

**Parliament Act No 26, dated 21 April 1999
on taxation of revenue relating to hydrocarbon activities**

(HYDROCARBON TAX ACT)

As amended by Parliamentary Act No. 26, dated 7 March 2000

**Part 1
General provisions**

§ 1 The provisions in this Act are applicable to taxation of any type of revenue relating to preliminary investigations, exploration for and extraction of hydrocarbons and activities related thereto, including pipeline construction, supply services and ship transport and pipeline transmission of extracted hydrocarbons, where the revenue has been acquired by such activities or work carried out

- 1) in the Faroe Islands, including the Faroese sea territory and continental shelf sector;
- 2) in a foreign state, including the sea territory and continental shelf sector of such a state, in relation to hydrocarbon deposits located in an area covered by No. 1 above, and in another state in case the extraction has been made fully or partly subject to Faroese jurisdiction by agreement with such other state;
- 3) outside the areas referred to in No. 1 in relation to pipeline transmission of hydrocarbons, which have been extracted in an area covered by No. 1 or No. 2 insofar as the right of taxation is reserved to the Faroe Islands according to agreement with another state.

Subsection 2 The revenue shall be calculated according to the general provisions of current fiscal legislation subject to the variations following from this Act.

§ 2 Revenue earned according to section 1 shall be liable to personal income tax, estate duty, corporation tax, etc. according to the general provisions of current fiscal legislation but subject to the variations following from Part 2 and Part 3 of this Act.

§ 3 The liability to pay tax according to the provisions of this Act shall rest on individuals, estates left by deceased persons, companies, independent institutions and associations, etc. which carry out operations governed by this Act.

Subsection 2 Entities liable to tax pursuant to this Act which are not likewise covered by the provisions of §§ 1 and 2 of the Tax Act [Skattalógin, Parliamentary Act No. 86, dated 1 September 1983, as amended], are only entitled to deduct expenses insofar as they are related to revenue covered by section 1 hereof. Where a taxpayer is also liable to pay tax according to the Tax Act, the calculation made according to this Act shall be included in the calculation of the taxpayer's total income, but cf. § 4.

Subsection 3 In other respects, the provisions on tax liability contained in the Tax Act shall apply correspondingly.

**Part 2
Special provisions on the calculation and assessment of taxable income**

§ 4 The taxpayer shall be assessed separately for tax on the following revenues:

1. revenue on the first sale of extracted hydrocarbons;

2. revenue fixed as a share of the extracted hydrocarbons or the value thereof;
3. gains or losses on direct or indirect assignment of a licence, permit or right to carry out preliminary investigations, exploration for or extraction of hydrocarbons;
4. gains or losses as referenced in § 4, 5 and 12 of the Depreciation Act [Avskrivingslógin, Parliamentary Act No. 52, dated 29 December 1971] in respect of assets governed by the provisions set out in § 7, subsections 3 and 8 hereof;
5. gains as referenced in § 25 of the Depreciation Act insofar as the assets have been used in connection with the production of hydrocarbons.

Subsection 2 The sales value of hydrocarbons appropriated by the taxpayer for processing or for the taxpayer's own use shall be included in the calculation of the taxpayer's income.

Subsection 3 Gains or losses pursuant to subsection 1, No. 3 above shall be calculated as the difference between the consideration obtained by the assignment and the cost of acquisition less amortisation according to § 9.

Subsection 4 The separately assessed income shall be calculated according to the general provisions of current tax legislation subject to the variations following from the provisions set out in §§ 5 - 10 below. In the calculation of the taxable income, expenses are only deductible insofar as they are related to the revenue referred to in subsections 1 and 2 above. No deduction shall be allowed for sales commissions, discounts or similar reductions granted when hydrocarbons are transferred between companies which are considered to be associated.

Subsection 5 Tax paid on the revenue referred to in subsections 1 and 2 shall accrue to the Faroese Treasury [Landskassin].

Subsection 6 The separate assessment shall take place the first time for the income year in which preliminary investigations and exploration are commenced.

§ 5 The Minister of Finance [landsstýrismaðurin] is entitled to decide on the adoption of norm prices for the extracted hydrocarbons for the purpose of assessing taxable incomes. It may be decided that norm prices shall exclusively be set for liquid hydrocarbons.

Subsection 2 The norm price shall be equal to the market price charged in trading between independent parties on an arm's length basis. The norm price shall be fixed retroactively for three months at a time.

Subsection 3 Where norm prices have been fixed according to subsection 1 above, the revenue referred to in No. 1 and 2 of § 4, subsection 1 and in § 4, subsection 2 shall be calculated on the basis of the norm price ruling on the date of the sale or appropriation according to § 4, subsection 2 of extracted hydrocarbons, but adjusted as required by variances as to quality, place of delivery and terms of delivery and terms of payment for the particular supply.

Subsection 4 The method of calculation set out in subsection 3 shall be applied irrespective of whether the revenue actually obtained varies from the revenue assessed.

