017-12	8.20	2018-12	8.64		175	
USD500m bond	500	2018-03	7.84	2018-12	8.64		400	
USD 1.5bn bank loan	1 500	2017-12	8.20	2018-11	8.62		622	
Total taxable FX losses, NOK million							**1 196**	**1 053**
Total taxable FX losses, USD million							147	

Calculation of SPT interest deduction (using formula in Exhibit 13)	**Estimate**	**Actual**
Share of interest expenses and FX loss/gain	45%	43%
Amount deductible, NOK million	**1 173**	**1 049**
Amount deductible, USD million	144	129
USDNOK average	8.14	8.16

Deferred tax

Deferred tax liabilities or assets arise when the periodization of taxable income is different from the periodization of income in the financial statement. The difference in periodization creates temporary differences between the book values in the financial statements and the tax returns. For Aker BP, temporary differences mainly exist in four areas:

Property, plant and equipment is subject to different depreciation schedules. In the financial statements, the *Unit of Production* method is used. In the tax returns, the normal method is linear depreciation over six years. This creates a difference in the value of such assets between the financial statements and the tax returns. Note that future uplift is not capitalized, and does therefore not create temporary differences.

Capitalized exploration expenditures represent costs related to successful exploration wells, according to the Successful Efforts method. In the tax returns, all such costs are expensed. Hence the entire amount represents a temporary difference.

Other intangible assets mainly arise from acquisitions of companies where the purchase price partly has been allocated to future projects, which are not tangible assets at the time of acquisition. The tax value of such future projects is zero, as no investment has yet occurred. Deferred tax is thus normally recognized on the difference between the accounting value and the tax value. The exception from this main rule is when transactions have not been regarded as business combinations as defined by IFRS 3, which was the case for two license transactions in 2018. For these transactions, no deferred tax has been recognized in relation to the intangible assets acquired.

Abandonment provisions in the financial statements represent the estimated future costs of abandonment. For tax purposes, abandonment costs are deductible when incurred. The abandonment provision therefore represents a temporary difference.

Exhibit 15 – Deferred tax

31.12.2017	Book value	Tax balance	Difference	Deferred tax	Implied tax rate
Tangible fixed assets	5 582	2 487	3 096	-2 339	76%
Other intangible assets	1 477	0	1 477	-1 152	78%
Intangible asset w/o deferred tax	140	0	140	0	0%
Goodwill	1 860	0	1 860	0	0%
Capitalized exploration	365	0	365	-285	78%
Abandonment provision	-3 044	-9	-3 035	2 367	78%
Other				102	
Total				-1 307	
31.12.2018	**Book value**	**Tax balance**	**Difference**	**Deferred tax**	**Implied tax rate**
Tangible fixed assets	5 746	2 536	3 211	-2 402	75%
Other intangible assets	1 411	0	1 411	-1 100	78%
Intangible asset w/o deferred tax	595	0	595	0	0%
Goodwill	1 860	0	1 860	0	0%
Capitalized exploration	427	0	427	-333	78%
Abandonment provision	-2 553	-6	-2 547	1 987	78%
Other				49	
Total				-1 800	
2018 movement				**Deferred tax**	
Change in deferred tax in the balance sheet				-493	
- of which related to fiscal year 2018				-527	
- of which related to priod period adjustments				34	

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