

Danish hydrocarbon tax incentives - Draft bill

3 July 2017



Introduction

Introduction

The Danish Ministry of Taxation has on 26 June 2017 published the draft bill implementing the political agreement regarding tax incentives for the development of the Danish hydrocarbon activities in the North Sea.

The draft bill will undergo a public hearing period until 14 August 2017. After that the bill will be submitted to the Danish Parliament, expectedly beginning of October 2017 when the Parliament is back from Summer holidays. Adoption is expected during October – November 2017.

In headlines the incentive is similar to the previous press release regarding the political agreement published by the Ministry of Finance on 22 March 2017, but we now have a lot more details about the mechanics of the new incentive rules.

In essence Danish hydrocarbon companies/branches will continue to be taxed as follows:

- Ordinary (other) income (22% corporate income tax)
- Hydrocarbon Chapter 2 corporate tax income (25% tax), and
- Hydrocarbon Chapter 3 A income (52% tax)

The incentive introduces a new Chapter 3 B which provides certain extra deductions to be made in the calculation of the Chapter 3 A taxable income. The incentive is applicable to all entities subject to hydrocarbon tax under Chapter 3A.

The incentive only applies to the hydrocarbon tax layer, i.e. the 52% hydrocarbon taxation. The corporate tax layer (25%) is not covered by the incentive.

Below you will find an overview of the conditions applicable, the contents of the incentive, the Windfall Tax and the anti-avoidance rules. Lastly we have provided more detailed comments on certain contents of the bill.

The conditions

The conditions for using the new regime are the following:

- 1 The tax incentive window is open from 1 January 2017 to 31 December 2025.
- 2 Investments covered by this incentive must be paid within this period. Payments made outside the window are not covered by the incentive.
- 3 Acquisition/development of the assets included in the incentive must take place according to a plan filed for approval between 1 January 2017 to 31 December 2025 according to the Danish Subsoil Act s. 10 (2-3). Assets covered by plans already filed are not covered by the incentive.
- 4 The assets covered are defined in s. 5 C (1), no. 3, of the Danish Depreciation Act, i.e. drilling rigs, production platforms and other facilities used for preliminary investigations, exploration, extraction and refinery of oil and gas).
- 5 The plan mentioned above must be approved by the Danish Energy Agency in 2026 at the latest and the assets must - at the same time - have been completed and fulfill the conditions for tax depreciation.
- 6 It is optional to use the incentive rules. The opt in election can be made for 2017 or for a following income year. Once the election is made it is not possible to opt out again.
- 7 Election to opt in must be made no later than on the latest filing date for the tax return for the previous income year (1 May). A forgotten election, late filing of the tax return and late election will imply that the election cannot be made for that income year and will have to wait until the next income year.

The incentive and the Windfall Tax

The incentive

The incentive includes:

- All investment amount eligible for the incentive must be kept in a separate account (Section 3 B Account). When calculating the Chapter 3 A income tax:
 - Depreciations are made from this Section 3 B Account with up to 20% (declining line basis) per year.
 - Hydrocarbon uplift is made from this Section 3 B Account with 6.5% per year over a period of 6 years
- Generally, depreciation/uplift deductions can be initiated when the asset has been acquired, completed and assembled to such a state that it may be used in the operation according to its purpose. For assets covered by the incentive the timing will be changed so that the depreciation/uplift is available when payment has been made to the supplier.

Sale of assets included in the Section 3 B Account are deducted from the account with an amount equaling the sales price.

The incentive only applies to the hydrocarbon tax layer, i.e. the 52% hydrocarbon taxation. The corporate tax layer (25%) is not covered by the incentive.

Assets not included in the incentive remain covered by the current Chapter 3 A rules, i.e.:

- The annual depreciation rate on large assets remains at a maximum of 15%
- The Chapter 3A uplift remains on 5% per year over a 6 year period, and
- Depreciation/uplift deductions can be initiated when the asset has been acquired, completed and assembled to such state that it may be used in the operation according to its purpose.

Windfall Tax

To ensure a balance between the hydrocarbon producers and the Danish State in case oil prices increase in the future, a repayment obligation is established, equivalent to the tax advantage obtained under the incentive rules. Entities choosing to take advantage of the investment window will be subject to a windfall tax ("Windfall Tax").

