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 2014-2020

Petroleum tax	2014	2015	2016	2017	2018	2019	2020
Company tax	27%	27%	25%	24%	23%	22%	22%
Special petroleum tax	51%	51%	53%	54%	55%	56%	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 2014-2020

Uplift	2014	2015	2016	2017	2018	2019	2020
Uplift per year	5.5%	5.5%	5.5%	5.4%	5.3%	5.2%	5.2%
Total uplift over four years	22%	22%	22%	22%	21.2%	20.8%	20.8%
Special petroleum tax	51%	51%	53%	54%	55%	56%	56%
After tax value of uplift	11.2%	11.2%	11.7%	11.7%	11.7%	11.6%	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	2018	2019
Current tax	803	462
Change in deferred tax	525	463
Prior period adjustments	-2	18
Total tax in income statement	1,326	943

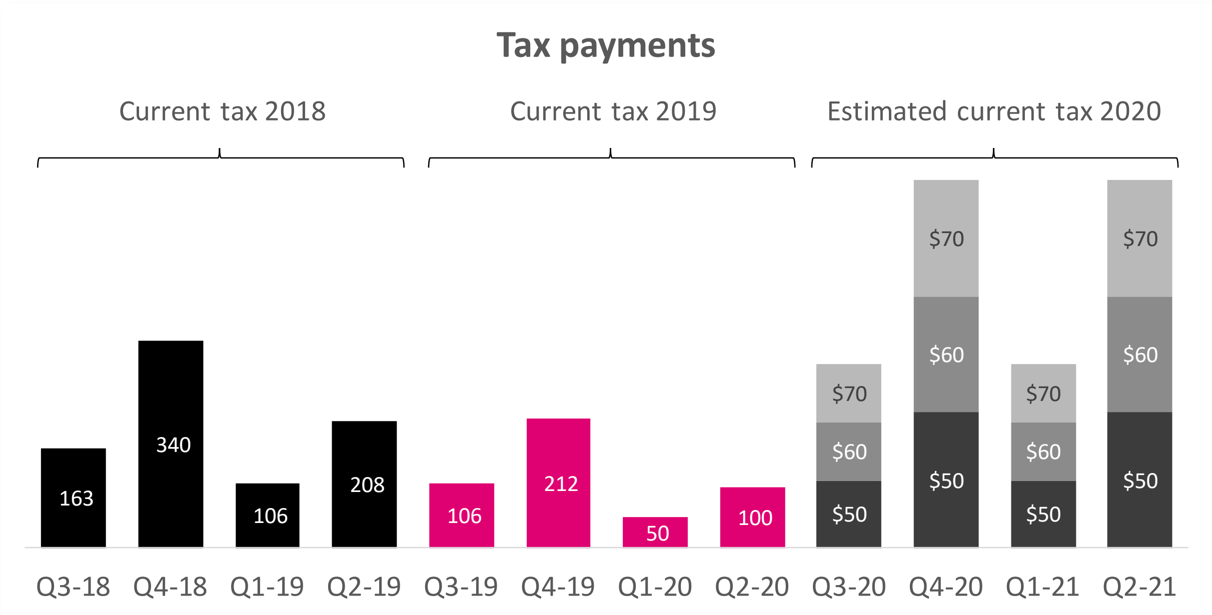
Current tax represents the payable tax related to the respective accounting period. The current tax is paid in six bi-monthly instalments, starting in August in the fiscal year and ending in June the following year. The first three instalments are based on the company's estimated tax for the year. After 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 2020 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 2019

USD million	Taxable income	Corporate Tax	Special Petroleum Tax	Total
Revenues	3,347			
Production cost	-720			
Other opex	-35			
EBITDAX	2,591			
Exploration spend	-500			
Abandonment spend	-109			
Capex depreciation	-1,072			
Tax EBIT	910	910	910	
<u>Financial items for corporate tax:</u>				
Net financial items from income statement		-243		
Foreign currency translation of NOK monetary items		-16		
Foreign currency translation of USD monetary items		-21		
Capitalized interest		-145		
Accretion		122		
<u>Special petroleum tax deductions:</u>				
Uplift			-231	
Interest expenses and currency gain/loss			-100	
<u>Other:</u>				
Other adjustments and non-taxable items		37	-7	
Taxable income		645	571	
Tax rate		22%	56%	
Current tax		142	320	462

