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Transfer Mispricing in the Oil Industry

How important has transfer mispricing been in the construction of the current Norwegian tax regime for the petroleum industry?

Master's thesis in Political Science

Trondheim, spring 2014

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Preface

I dedicate this work to my mother, who has been a tremendous help throughout my entire education. I have also appreciated the support from the rest of my family.

I would like to thank my instructor Jonathon Moses for interesting lectures and for giving me the idea to write about transfer pricing. I would also like to thank Bjørn Letnes for his help on this project. Their comments and instructions have helped me see the bigger picture when it comes to tax management and transfer mispricing in the oil industry. It has been a privilege to work with both of them.

Veronica has been a good friend since I moved to Trondheim. I would especially like to thank her for helping me with statistical papers, and for giving me good advice during our studying at Dragvoll. In the last stage of my work with transfer mispricing she has proofread my thesis, which has helped me finish it.

Furthermore I would like to thank Lone Semmingsen in the Ministry of Finance and Steinar Hambro in the Norwegian Tax Administration for helping me at the initial stage of the project. Their assistance in mapping out when changes have been made to the petroleum taxation for the Norwegian shelf was very helpful.

Lesjaskog, July 9th

Abstract

In this thesis I investigate how important transfer mispricing has been in the construction of the current Norwegian petroleum tax regime. Transfer mispricing has real world consequences, and recent studies (Pak, 2012, p. 36) show that in the time span 2000-2010 over \$110 billion have disappeared through mispricing of crude oil in the EU and the US. By doing a case study of the Norwegian case more information might uncover about transfer mispricing. I create a typology with six considerations, and test how important each of these have been in eight propositions concerning changes to the petroleum taxation. My findings show that transfer mispricing is not the most important consideration when changes have been made to the Norwegian tax regime for petroleum. I find that efficiency and fiscal considerations are the most important considerations over time. But transfer mispricing is an important consideration for tax officials when they make changes to the petroleum taxation system, in the sense that transfer mispricing is a problem that is constant over time and the officials have created an approach to the arms length principle, the norm price system, which is designed to control transactions between companies operating on the Norwegian shelf and stop transfer mispricing from happening.

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1 Introduction

Transfer pricing is *not* illegal. It is a normal commercial transaction that takes place every day, all over the world. It occurs whenever two companies, who are owned by another company, with each of them being located in different countries, trade with each other (Nieckels, 1976, p. 4). Transfer *mis*pricing however is a strategy where two related companies set a price that differs from the market price. In this way the multinationals can shift income from a high-tax area to a low-tax area even though the profits were earned in a high-tax country; the tax base is shifted out of the host country (Dunn & Mutti, 2000, p. 198; Dunning, 1981, p. 31; Glomsrød & Osmundsen, 2005, p. 3; May, 2001, pp. 1595-1596; Pak, 2012, p. 8; Pugel, 2009, p. 355; Rugman & Eden, 1985, p. 1; Weiss, 1998, p. 171). Michael Hudson provides a good description of this problem in the petroleum sector in the 1960's, and it shows that transfer mispricing has real-world consequences. He writes that "The industry seemed almost to be a charitable operation, investing billions of dollars in exploring and drilling for oil, building refineries and putting together vast shipping networks, all without making a profit" (Hudson, 2000). He was assigned to gather information about transactions involving international payments by a number of oil companies in the 1960's. He was perplexed by the findings and went to Jack Bennett, who was the treasurer of Exxon at that time, and asked him where they made their profits. The answer was that they "(...) were made right there in his office" (Hudson, 2000). His job was to identify where profits would be taxed at low rates, which was in tax havens like Panama and Liberia (Hudson, 2000).

Low-cost oil produced in Venezuela and Saudi Arabia was sold to shipping affiliates in Panama and Liberia. The transactions were invisible for the oil ministers in Saudi Arabia because they appeared under "international" in the U.S. balance of payments statistics and not assigned to any specific country. The shipping affiliates then sold the oil (at very high prices) to refineries in North America and Europe. The oil companies also avoided paying taxes to European governments, because the transfer price was high enough to show no profits for the refineries. The profits were made in tax havens like Liberia and Panama, where the oil companies used branches of U.S. banks to coordinate the transfer payments. The oil companies maximized their profits by eluding high tax regimes in Europe and North America (Hudson, 2000).

