

# Act No. 170/2008

## on the taxation of hydrocarbon extraction.

### SECTION I.

#### General

##### *Article 1*

###### Scope.

This Act shall apply to the taxation of income derived from prospecting for, and studies and extraction of, hydrocarbons and from derived activities:

- 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*, providing that Iceland has the right to tax the activity and work in accordance with ordinary law or a special agreement with a foreign state.

This Act also applies to extraction and other handling of hydrocarbons in areas specified in the first paragraph, including transport via pipelines, in ships or by other means, irrespective of the origin of the hydrocarbons.

##### *Article 2*

###### 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 to prospect for, study or process hydrocarbons under the Act No. 13/2001 on Prospecting for, Studying and Extracting 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.* the 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 metres or a corresponding quantity of other hydrocarbons, e.g. natural gas, with the same energy content.

##### *Article 3*

###### 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 to prospect for, study and/or process hydrocarbons in an area listed in Article 1 and also all other parties who participate, directly or indirectly, in the extraction and distribution of hydrocarbon products. Thus, legal persons, self-employed individuals and wage-

earners who earn income through activities which take place in an area listed in Article 1 are liable for taxation.

#### *Article 4*

##### General tax obligation.

In addition to taxes and levies under this Act, all other taxes and other public dues that are normally levied in Iceland under the laws and regulations in force at any given time shall be paid on income generated in the activities covered in Article 1, including wages.

## SECTION II

### **Extraction levy**

#### *Article 5*

##### Payment obligation.

Licensees who are liable for taxation (*cf.* Article 3) shall pay a special extraction levy which shall be calculated on the quantity of hydrocarbons, counted in barrels, which they process each year on the basis of their activities for which a licence is required. *Extraction* refers to all the hydrocarbons that are delivered from the resource, including those destined for further processing and for the parties' own use.

No extraction levy shall be calculated on the first 10 million barrels, or their equivalent, in each income year.

#### *Article 6*

##### Reference price for the extraction levy.

The Minister of Finance 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 possess knowledge in the fields of law, economics or hydrocarbon extraction. 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 recognised 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 complaints as executive decisions. The Minister shall issue further regulations on the determination of the reference price and the work of the committee.

#### *Article 7*

##### Levy rate, levy base and amount of the extraction levy.

The extraction levy provided for in Article 5 shall increase in steps corresponding to the quantity of hydrocarbons processed by the licensee. The levy rate, as a percentage, shall be determined as follows, based on quantities in millions of barrels or their equivalent:

$$(\text{Processed quantity, in millions of barrels} - 10 \text{ million barrels}) / 1,000,000 * 0.5.$$

The levy base of the extraction levy shall be based on the value of the total processed by the licensee each year, and shall be determined as the product of the processed quantity and the reference price in accordance with Article 6.

The monetary amount of the extraction levy is the product of the levy rate (*cf.* the first paragraph of this Article) and the levy base (*cf.* the second paragraph).

## *Article 8*

### Payment of the extraction levy.

Each settlement period for the extraction levy shall be one month.

Before the end of the year, parties liable for taxation shall send the Director of Internal Revenue an estimate of the total quantity of hydrocarbons they expect to process in the coming year; these estimates shall be endorsed by the National Energy Authority. Estimates shall be revised every quarter, amendments being endorsed by the National Energy Authority.

Estimates as provided for in the second paragraph of this Article shall serve to determine the levy rate, levy base and the amount of the extraction levy that is paid in the form of tax deductions at source until a final settlement or a retrospective assessment as provided for in the seventh paragraph of this Article has been made. Monthly payments of at-source tax deductions shall be based on one twelfth of the estimated total quantity of hydrocarbons (*cf.* the second paragraph of this Article).

Following the end of each settlement period, parties liable for taxation shall, without being called upon to do so, pay to the collection agents of the Treasury the extraction levy which they are obliged to pay in accordance with a statement in a form determined by the Director of Internal Revenue. The payment date of the extraction levy shall be the first day of each month, with the final due date 14 days later.

In other respects, payment at source of the extraction 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 the Act No. 90/2003, a final settlement or retrospective assessment, as appropriate, of the extraction levy shall be made for the immediately preceding year. Discrepancies between the estimate as provided for under the second paragraph of this Article and the final processed quantity shall be settled at the average reference price for the year.

## SECTION III

### Hydrocarbon tax Payment obligation.

## *Article 9*

When the taxable profits of parties specified in Article 3 amount to 20% of their taxable operating income for a whole tax year, a special hydrocarbon tax shall be levied on that profit, replacing the extraction levy in the case of those who have paid it.

