

Act on taxation of hydrocarbon production

SECTION I

Article 1

Scope.

This Act shall apply to the taxation of all income derived from exploration, production and sales of hydrocarbons, including all derived activities, such as transportation in pipelines or by ships and other work and service provided:

- a) in Iceland's territorial waters, its exclusive economic zone and on its continental shelf,
- b) in the adjacent ocean region where hydrocarbon resources extend across the centre line with another state, when entitlement to the hydrocarbons falls to Iceland under an agreement with the other state, and
- c) outside the areas specified in sub-paragraph a, provided that Iceland has the right to tax the activity and work in accordance with ordinary law or a special agreement with a foreign state.

From income, including income derived from activities discussed in Para. 1, all taxes and duties levied on taxable entities in Iceland according to the applicable laws and regulations in force at each time shall be paid in addition to taxes and duties according to the present Act.

Article 2

Parties liable for taxation.

An obligation to pay taxes and levies, as provided for in further detail in this Act, lies with those parties who have received licences for exploration and/or production of hydrocarbons and also all other parties who participate, directly or indirectly, in the exploration, production and distribution of hydrocarbon products and other related activities. Thus liability of taxation, also with reference to Act No. 93/2003 on income tax, rests with legal persons, self-employed individuals and wage-earners who earn income through activities which take place in an area listed in Art. 1.

Article 3

Definitions.

For the purposes of this Act, hydrocarbons denotes petroleum (crude oil), natural gas or other types of hydrocarbons which occur naturally in geological layers beneath the seabed and which can be exploited in gaseous or liquid form.

For the purposes of this Act, Licensee denotes a party, who has received a licence wholly or in part ,, for exploration or production of hydrocarbons under Act No. 13/2001 on Prospecting, Exploration and Production of Hydrocarbons.

For the purposes of this Act, continental shelf denotes the seabed and the submarine regions outside the territorial waters that constitute an extension of the land area to the outer limits of the continental shelf area, extending nevertheless to a distance of 200 nautical miles from the base-line of the territorial waters where the outer limits of the continental shelf do not reach this distance (cf. Act No 41/1979, on the Territorial Waters, Economic Zone and Continental Shelf). Between Iceland, on the one hand, and the Faroes and Greenland, on the other, where the distance between the base-

lines is less than 400 nautical miles, Iceland's economic zone and continental shelf shall be defined by the centre line.

For the purposes of this Act, barrel or its equivalent denotes a unit of measurement for petroleum, one barrel being equal to 0.15898 cubic meters or a corresponding quantity of other hydrocarbons, e.g. natural gas, with the same energy content.

SECTION II

Production levy

Article 4

Payment obligation.

A Licensee who is liable for taxation in accordance with Art. 3, Para. 2 shall pay a special production levy which shall be calculated from the value of the quantity of hydrocarbons, counted in barrels, which they produce each year on the basis of their activities for which a licence is required. Production refers to all the hydrocarbons that are delivered from the resource, including those destined for further processing and for the Licensee's own use.

Article 5

Reference price for the production levy.

The Minister shall appoint three persons to a committee for five years at a time, with the same number of alternates, to determine a reference price for hydrocarbons; they shall either possess knowledge in the fields of law, economics or hydrocarbon production. At the beginning of each month, the committee shall determine a reference price for hydrocarbons for the month that has just passed. The reference price shall be based on the average price of hydrocarbons on a recognized international market trading in comparable hydrocarbon products, also taking into account the cost of sales and the point of delivery.

Decisions by the reference price committee may not be made the subject of administrative complaints. The Minister issues further regulations on the determination of the reference price and the work of the committee.

Article 6

Levy base and the rate of the production levy.

The levy base of the production levy in accordance with Art. 4 is the annual value of the total production of the Licensee and is calculated as the product of the extracted quantity and reference price, according to Art. 5.

The production levy shall be 5% and is a part of operational expenses.

Article 7

Payment of production levy.

Monthly payments of the production levy shall be paid at source to the Treasury to be considered as intermediate payments towards a final taxation, cf. Para. 4.

Following the end of each settlement period, parties liable for the production levy shall, without being called upon to do so, pay to the collection agents of the Treasury the production levy which

they are obliged to pay in accordance with a statement in a form determined by the Directorate of Internal Revenue. The payment date of the production levy for each month shall be the first day of the following month, with the final due date 14 days later.