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 2019 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 4 Exploration expenses

Breakdown of exploration expenses (USD 1 000)	**2019**	**2018**
Seismic	28,875	95,458
Area fee	15,537	13,822
Field evaluation	42,532	79,323
Dry well expenses	176,419	65,852
Other exploration expenses	42,153	41,453
Total exploration expenses	**305,516**	**295,908**

Note 6 Tangible fixed assets and intangible assets

Exploration wells	**2019**	**2018**
Additions	370,185	128,794

Note 7 Leasing

Payments of lease debt split by activities (USD 1 000)	**2019**	**2018**
Exploration expenditures	1,384	N/A

Exploration spend calculation

	2019
Total exploration expenses	305,516
Dry well expenses	-176,419
Additions	370,185
Leasing related	1,384
Exploration spend	**500,666**

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

CASH FLOW FROM INVESTMENT ACTIVITIES (USD 1 000)	**2019**	**2018**	
Payment for removal and decommissioning of oil fields	-104,890	-242,545	← Abandonment spend
Disbursements on investments in fixed assets	-1,703,213	-1,312,697	
Disbursements on investments in capitalized exploration	-370,185	-128,795	
Disbursements on investments in licenses	-143	-463,049	
NET CASH FLOW FROM INVESTMENT ACTIVITIES	**-2,178,431**	**-2,147,085**	

Note 7 Leasing

Payments of lease debt split by activities (USD 1 000)	**2019**	**2018**	
Abandonment activity	4,444	N/A	← Abandonment spend

Calculation	**2019**	**2018**
From cash flow statement	104,890	242,545
Abandonment-related lease payments	4,444	
Total abandonment spend	**109,334**	**242,545**

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 9 Tax

Reconciliation of tax expense (USD 1 000)	**2019**	**2018**
78% tax rate on profit before tax	845,718	1,405,541
Tax effect of uplift	-129,619	-130,767
Change in tax rates	0	-2,047
Permanent difference on impairment	114,907	0
Tax effect on OCI reclassification	0	37,053
Foreign currency translation of NOK monetary items	-12,535	-34,002
Foreign currency translation of USD monetary items	-16,006	-111,806
Tax effect of financial and other 23%/24% items	81,593	50,578
Currency movements of tax balances	34,297	113,147
Other permanent differences, prior period adjustments and change in estimate of uncertain tax positions	24,848	-1,498
Total taxes (+)/tax income (-)	**943,204**	**1,326,198**

Foreign currency translation effect calculation

Divided by 78%	**2019**
← NOK items	-16,071
← USD items	-20,521

Exhibit 9 - Estimating USD forex effects

Taxable FX losses 2019	USDm	From	USDNOK	To	USDNOK	NOKm	USDm
USD400m bond	400	2018-12	8.64	2018-12	8.79	58	7
USD500m bond	500	2018-12	8.64	2018-12	8.79	72	8
USD750m bond	750	2019-06	8.70	2018-12	8.79	60	7
Total taxable FX losses, USD million							22
Actual taxable FX losses, USD million							21

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 8 Financial items

(USD 1 000)	2019	2018	
Interest income	**16,490**	**25,976**	
Realized gains on derivatives	11,261	141,823	
Change in fair value of derivatives	7,316	0	
Net currency gains	16,677	0	
Total other financial income	**35,255**	**141,823**	
Interest expenses	175,672	200,524	
Interest on lease debt	23,897	0	
Capitalized interest cost, development projects	-144,686	-110,213	← Capitalized interest
Amortized loan costs	21,705	29,722	
Total interest expenses	**76,587**	**120,033**	
Net currency loss/gain (-) before reclassification from OC	0	-43,592	
Reclassification from OCI	0	47,504	
Realized loss on derivatives	46,751	45,993	
Change in fair value of derivatives	10,742	36,503	
Accretion expenses	121,723	128,737	← Accretion
Other financial expenses	38,929	3,128	
Total other financial expenses	**218,145**	**218,272**	
Net financial items	**-242,986**	**-170,505**	← 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 2019. 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 31.12.2019