§ 6 The norm price shall be fixed by a board appointed by the Minister of Finance. The Board shall comprise a chairman, four more members and four alternate members. The chairman shall be appointed at the recommendation of the Judge of the Faroe Islands [sorinskrivarin]. The members of the Board shall represent legal, financial, accounting and technical expertise. At least two members shall have special insight into hydrocarbon trading. The members and their alternates shall be appointed for a term of four years.

Subsection 2 The rules of procedure of the Board shall be determined by the Minister of Finance.

Subsection 3 Decisions made by the Board may not be brought before any other administrative authority.

§ 7 In calculating the taxable income referenced in § 4, taxpayers are entitled to deduct expenses, which have been paid in connection with their activities aimed at hydrocarbon extraction. Where

the expenses were paid before a taxpayer commenced extraction in an area governed by this Act, the taxpayer may decide to deduct them over five income years instead, at the rate of 20 per cent a year, with the first deduction being carried out in the income year in which the taxpayer commenced such extraction.

Subsection 2 Where the taxpayer assigns or relinquishes a licence, permit or right, or where it is revoked by the Minister, and the taxpayer does not subsequently carry on business aimed at extracting hydrocarbons in an area governed by this Act, the expenses may be deducted in the income year in which the assignment, relinquishment or revocation has taken effect.

Subsection 3 Expenditure paid to acquire machinery, plant and similar operating equipment as well as ships and buildings used in connection with preliminary investigations and exploration activities shall be depreciated according to the provisions in the Depreciation Act. Depreciation of drilling rigs shall be provided for according to the provisions in Part I of the Depreciation Act.

Subsection 4 Where the assets referenced in subsection 3 are used partly in connection with other activities, the depreciation according to subsection 3 shall be based on that part of the written-down value which corresponds to the proportional use of the asset for preliminary investigations and exploration activities. The proportional use of the asset for other activities shall apply for depreciation of the asset in calculating that part of the taxable income, which is not covered by § 4 above. Depreciation according to this present provision shall be carried out separately for each asset.

Subsection 5 Until the taxpayer has commenced extraction in an area governed by this Act, depreciation amounts made up according to subsection 3 may be transferred to deduction against income according to the provisions of the second sentence of subsection 1 above.

§ 8 Depreciation of production plant, rigs and other installations, including pipelines and plant related thereto as well as other equipment used in earning the revenue referred to in No. 1 and 2 of § 4, subsection 1 or in § 4, subsection 2, shall be depreciated according to the provisions concerned with operating equipment contained in part I of the Depreciation Act.

Subsection 2 Ships and buildings, which are not covered by subsection 1 above, shall be depreciated according to the provisions thereon contained in the Depreciation Act.

Subsection 3 Where a depreciable asset is used partly for other activities, the depreciation according to subsections 1 and 2 shall be based on that part of the written-down value which corresponds to the proportional use of the asset for the activities referenced in subsection 1. The proportional use of the asset for other activities shall be applied for depreciation of the asset in the calculation of that part of the taxable income, which is not covered by § 4. Depreciation according to this present provision shall be carried out separately for each asset.

§ 9 The acquisition price of the licences, permits and rights referred to in § 4, subsection 1, No. 3 may be depreciated at equal yearly amounts over a period of five years.

Subsection 2 Where the taxpayer assigns or relinquishes a licence, permit or right, or where it is revoked by the Government [landsstýrið], the portion which has not been depreciated according to subsection 1 may be written off in the income year in which the assignment, relinquishment or revocation has taken place.

§ 10 In case the taxable income referenced in § 4 is negative, the loss may be deducted from the taxable income of the same nature over the immediately following 20 years. Within this period, the deductible loss may however only be carried over to a later income year, if it cannot be accommodated by the income of previous years.

Subsection 2 Where the taxable income referenced in § 4 is negative, the taxpayer shall be entitled to transfer this loss fully or partly for deduction from other income.

Subsection 3 Losses related to other income than that referred to in § 4 may not be transferred to deduction of the types of income referred to in § 4.

"Part 2a
Assessment of special hydrocarbon income tax¹⁾

§ 10a Special hydrocarbon income tax shall be assessed based on income from each hydrocarbon field individually.

Subsection 2 When a permit to explore for and extract hydrocarbons is extended with regard to extraction, the hydrocarbon accumulation is delimited by the Minister of Finance. This delimitation of the hydrocarbon accumulation shall be used as the basis for the calculation of special tax.

Subsection 3 Revenue and expenditure are liable for special taxation from the day of approval of the field development plan for the hydrocarbon accumulation concerned. Where the approved field development plan involves a number of hydrocarbon accumulations to be exploited as one, the Minister of Finance is entitled to decide that these accumulations shall be considered as one hydrocarbon field as regards special taxation.

§ 10b Expenses incurred before the field development plan approval are not deductible. However, expenditure related directly to discovery and assessment of the hydrocarbon field(s) concerned is deductible. These expenses may be deducted in the year of field development plan approval. The Minister of Finance may promulgate specific regulations regarding what kinds of expenses are deductible.