In other respects, payment at source of the production levy shall be subject to the Payment of Public Levies at Source Act No. 45/1987; regarding sanctions and procedure, the provisions of Section VI shall apply as appropriate.

At the same time as the retrospective assessment of public levies is made in accordance with Act No. 90/2003, a final settlement or retrospective assessment, as appropriate, of the production levy shall be made for the immediately preceding year. Discrepancies between the estimate as provided for under Para. 2 of this Article and the final processed quantity shall be settled at the average reference price for the year.

Before the end of the year parties liable for production levy shall send to The Directorate for Internal Revenue the planned total production of hydrocarbons along with the operating budget for the coming year, endorsed by the National Energy Authority. The plan is to be revised quarterly and The National Energy Authority shall endorse the changes made.

SECTION III

Special hydrocarbon tax

Article 8

Taxable entities.

Taxable Licensees according to Art. 3, having income from exploration, production, distribution or sale of hydrocarbons, as well as other parties receiving a part of such income, are obliged to pay a special hydrocarbon tax on a tax base specified in Art. 9.

Article 9

Tax base of special hydrocarbon tax.

The tax base for the special hydrocarbon tax for a taxable entity in accordance with Art. 8 shall include all income under items B and C of Art. 7 of the Income Tax Act No. 90/2003 with those items of costs specified in Art. 10 deducted with the exemptions specified herein below.

If sales of hydrocarbons during any period have been made at a price lower than the reference price for the production levy according to Art. 5, then the reference price shall be used when the tax base is calculated.

The provisions of the Income Tax Act No. 90/2003, shall as far as applicable and when the present Act does not state otherwise, be used when determining the tax base of the hydrocarbon tax.

Article 10

Deductions from taxable income.

In the year when income starts to be earned according to an issued licence, it is permitted to deduct from income with reference to Art. 9 accumulated and annual operating expense accrued in accordance with Art. 31 and depreciation of assets in accordance with Art. 32 of Act No. 90/2003 on Income Tax, with those exemptions specified in the present Act.

When determining the base of the hydrocarbon tax, financial costs deducted from the year's income may not exceed 5% of the liability position, less financial assets, including receivables and inventory, at the end of the relevant financial year. The Minister may raise or lower this reference percentage, taking into account the currency used in the Licensee's operations and financing and the general rate of interest in the currency involved. When calculating this base, calculated unpaid income tax or calculated unpaid hydrocarbon tax shall not be included among liabilities. The same shall apply to calculated tax commitments and tax credits arising from a permanent incongruity in the timing of compilation of annual accounts and the payment of tax. Financial costs shall include all interest costs, indexation adjustments, depreciation and exchange-rate gains or losses on the book value of liabilities (cf. Art. 49 of Act No. 90/2003), after interest earnings, indexation adjustments, depreciation and exchange-rate gains or losses on the book value of assets, in accordance with Art. 8 of the same Act, have been deducted from them. If such financial costs arise in connection with the acquisition of assets other than those that are used in the operations for which the License is required, it shall be divided in direct proportion to the outstanding balance of the depreciated value, for tax purposes, of all depreciable assets at the end of the year, and that part of the financial costs which pertains to assets that are not used in connection with hydrocarbon production shall not be deductible from income when the tax base is determined.

Rental paid for structures or equipment which is used for exploration or extracting hydrocarbons and which exceeds normal depreciation and interest on the assets involved, based on the utilization time each year, may not be deducted from income. When an assessment is made of what is to be regarded as normal depreciation and interest, the provisions of Act No. 90/2003, and other rules that have been set with reference to that Act, shall be taken into account. If equipment is rented by an associated party, the tax authorities may disallow the entry of the rental as a cost item unless the lessee submits information and materials demonstrating the cost price and accrued depreciation of such equipment in the ownership of the lessor so that it is possible to establish that the conditions set forth above have been met.

The cost of the hire of labour may only be deducted from income if the work agency has registered itself in Iceland (cf. Art. 7, Para. 3 and 4 of the Act on Payment of Public Levies at Source, No. 45/1987).

Insurance fees, distribution costs and all service fees to related parties can only be deducted from income if the taxable entity can show in a sufficient way that these costs are no higher than would apply in arm's length transactions.

In the year in which a production area is closed (cf. Art. 16 of the Act No. 13/2001), 20% of operating income for the preceding year may be entered as income for that year.

Article 11

Disallowed deductions from income.