As from the beginning of the income year 2022:

- If the price per barrel increases to an average of USD 75 (2017 prices) or more over a year an additional tax of 5% is levied.
- If the average price increases to USD 85 (2017 prices) or more the additional tax is increased to 10%.

The trigger prices will be inflated with 2% per year from 2018.

The Windfall Tax is payable of the profits from hydrocarbon activities before net financial income/expense and tax (EBIT), basically EBIT calculated under Chapter 2.

To keep track of the repayment obligation a separate tax recapture balance ("Tax Recapture Balance") must be kept. The Tax Recapture Balance is equal to 20.1% of the investment amounts added to the Section 3 B Account in the years 2017-2025.

The Windfall Tax in a particular year can never exceed the amount in the Tax Recapture Balance, and any exceeding Windfall Tax amount does not carry over to future income years.

The Windfall Tax is deductible in the calculation of the Chapter 3 A taxable income.

When the investment window ceases in 2025 no further amounts are added to the Tax Recapture Balance. The Tax Recapture Balance is inflated with 4.5% from the beginning of 2023.

If the Tax Recapture Balance has not been repaid in 2037 the balance ceases (without being repaid).

Anti-avoidance and third party access

Anti-avoidance rules

Anti-avoidance rules are introduced to ensure that a buyer of hydrocarbon activities takes over (succession) seller's liability to pay the Tax Recapture Balance and that restructurings cannot eliminate the Tax Recapture Balance.

A joint liability for seller is also introduced to ensure the payment of the Tax Recapture Balance.