The problem with tax evasion by the oil companies has also been reported in Alaska, which is an oil rich state in the US. In a case from the 1980's concerning cheating by the oil companies, Stiglitz (2007, p. 25) found that, in addition to selling oil to subsidiaries at a lower than fair market value, the oil companies found other ways to increase their total profits. E.g. it was decided that the oil companies had to pay 12.5% of the gross receipts, minus the cost of transporting the oil from the site. So to increase their profits, the oil companies just overestimated their costs by a few pennies per gallon. The state then used tens of millions to detect this behaviour by the oil companies, millions that could have been used in more important areas of society (Stiglitz, 2007, p. 25). In a more recent study, Pak (2012) found that in the time span 2000-2010 over \$110 billion have disappeared through mispricing of crude oil in the EU and the US. Furthermore he also pointed out that transactions from tax havens are more or less invisible in his analysis, because the published import data only shows where the oil originally comes from (Pak, 2012, p. 36). This means that there might be hidden statistics here that can make the issue of transfer mispricing even more extensive than it already is.

Pak's study takes us back to Hudson's description of the petroleum industry in the 1960's, where tax havens played an important part. As was mentioned earlier multinational companies often establish offices in so-called tax havens, states where there are very low or no taxes, in order to maximize their profits. An example of this is the small state of Delaware, in the US. Here over 285,000 businesses have their legal address. The reasons for establishing a dropbox here varies between each company, but one reason might be to minimize taxes paid. According to the New York Times this loophole has over the last decade reduced taxes for businesses with operations in other US states by an estimated amount of \$9.5 billion (Wayne, 2012). Statoil is one of the companies that have a legal address in Delaware. Statoil is a Norwegian oil company that is partly owned by the Norwegian government. From 1972 to 2001 the state was the only owner of Statoil (Regjeringen, 2013a), but this has changed over the years and the current state ownership share is 67% (Meld. St. 13, 2011, p. 94). Statoil has 25 subsidiaries in the US, and 23 of them are registered in Delaware. There are no employees, but an agent represents the company in the state (Seglem & Sverdrup, 2012). When confronted with this information, Statoil answered that the company doesn't save taxes by being registered in Delaware, and argued that it is the industry friendly, just and predictable legislation that is the main reason (Stavanger Aftenblad, 2012). But it is hard to

escape the simple fact that Delaware is an ideal place to siphon funds from host countries, in order to reduce global taxes paid for the multinational companies.

The Norwegian case might be very helpful in acquiring more knowledge about transfer mispricing; a mapping out of how the Norwegian government has faced issues like transfer mispricing, and which motivation has been important in this process, might help uncover how important transfer mispricing is when setting up a tax regime for the petroleum sector. Countries with large natural resources have had problems with benefiting from their natural wealth, a problem that is often referred to as “the resource curse”. Throughout history there have been many examples of this (Humphreys, Sachs & Stiglitz, 2007, p. 1). Norway is a resource rich country, and in 2007 the Norwegian government had 31% of its total income from the petroleum industry (Osmundsen, 2010, p. 435). They have in other words been able to escape this curse, and this is also what makes the Norwegian case interesting. I am going to map out how Norway has been able to manage its petroleum reserve so that the revenues benefit the public, not just the multinational enterprises. In particular, focus is turned to the problem of transfer mispricing.

It is quite clear that this is an important issue, and multinational enterprises have a lot of leeway in the present regime. Things have changed since the 1960’s, but the need for more information on transfer mispricing is evident. The thesis’ main task is to map out which considerations were important when officials first sat down to write the laws for the petroleum sector, and what changes have been made in the Norwegian petroleum taxation over the years. The main objective is to evaluate how important transfer mispricing has been in this process. Transfer mispricing is relevant because several countries are struggling with it, and there are a good deal of attempts (by various host countries) trying to deal with this problem. Implementing and designing fiscal regimes for the extractive industry “(...) is now a major focus of IMF policy support and technical assistance” (International Monetary Fund, 2012, p. 7).