In calculating the tax base for the special hydrocarbon tax it is not permitted to deduct the following items:

- a) Losses incurred on sales of assets to related parties.
- b) Any gifts or contributions to charities, cultural activities, political organizations and sports clubs.
- c) Depreciation of receivables and inventories
- d) Losses or expenses in activities not covered by this Act, including places of business onshore
- e) Losses or expenses incurred by a taxable entity before the issuing of a license, in accordance with Art. 8 in Act. No 13/2001 on Prospecting, Exploration and Production of hydrocarbons.

Article 12

Tax rate.

The tax rate of the special hydrocarbon tax, measured as a percentage, is progressive and decided as a product of the profit rate according to Para. 2, and the ratio 0.45.

The profit rate in percent is the ratio of tax base to total income, cf. Art. 9.

The value of the special hydrocarbon tax is the product of the tax rate according to Para. 1 and the tax base according to Article 9.

Article 13

Payment of the hydrocarbon tax.

Retrospective assessment of the hydrocarbon tax shall be made together with the assessment of public levies under Act No. 90/2003, on a tax return made in a manner determined by the Directorate of Internal Revenue.

Based on the estimates specified in Art. 7, Para. 5, taxable entities shall pay in advance towards the final levying of the special hydrocarbon tax on the same due dates as in Art. 7, Para. 2, for the production levy. The advance payment shall take into account a revision of the estimates for the year as a whole.

SECTION IV

Miscellaneous provisions on income

Article 14

If expenses, other than financial costs, relate simultaneously to the earning of income from the activity for which the licence is required and the earning of other income, not including capital earnings, then the expenses shall be divided in direct proportion to the income.

Article 15

Profit from the sale of permanent operating assets shall be determined and taxed in the same way as profit from depreciable assets in accordance with the Income Tax Act No. 90/2003.

SECTION V

Miscellaneous provisions

Article 16

Taxable entities who pay tax under this Act shall distinguish, in their accounts, between income and expenses of the activities covered by the licence and income and expenses of other activities.

Article 17

The accounting year of legal persons, or of their branches which are registered in Iceland because of activities defined in Art. 1, shall be the calendar year. Parties' tax obligations under this Act shall become effective as from and including the year of issue of the licence on which the activity is based.

Article 18

Taxable entities may not disburse income surpluses if this would result in their equity ratio falling below 15% of the book value, for tax purposes, of their total assets.

Article 19

The delimitation of tax liability specified in Art. 2 of the present Act is in accordance with Art. 1, 2 or 3 of Act No. 90/2003 as applicable.

SECTION VI

Tax returns, reporting, assessment, monitoring, appeals, collection, etc.

Article 20

In all respects not covered in the present Act, tax returns, reporting, assessment, monitoring, appeals and the collection of the production levy and the special hydrocarbon tax shall be subject to Sections IX-XIV of the Income Tax Act No. 90/2003; specific reference is to be made to Section XII of that Act regarding sanctions.

Article 21

Assessment, collection and responsibility for tax payments.

Taxes under this Act shall be assessed by the Directorate of Internal Revenue in Reykjavík, and shall be paid to the Treasury. The Directorate of Customs shall be responsible for collecting the taxes.

From wages according to this Act that are taxable in accordance with Art. 1 and items 1 and 2 of Art. 3 of Act No. 90/2003, (pay-as-you-earn tax) shall be collected in accordance with Subsection A of Art. 2 and 3 of Act No. 45/1987. The same applies to payments made towards entities in accordance with items 3, 6, 7 or 8 in Art 3 of Act No 90/2003, in case they are not taxable in accordance with item 4 of the same Art. The wage payer shall also pay at source the social security contribution in accordance with the Act on Social Security contribution, No. 113/1990.

The Minister can request that taxable entities under this Act post collateral for anticipated tax and levy payments and payments from other parties for which they are responsible.

Article 22

The Minister of Finance issues regulations containing more detailed provisions on the application of this Act, e.g. as regards the determination in further detail of income and assets, the functions of the Directorate of Internal Revenue, the Directorate of Tax Investigations and the Tax Tribunal, and the conduct of tax monitoring and tax investigations.

The Minister may issue regulations containing provisions on special accounting by parties required to submit tax returns, including inventory accounting. The Minister may also set provisions on the compilation of accounts and the preservation of bookkeeping records and other materials relevant to tax returns.

Article 23

Commencement.

This Act shall take effect immediately.

Act No. 170/2008, on the taxation of hydrocarbon extraction with amendments, shall be repealed from the commencement of this Act.