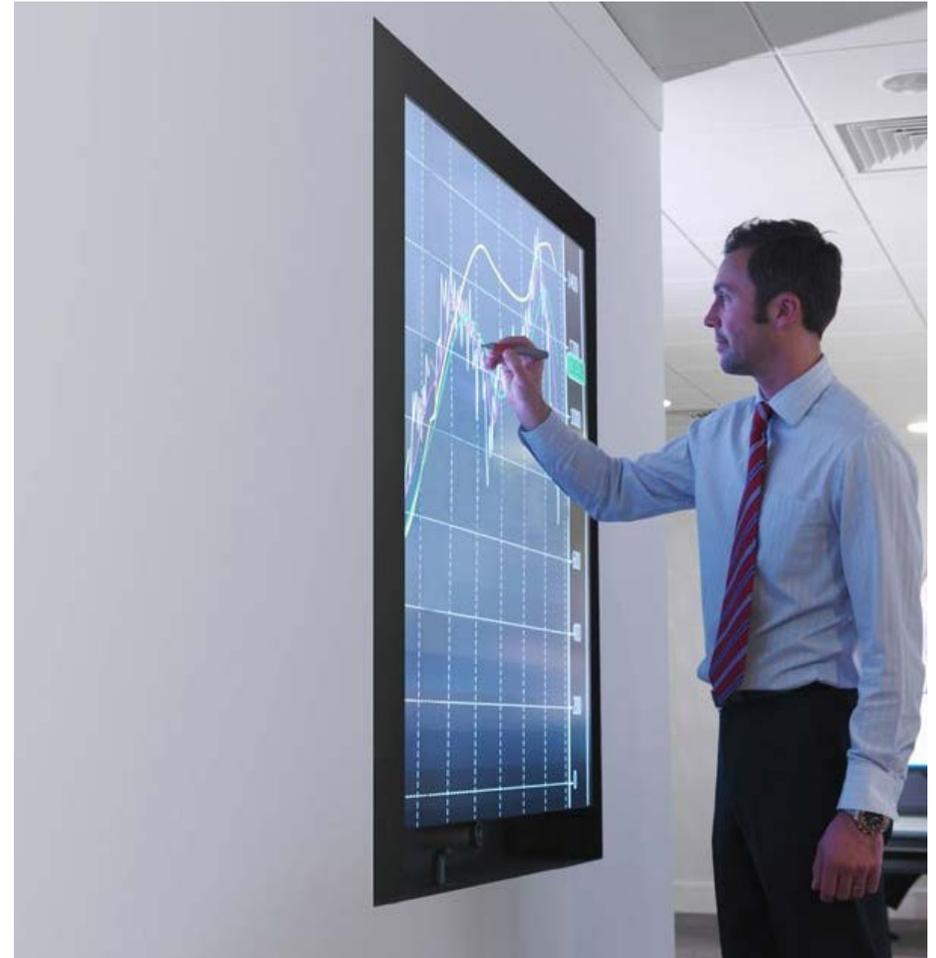
Third party access

In separate regulations it is the intention to improve the third party access to the central hydrocarbon infrastructure. Third party access means that other companies than the owners of the infrastructure can get access to use the infrastructure (platforms, pipelines etc.). Among others, this means that:

The pipeline law will be amended to make it more flexible to reserve capacity in the oil pipes. The tariff system is amended so that operating expenses are calculated according to actual use, the capital costs are calculated according to reserved capacity etc.

The Subsoil Act is amended so that the Energy Agency is granted clear authority to insert conditions in approvals for expansions of facilities/developments of facilities etc. to reserve capacity for third party option to use the facility etc.

A number of other conditions are made to ensure that third party access is made easier at reasonable terms. We will not comment further on this in this presentation.



The Details

Incentive is conditioned on approval from the Danish Energy Agency	
Issue	Comment
Approval	<p>The incentive rules are only applicable if the acquisition/development of the asset requires approval according to the Danish Subsoil Act s. 10, subsection 2 and 3, and the acquisition/development is comprised by a plan which - inside the incentive window - has been filed with the Danish Energy Agency for approval.</p> <p>The Danish Subsoil Act s. 10, subsection 2, states that <i>“Before production and measures aimed at production are initiated, a plan for the production activities, including the organization of production and the layout of production installations and any pipelines (production measures, etc.), shall be approved by the Minister for Climate and Energy.”</i> The Danish Subsoil Act s. 10, subsection 3, states that <i>“Substantial changes and supplements to an approved plan for the production activities are subject to approval by the Minister for Climate and Energy before they are initiated.”</i></p> <p>If no approval is necessary according to the Subsoil Act, payments will not be covered by the incentive rules in Chapter 3B. This also applies even if the payments are made in relation to assets covered by s. 5 C (1), no. 3 of the Danish Depreciation Act. The Danish Energy Agency will assess whether approval is needed.</p> <p>If the acquisition/development of an asset is included in a plan filed with the Danish Energy Agency before 1 January 2017 the incentive rules will not apply to this assets, irrespective that the payments are made inside the incentive window. It is stated in the commentary to the bill that renewing a previously filed plan will also not give access to use the incentive for the asset mentioned in the already filed plan.</p>
Use of the incentive before approval	<p>Regardless that the plan has not yet been filed with the Danish Energy Agency the incentive rules can be used, as long as the plan is filed within the incentive window and approved in a timely manner.</p>
Approval deadline / asset completed for tax depreciation purposes	<p>The plan has to be approved by The Danish Energy Agency no later than by the end of 2026 and the asset must - at the same time - have been completed and fulfill the conditions for tax depreciation.</p> <p>If one of these conditions is not met the incentive rule cannot be applied. See further comments about “Unwinding incentive if conditions are not met” on the last slides.</p>

The Details

The Chapter 3 B Account / Depreciation / Uplift	
Issue	Comment
The Chapter 3 B Account	<p>All investment amount eligible for the incentive must be kept in a separate account (Section 3 B Account). A payment criteria is applied, see comments on next slide.</p> <p>If an asset will be used for mixed purposes, only the part which would be covered by s. 8(1) of the Hydrocarbon Tax Act can be added to the account.</p> <p>Depreciation is limited to a maximum of 20% of the Chapter 3 B Account after deductions of the assets disposed of during the year.</p> <p>If a completed asset or asset under construction is sold, the sales price is deducted from the Section 3 B Account.</p> <p>The Section 3 B Account can become negative due to disposals of assets. In that case the amount of the negative account is added to the Chapter 3 A income. A special rule applies in relation to reduction of the Tax Recapture Balance in this situation.</p>
Depreciation	<p>Depreciation on the amounts in the Chapter 3 B Account can be initiated in the income year where the amount is added to the account. This principle only applies to the Chapter 3 B Account depreciations.</p> <p>Principles for depreciations under Chapter 2 and 3 A are still the same, i.e. depreciation can be initiated when the asset has been acquired, completed and assembled to such a state that it may be used in the operation according to its purpose.</p>
Uplift	<p>Uplift on amounts in the Chapter 3 B Account can be initiated in the income year where the amount is added to the account. This principle only applies to the Chapter 3 B Account uplifts. The Chapter 3B uplift is 6.5% per year over a 6 year period</p> <p>Principles for uplift under Chapter 3 A for assets not covered by the incentive are still the same, i.e. uplift can be initiated when the asset qualifies for depreciation (depreciation can be initiated when the asset has been acquired, completed and assembled to such a state that it may be used in the operation according to its purpose). The Chapter 3 A uplift remains at the current level, i.e. 5% per year over a 6 year period.</p>