The main question in this thesis is: How important has transfer mispricing been in the process of building the Norwegian tax regime for the petroleum industry? By answering this question I might also be able to find out what has changed in this regime since it first was introduced in 1965, and what other considerations there are when establishing a tax regime for the petroleum industry. To measure how important transfer mispricing has been, is somewhat challenging, but by mapping out *what* changes have been made over the years, and *how* the

policymakers have prioritized, it might be possible to identify this. I have done this by ranking six considerations in eight propositions concerning changes to the petroleum taxation, and the findings indicate that the Norwegian approach to the arm's length principle, the norm price system, is the current solution to transfer mispricing, and that it has not changed since its implementation in 1975. Also I find that compared to other considerations, transfer mispricing has not been the most important consideration, but that the threat of it is constant over time. This argument is based in the simple fact that the norm price system is still a part of the petroleum tax regime.

The project has some theoretical and empirical challenges because very little is done on this subject and "Data on transfer prices is hard to come by" (Rugman & Eden, 1985, p. 7). Determining how extensive this problem is can also be challenging because "How far MNEs actually do manipulate intra-group prices to transfer income across national borders is still a matter for empirical research; so far the evidence collected is partial and impressionistic" (Dunning, 1981, p. 31). To overcome these challenges I have decided to employ a descriptive approach, with a document's analysis of changes to the Norwegian Petroleum act from 1975. By doing this I hope more information will emerge concerning how important a consideration of transfer mispricing has been when changes have been made to the act. I have focused attention on eight propositions regarding changes to the petroleum tax regime. In each of these propositions I have analysed what was the most important motivating factor for the change, and ranked them from 0 (not important) to 3 (very important).

In the next part, chapter two, I present a typology of six taxation considerations: fiscal, allocation, administrative, evasion, efficiency and transfer mispricing. An Official Norwegian Report (NOU 1989:14, p. 93) has been used as a point of departure. In this report the first five considerations are lifted up as being important when a system is being built up or changed. Transfer mispricing is not specifically mentioned in that report, which indicates that transfer mispricing is not an important consideration, but to answer my main question I have made it a consideration. I describe what distinguishes a tax regime that is most geared to each of these considerations. By doing this I will be able to separate them. And in order to answer the main question about how important transfer mispricing has been in the process of building the Norwegian tax regime for the petroleum industry, a measure of importance has been established in chapter three.

In chapter three the case study is presented. More specifically this is a hypothesis generating case study (Lijphart, 1971, p. 691-692). This method is selected because very little theory exists on transfer mispricing and the evidence of it is impressionistic and partial (Dunning, 1981, p. 31). I have identified 43 propositions that address changes to the petroleum taxation on the Norwegian shelf. From these 43 I have picked out eight important propositions that are highlighted in chapter four. Each of these eight propositions are treated as cases. In each case I search for the six considerations, and rank them with an importance scale. This scale varies from 0 (not important) to 3 (very important), and is more thoroughly presented in chapter three. The remaining 35 propositions are included in the appendix, with a description of what they pertain. I also identify which of the six considerations is most important in 15 of them, but in 20 of the propositions I have not been able to assign what consideration is most important.

Chapter four is the analysis chapter. Here I work through each of the eight cases, and rank which of the six considerations are most important in each case. At the end of each case a table is presented that shows what ranking each of the considerations has been given. In chapter five I discuss how the importance of transfer mispricing has changed over time, and what trends are evident. In chapter six my findings are summarized. Here I also address my main concerns about the sampling strategy and the operationalization of importance. There is a chance my case selection has had an effect on my findings. I have identified 43 propositions that discuss changes to the Norwegian petroleum tax regime. The reason I have only analysed eight propositions in chapter four, is that it would have taken too much time and space to analyse all 45, and that is why I have chosen eight propositions that are spread across time. But we would have achieved the best result if all propositions had been analysed. Another aspect that might have had an effect on my findings is the way I have operationalized importance. But I argue that these concerns have not had an impact on my conclusion that transfer mispricing has not been the most important consideration when changes have been made to the Norwegian tax regime for petroleum, but that it is a problem that is constant over time.