NOK million	Capex	2019 tax depreciation	Remaining tax balance end 2019	2019 uplift	Remaining uplift end 2019
2014	9,433	1,572	0		
2015	8,548	1,425	1,425		
2016	6,811	1,135	2,270	421	
2017	7,564	1,261	3,782	412	412
2018	9,211	1,535	6,141	488	976
2019	13,727	2,288	11,439	714	2,141
Onshore assets	564	231	1,516		
Total NOK million		9,446	26,573	2,035	3,530
NOK/USD		8.81	8.78	8.79	8.78
Total USD million		1,072	3,027	231	402

Exhibit 12 - Future tax depreciation and uplift from investments made before 2020

Year	Depreciation NOK million	Uplift NOK million	Tax effect NOK million	Tax effect USD million*
2020	7,903	1,614	7,068	805
2021	6,449	1,202	5,703	650
2022	5,289	714	4,525	515
2023	3,982		3,106	354
2024	2,425		1,892	215
2025	87		68	8
2026 onwards	438		341	39
Total	26,573	3,530	22,704	2,586

* Based on USDNOK 8.78

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 2019, 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 31.12.2019, NOK million	**2018**	**2019E**	**Actual**
Tax balances total (from specification of Tax Balances)	21,912	26,573	26,573
- tax balances excluded (related to investments in onshore assets)	431	431	430
= Tax balances subject to calculation of SPT interest deduction	**21,481**	**26,142**	**26,143**

Gross interest-bearing debt	**Interest**	**Q4-18**	**Q1-19**	**Q2-19**	**Q3-19**	**Q4-19**	**2019E**	**Actual**
USDNOK end of period (Bloomberg)		8.64	8.63	8.53	9.10	8.79		
USDNOK average for period (Bloomberg)			8.58	8.65	8.86	9.11	8.80	
Interest-bearing debt, USD million								
DETNOR02	7.50%	220	220	223	209	216		
USD400m	6.00%	400	400	400	400	400		
USD500m	5.875%	500	500	500	500	500		
USD750m	4.75%	-	-	750	750	750		
Bank debt drawn *	4.00%	950	1,150	800	1,100	1,450		
Total, USD million		2,070	2,270	2,673	2,959	3,316		
Average gross debt, USD million			2,170	2,471	2,816	3,138		
Average gross debt, NOK million			18,617	21,374	24,949	28,572	**23,378**	**23,836**
Bank undrawn, USD million *	0.50%	3,050	2,850	3,200	2,900	2,550		
Bank undrawn average, USD million			2,950	3,025	3,050	2,725		

Interest expenses	**Q1-19**	**Q2-19**	**Q3-19**	**Q4-19**	**2019E**	**Actual**
Interest on average debt outstanding, USD million	29	32	36	39	136	
Commitment fee RBL, USD million	6	6	6	5	24	
Total interest expenses, USD million	35	38	42	45	160	
Total interest expenses, NOK million	302	331	369	406	**1,408**	**1,367**

Taxable FX losses	**USDm**	**From**	**USDNOK**	**To**	**USDNOK**		**2019E**	**Actual**
USD400m bond	400	2018-12	8.64	2019-12	8.79		58	
USD500m bond	500	2018-12	8.64	2019-12	8.79		72	
USD750m bond	750	2019-06	8.70	2019-12	8.79		60	
Total taxable FX losses, NOK million **							**191**	**243**
Total taxable FX losses, USD million							22	

Calculation of SPT interest deduction (using formula in Exhibit 13)	**Estimate**	**Actual**
Share of interest expenses and FX loss/gain	56%	55%
Amount deductible, NOK million	**894**	**883**
Amount deductible, USD million	102	100
USDNOK average	8.80	8.80

* Generic assumptions for interest terms

** The actual NOK amount also includes fees related to loans

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. For such transactions, no deferred tax is 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

31.12.2018 (restated)	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				96	
Total				-1,753	
31.12.2019	**Book value**	**Tax balance**	**Difference**	**Deferred tax**	**Implied tax rate**
Tangible fixed assets	7,023	3,027	3,997	-2,983	75%
Other intangible assets	1,330	0	1,330	-1,038	78%
Intangible asset w/o deferred tax	585	0	585	0	0%
Goodwill	1,713	0	1,713	0	0%
Capitalized exploration	621	0	621	-485	78%
Abandonment provision	-2,788	-6	-2,782	2,170	78%
Other				99	
Total				-2,235	
2019 movement				**Deferred tax**	
Change in deferred tax in the balance sheet				-483	
- of which related to fiscal year 2019				-463	
- of which related to prior period adjustments				-19	

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