§ 10c Expenditure from acquisition of production plants, rigs, ships, buildings and other installations, including pipelines and plant related thereto, as well as other equipment used in earning the revenue from a hydrocarbon field referred to in No. 1 and 2 of § 4, subsection 1 or in § 4, subsection 2, shall be fully deducted within the year of acquisition.

Subsection 2 Expenditure relating to assets referred to in subsection 1 that are in progress by the end of the year at one's own expense may be deducted within the same year as they are incurred.

Subsection 3 Where a contract is made with a contractor on building/acquisition of the assets referred to in subsection 1, instalments of the acquisition expenditure may be deducted according to the provisions in the contract concerned. However, the amounts deducted may not exceed the amounts common in the industry sector, and the deduction shall not exceed the value of the work in progress at the time of payment of the instalments.

Subsection 4 Where assets, for which the acquisition expenditure is deductible, are partially used for other activities, the taxable deduction is calculated as the proportion of the value corresponding to the proportional use of the assets for activities mentioned in subsection 1.

Subsection 5 Where assets, for which the acquisition expenditure has been deducted according to the provisions laid down in subsections 1 through 4, are sold or used for other activities than those referred to in § 8, the proportional part of the sales revenue or market value that corresponds with use in connection with activities referenced in § 8, shall be included in the calculation of the special taxable income.

§ 10d Acquisition expenditure for licenses, permits or rights referenced in No. 3 of § 4, subsection 1 that are acquired after the field development plan approval shall be deducted within the year of acquisition.

§ 10e When the special taxable income is calculated, financial income and expenditure shall not be included.

Subsection 2 When the special taxable income is calculated, tax paid and assessed according to the regulations of Part 2 shall be deducted. Where such paid tax relates to income from a number of hydrocarbon fields, the tax paid shall be divided between the fields in the same proportion as that in which they have contributed to the taxable income of which the tax paid is calculated.

Subsection 3 The Minister of Finance may promulgate specific regulations regarding the calculation referenced in subsection 2.

§ 10f The special tax is arranged in three tiers, the tiers being calculated individually according to the regulations in subsections 2 through 4.

Subsection 2 First tier. The special income from a hydrocarbon field is calculated on a yearly basis according to the regulations in § 10a-e, the first time being in the year of the field development plan approval. Negative special income is then carried forward to the following year with a compounding of 20 per cent and is set off against positive special income from the following years. Special income calculated in this way is taxable with 10 per cent.

Subsection 3 Second tier. Special hydrocarbon income is calculated in the same way as in subsection 2. Negative special hydrocarbon income is carried forward to the following year with a compounding of 25 per cent and set off against positive special hydrocarbon income from the following years. Special hydrocarbon income calculated in this way is taxable with 15 per cent.

Subsection 4 Third tier. Special hydrocarbon income is calculated in the same way as in subsection 2. Negative special hydrocarbon income is carried forward to the following year with a compounding of 30 per cent and set off against positive special hydrocarbon income from the following years. Special hydrocarbon income calculated in this way is taxable with 15 per cent.

Subsection 5 Where more than 6 years pass from the year of the field development plan approval until commercial production of hydrocarbons from the hydrocarbon field referred to commences, negative special income from years that lie further back than 6 years back from the year when commercial production commences, shall be carried forward with a compounding no longer than the last 6 years before commercial production commences.

Part 3

Other provisions

§ 11 Individuals who are not governed by the provisions on tax liability contained in §§ 1 or 2 of the Tax Act, and who receive revenue from operations covered by this Act other than the revenue referred to in § 4, shall exclusively pay income tax to the Faroese Treasury at the rate of 35 per cent of their taxable income.

Subsection 2 Persons, who are not subject to the regulations in § 1 of the Tax Act and who carry out work for an employer who is not a resident of this country, shall pay a final tax to the Faroese Treasury at the rate of 35 per cent on income which is covered by this Act other than the revenue referred to in § 4 and on other types of revenue from commercial activities.

Subsection 3¹⁾ Persons and companies, independent institutions, associations, estates of deceased persons, etc. with such income as referred to in § 4, subsections 1 and 2 are, apart from the special tax referred to in part 2a, also liable to pay income tax to the Faroese Treasury of such income with 27 per cent. The income tax for income referred to in § 4, subsections 1 and 2 shall be calculated separately.

Subsection 4 Tax paid by companies, independent institutions and associations, by estates of deceased persons, etc. which are not covered by the regulations of § 1 or 2 of the Tax Act, and which receive other revenue covered by this Act than the revenue referred to in § 4, shall accrue to the Faroese Treasury.

Part 4

Entry into force

§ 12 This Act shall enter into force on the day of publication [which was on 19 February 1999], and apply to revenue and income acquired on and after that date.

Amendments and effective dates

¹⁾ Amended by Parliamentary Act No. 26, dated 7 March 2000