The Details

Payments which can be included in the Chapter 3 B Account	
Issue	Comment
Timing	<p>Only costs de facto paid within the period 1 January 2017 to 31 December 2025 can be included in the Chapter 3 B Account. Payment has to be received by the supplier.</p> <p>Payments to be made after 31 December 2025 cannot be added to the Chapter 3 B Account regardless that previous payments made on the same assets before that date have been added to the account.</p> <p>In joint ventures the operator will normally do the bookkeeping and arrange payments to suppliers. The joint venture partners will pay in the cash calls made by the operator and the operator will use the cash to pay the suppliers.</p> <p>Payment of the cash calls itself does not qualify to be added to the Chapter 3 B Account as the payments end up on the operator escrow account. Once paid by the operator to the supplier the amount can be added to the Chapter 3 B Account.</p> <p>Payments to an escrow account which will not be released to the supplier until certain milestones or completion stages are also not considered a payment for purposes adding the amount to the Chapter 3 B Account.</p>
Type of assets	<p>Payments made in relation to the assets covered by s. 5 C (1), no. 3 of the Danish Hydrocarbon Tax Act qualify, i.e. drilling rigs, production platforms and other facilities used for preliminary investigations, exploration, extraction and refinery of oil and gas.</p>
Type of costs	<p>Internal costs, e.g. salary costs in connection with projecting cannot be added to the Chapter 3 B Account, irrespective that such costs generally are added to the acquisition costs of the asset.</p> <p>Costs incurred on improvements of existing assets can be added to the account. Maintenance costs cannot be included in the account. Payments covering both acquisition price for assets and other goods and services will need to be split.</p>

The Details

Tax Recapture Balance and Windfall Tax (1 of 2)	
Issue	Comment
20.1% of the Chapter 3 B Account	<p>The Chapter 3 B Tax Recapture Balance is 20.1% of the amounts added to the Chapter 3 B Account.</p> <p>The Ministry of Taxation has made calculations (not enclosed in the commentary to the bill) according to which the advantage of the Chapter 3 B tax incentive equals 20.1% of the amounts added to the Chapter 3 B Account.</p>
Basis for calculating the Windfall Tax	The Windfall Tax is payable out of the profits from hydrocarbon activities before net financial income and tax (EBIT), basically EBIT calculated according to Chapter 2.
The Windfall Tax is deductible	The Windfall Tax is deductible in the composition of the Chapter 3 A taxable income, but not in the Chapter 2 taxes.
Information requirement	<p>A taxpayer which has elected to apply the tax incentive rules must no later than 1 July during the income year file a form for preliminary assessment of the Windfall Tax. The tax authorities will use this information to assess the preliminary Windfall tax payable, cf. further below.</p> <p>The form must include information on:</p> <ul style="list-style-type: none"> — Expected average oil price for the year — The expected Chapter 2 income for the year — The expected amount in the Tax Recapture Balance at the end of the year.
Payment of the Windfall Tax	<p>The Windfall Tax is payable in two installments similar to Chapter 3 A tax, i.e. payable on 1 October during the income year and 1 June in the following income year. The Danish tax authorities assess the preliminary tax payments.</p> <p>The 1st payment will be based on the information provided by the taxpayer, provided that the tax authorities find the amount reasonable. The 1st payment is half of the preliminary tax for the year. The 2nd payment is based on the tax return, so that 1st and 2nd payment equal the total Windfall Tax payable for the year.</p> <p>Over- and under-payment of Windfall Tax will be subject to surcharge or surplus interest charges similar to Chapter 3 A taxes.</p>