2 Theory

One way of identifying why Norway has been able to keep the revenue within its borders is to study how the tax regime has changed since oil first was discovered on the Norwegian shelf, and which considerations have been important in the construction of the current regime. In order to evaluate this, one has to identify which considerations the government value when making changes to a tax regime. In this chapter a typology of six considerations is established. I will describe what we are looking for in the data for each of these. This is done for all the considerations, so that one can separate them. An importance scale, which varies from 0 (not important) to 3 (most important), is established in chapter three. Thus, after testing each of these considerations up against one another, in each regime change, it might be possible to rank the different motivations for changes in the petroleum tax. In this way we can see if transfer mispricing has been important, and which other considerations have been important in the construction of the Norwegian petroleum taxation system. Since transfer mispricing is not mentioned as one of the considerations in NOU 1989:14 a more detailed description is presented. I have chosen to have transfer mispricing as a consideration, and this might affect my results, since transfer mispricing can overlap with the other considerations. In section 2.1.7 I take a closer look at how the considerations might overlap with each other, and potential problems with having transfer mispricing as a consideration.

2.1 Considerations

Generally there are several considerations Norwegian officials have to evaluate when they are establishing a new tax regime, or making a change in an existing regime. In NOU 1989:14 they point to five considerations: *fiscal*, *allocation*, *efficiency*, *administrative* and *evasion* (NOU 1989:14, p. 93). Since my main focus is on transfer mispricing I have decided to include it with the five other considerations, making the total of considerations into six. Tax treatment, especially in connection with transfer mispricing, is the most important subject I will address. In the following part I will describe what distinguishes each of these considerations in a tax law, and what we will find in the documents if one consideration is more important than the others. This is done for each of the six considerations. When this is in place it is possible to compare the importance of each up against one another, by searching in the documents for what the officials have chosen to focus on. After identifying what I am looking for in the documents, I might be able to answer my main question: How important has transfer mispricing been in the construction of the current Norwegian tax regime for the

petroleum industry? In so doing I might also identify what considerations the tax officials value the most when changes are made to the regime.

2.1.1 Fiscal considerations

The taxation is supposed to provide the government with income so that it can finance public sector activities and transfers (NOU 1989:14, p. 93). These are called *fiscal considerations*. The fiscal terms cannot be too tough; this could lead oil companies to search for oil in other areas with more favourable tax rules. If the fiscal terms are too generous the returns to government are weakened (Nakhle, 2010, p. 90). The government has to find a balance between these two in order to achieve the best outcome both for the oil companies and themselves. How is the regime organized when fiscal considerations are important? In order to capture most of the profits the government has to implement taxes that secure the government with most of the revenues, and in this regard a taxation based on the profits from the oil companies is a good choice. But a production-based taxation is a good alternative if the government wants to secure income from the industry from the onset. With this kind of taxation the government does not have to wait until the oil company makes a profit. As soon as the oil company has produced oil the government receives revenue from the activity. Any change in the law that secures the government more of the profits will indicate that fiscal considerations are important.

2.1.2 Allocation considerations

Allocation considerations are also important objectives for the taxation of petroleum. The tax should affect the allocation of income between people, and thereby provide a just allocation of welfare (NOU 1989:14, p. 93). How is the regime organized when allocation considerations are important? The regime will be organized in a way that distributes the profits equitable between the government and the oil companies. The oil companies are entitled to some of the revenues, but the oil resources are owned by the Norwegian state. The large portion of the profits should therefore benefit the society. There is not one tax in particular that ensures this, only the rate of the tax. If the proposition emphasize that a change is made to influence the allocation of income between the state and the oil companies so that it is more equitable, it will indicate that allocation considerations are important. Fairness is a keyword here.