## *Article 10*

### Taxable operating income

The tax base for the hydrocarbon tax shall include all income under items B and C of Article 7 of the Income Tax Act, No. 90/2003. If monthly sales of hydrocarbons have been made at a price lower than the reference price for the extraction levy according to Article 6, then the reference price shall be used when the tax base is calculated.

Regarding matters not covered above, the provisions of the Income Tax Act, No. 90/2003, shall be observed when determining the tax base of the hydrocarbon tax, as appropriate.

## *Article 11*

### Deductions from taxable operating income.

Operating expenses and depreciation of assets under Articles 31 and Article 32 of the Act No. 90/2003 may be deducted from income under Article 10, with the exceptions stated in this Act.

Nevertheless, when the base of the hydrocarbon tax is determined, 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.* Article 49 of the 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 Article 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 licence is required, they 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 extraction shall not be deductible from income when the tax base is determined.

Rental paid for structures or equipment which are used for prospecting, studying 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 the 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 hiring agency has registered itself in Iceland (*cf.* the third and fourth paragraphs of Article 7 of the Payment of Public Levies at Source Act, No. 45/1987).

In the year in which an extraction area is closed (*cf.* Article 16 of the Act No. 13/2003), 10% of operating income for the preceding year may be entered as income for that year.

## *Article 12*

### Payment base of the hydrocarbon tax.

The payment base of the hydrocarbon tax shall consist of the operating income of the party liable to taxation (*cf.* Article 10), less operating expenses (*cf.* Article 11). If the difference is positive, a taxable profit will be generated by the activity for which the licence is required. If this profit amounts to 20% of the licensee's taxable operating income for a whole tax year, then a special hydrocarbon tax shall be imposed on that profit, replacing the extraction levy (*cf.* Article 9).

The following expenses and deduction items may not be deducted when determining the payment base of the hydrocarbon tax:

- a. The extraction levy under Article 5.
- b. Losses on sales of assets to associated parties.
- c. Donations and contributions of all types, e.g. to charities, cultural activities, political parties and sports clubs.
- d. Depreciation of accounts receivable and goods inventories.
- e. Losses or expenses associated with activities lying outside the scope of this Act.
- f. Losses on activities for which the licence is required may not be transferred between licensees or between individual licence areas
- g. Losses or costs that came into existence before the commencement of this Act.

## *Article 13*

### Levy rate and amount of the hydrocarbon tax.

The levy rate of the hydrocarbon tax, as a percentage, shall increase in steps relative to the profit ratio, being calculated as follows:

*(Profit ratio, expressed as a percentage according to Article 9 and the first paragraph*

*of Article 12 - 10 percentage points)\*0.55*

The amount of the hydrocarbon tax is the product of the levy rate (*cf.* the first paragraph of this Article) and the payment base (*cf.* Article 12).

#### *Article 14*

##### Payment of the hydrocarbon tax.

Retrospective assessment of the hydrocarbon tax shall be made together with the assessment of public levies under the Act No. 90/2003, on a tax return made in a manner determined by the Director of Internal Revenue. If it is found that the hydrocarbon tax as provided for in Section III of this Act is to be assessed on income for a year in which the extraction levy has been paid, the amount paid in the form of the extraction levy shall be regarded as a prior payment towards meeting the assessed hydrocarbon tax.

A licensee who is liable for taxation and extracts more than 50 million barrels a year may apply to the Director of Internal Revenue to have the extraction levy, which is paid as a provisional part-payment of the hydrocarbon tax, based on the extraction of 50 million barrels, providing it is demonstrated that the conditions of the first paragraph of this Article are met.

Operators who have paid the extraction levy, but have hydrocarbon tax assessed, shall pay an advance payment towards the expected assessed hydrocarbon tax in the same way as advance payments of income tax are required in the Act No. 90/2003.

### SECTION IV

#### **Miscellaneous provisions on income**

#### *Article 15*

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 16*

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 17*

Licensees 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 18*

The accounting year of legal persons, or of their branches which are registered in Iceland in connection with the activities defined in Article 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 19*

Licenses 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.

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 extraction levy and the hydrocarbon tax shall be subject to Sections IX-XIV of the Income Tax Act, No. 90/2003; specific reference should 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 Director of Internal Revenue in Reykjavík, and shall be paid to the Treasury. The Director of Customs shall be responsible for collecting them.

All parties who make payments in connection with the activities specified in Article 1, the recipient not being liable for taxation under Article 2 of the Act No. 90/2003, shall retain tax deductions in accordance with section *a* of Article 2 of the Act No. 45/1987.

The Minister of Finance may demand that parties liable for tax under this Act advance securities to guarantee the payment of their expected taxes and levies, and also for tax payments by other parties for which they are responsible.

*Article 22*

The Minister of Finance shall issue 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 directors of internal revenue, the National Director of Tax Investigations, the Director of Internal Revenue 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 on 1 January 2009.