The Details

Tax Recapture Balance and Windfall Tax (2 of 2)	
Issue	Comment
Recapture balance movements	<p>Each year the capture balance is added 20.1% of the amount added to the Chapter 3 B Account.</p> <p>The Recapture Balance is deducted the Windfall Tax amount which has been assessed in the previous income year, provided that the Windfall Tax has been paid.</p> <p>The Windfall Tax in a particular year can never exceed the amount in the Tax Recapture Balance at the end of the income year, and any exceeding Windfall Tax amount does not carry over to future income years.</p>
Average oil prices	<p>As from the beginning of the income year 2022, if the price per barrel increases to an average of USD 75 (2017 prices) or more over a year, an additional tax of 5% is levied. If the average price increases to USD 85 (2017 prices) or more, the additional tax is increased to 10%. The trigger prices will be inflated by 2% per year from 2018.</p> <p>Average oil price for each of the income years 2022-2037 is calculated by Statistics Denmark based on the Brent Dated reference price. The average price will be published on 15 February in the subsequent year at the latest.</p> <p>If Brent Dated reference price is no longer published, or if the basis for the statement of this reference price changes significantly, Statistics Denmark will calculate the average oil price on basis of an equivalent publicly available international price index, which to the extent possible reflects the characteristics applicable to the oil production in the North Sea.</p>

The Details

Unwinding incentive / Anti-avoidance rules	
Issue	Comment
Unwinding incentive if conditions are not met	<p>If the plan is not approved by the Danish Energy Ministry or an asset is not completed for ordinary tax depreciation purposes (e.g. Chapter 2 purposes) before 31 December 2026, it implies that the Chapter 3 B incentive has to be unwinded by adjusting the previous income tax returns, as if the incentive had not applied.</p> <p>As the Danish tax authorities cannot assess whether the conditions for applying the incentive are met until the 2026 tax return has been filed by the taxpayer, the unwinding tax claim has not been established until that time, and therefore the statute of limitation does not apply to an unwinding of the incentive.</p> <p>If the reason for the asset not being completed for tax depreciation purposes before 31 December 2026 is force majeure, an extension of the deadline may be granted until 31 December 2027. Force majeure is described as incidents outside the control of the taxpayer, e.g. natural disaster, terror attack etc. Thus, only extraordinary conditions can prolong the deadline.</p>
Anti-avoidance rules	<p>In case license rights are transferred to another party (intercompany or external buyer), the buyer will take over the Tax Recapture Balance. The Tax Recapture Balance taken over by the buyer is the sum of the balance at the end of the income year prior to the year of the transfer and the amounts added to the balance in the year of the transfer.</p> <p>If the transfer only involves part of the assets of the seller, only a proportional part of the Tax Recapture Balance related to the assets transferred is taken over by the buyer. If the buyer has a Tax Recapture Balance itself, the Tax Recapture Balance taken over is added to the existing balance.</p> <p>Seller has a joint and several liability to the buyer for the payment of the Tax Recapture Balance transferred. If the buyer subsequently reduces (by repaying the Windfall Tax), the Tax Recapture Balance liability of the seller is reduced accordingly and cannot exceed this lower amount. The transfer does not imply that the buyer has to apply the incentive in Chapter 3 B.</p> <p>If the license rights are transferred multiple times the new buyer (e.g. buyer no. 2) will still take over the Tax Recapture Balance and the original seller (i.e. Seller no 1) will continue to have a joint and several liability. Whether Seller no. 2 also has a joint liability and several is not clear, but it must be assumed that seller no. 2 at least has a liability if seller no. 2 has used the incentive rules and added amounts to the Tax Recapture Balance.</p> <p>Transfer of the Tax Recapture Balance is likely to affect the price for the assets transferred. The seller must inform the buyer of the amount of the Tax Recapture Balance which the buyer takes over and how the Tax Recapture Balance has been calculated. This information must also be filed to the Danish tax authorities.</p>

Contact

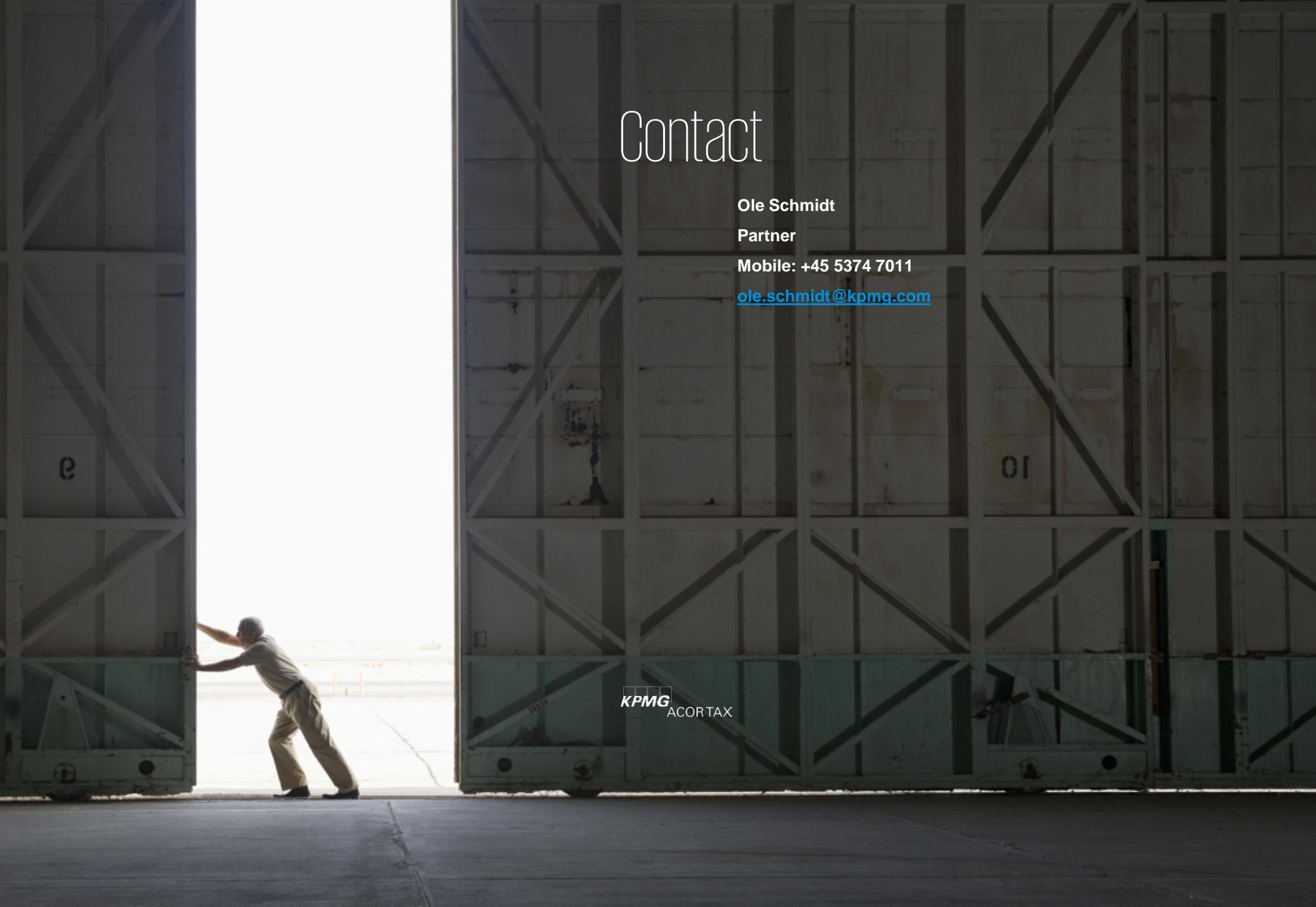
Ole Schmidt

Partner

Mobile: +45 5374 7011

ole.schmidt@kpmg.com

KPMG
ACORTAX





kpmg.com/socialmedia



kpmg.com/app

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG ACOR TAX, a Danish limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative, a Swiss entity. All rights reserved.

The KPMG name, logo are registered trademarks or trademarks of KPMG International.