2.1.3 *Efficiency considerations*

Efficiency considerations are the third consideration. Some taxes have a negative effect on extraction efficiency. If the resource is not efficiently extracted, it is negative for both the oil companies and the government; the government wants to maximize the potential of the resources, and the oil company wants to sell as much oil as it can. The tax might e.g. influence the oil companies' decision to close down oil fields (as is often the case with royalties (Glomsrød & Osmundsen, 2005, p. 2)); but it is both in the government's and in the oil companies' interest that oil is effectively extracted. In addition to this the government wants to maximize its share of the revenue by having a high tax rate, but it cannot be too high. Because then it might influence Norway's competitiveness when it comes to attracting activity from oil companies. The oil companies might decide to search for petroleum in areas where the overall tax rate is lower than on the Norwegian shelf (NOU 1989:14, p. 93). Furthermore the taxation has to be built on a principal of neutrality; the different incomes have to be taxed with the same rate. If they are not it might lead to investments that does not give the highest return (before tax), because investors want to optimize their investments with the aim of a higher yield after tax (Syversen, 1991, p. 37).

Another issue that relates to efficiency considerations is asymmetric information. The oil company has a lot of expertise in the extraction of oil (costs, risks etc.) while governments might not. In a situation with only one company interested in the oil the government might be in a bad position. When there are a number of companies wanting to have the license to look for oil this will not be a problem, because the government will have several companies to choose from (Humphreys, Sachs & Stiglitz 2007:5). How is the regime organized when efficiency considerations are important? If this is an important consideration the government will implement taxes that urges the oil companies to extract as much oil as possible from the oil fields. Taxes that have negative effects on investments e.g. will be left out from the taxation. Profit based taxation are taxes that urges the oil companies to extract as much oil as possible, since they are not levied a tax unless a profit is made. Production based taxation can have negative effects on investments, because the oil companies are in this case levied a tax as long as they are producing, and if the cost of producing is higher than the revenues the oil companies will not extract the oil. In addition to this government will be interested in attracting more oil companies to the shelf, so that there is more competition for the licenses.

2.1.4 Administrative considerations

The tax should not be too expensive to manage for the tax administration or the taxpayer (NOU 1989:14, p. 93). These are called *administrative considerations*. To determine profits one has to value the production and also other revenues that might be included. In addition to this costs have to be established (Calder, 2010, p. 321). This requires the administration to have a lot of information from the oil companies concerning their revenues. Therefore profit taxes present administrative problems, and increase the opportunity for corruption (Calder, 2010, p. 323). However, Syversen (1991, p. 41) points out that this consideration is not as important as the other considerations. This is because the oil sector has a specialized tax administration, which is capable of mastering a complicated set of rules. So if Norwegian officials find a more complex regulation that improves the system, *administrative considerations* are not likely to affect their determination of implementing the change. How is the regime organized when administrative considerations are important? A production-based taxation is most likely employed if these considerations are important, because this tax is simple to administer (Calder, 2010, p. 320; Glomsrød & Osmundsen, 2005, p. 2; Radon, 2007, p. 104). If a change is made in order to make the taxing cheaper or easier to manage it will indicate that administrative considerations are important.

2.1.5 Evasion considerations

Evasion considerations are the fifth consideration. The tax system should be devised in a way that limits tax evasion (NOU 1989:14, p. 93). How is the regime organized when evasion considerations are important? These considerations can be considered to be important if the government implement changes to the taxation that prevents the oil companies from siphoning profits made on the Norwegian shelf to other countries where tax rates are lower. It is naïve to think that the taxpayer will not use those opportunities that exist to make profits on the shelf as low as possible, in order to evade the tax levels on the shelf. There are several ways of avoiding this. One way is to implement a tax based on how much oil the oil company produce. The Norwegian government knows how much oil they have, and this makes it easy to control how much they are entitled to. Another way to ensure profits stay in Norway is to set down a committee that supervises all of the transactions between subsidiaries in the same company. This committee would also have to set a price for oil, since many of the companies trade between different parts of the same company. The arm's length principle is used to determine this price; by stating that the price paid for the oil should be the same as if the two

companies had no commonality of interest. If the oil companies report a lower price than the arm's length price, the government can levy an extra tax or some other sanction.

2.1.6 Transfer mispricing considerations

Transfer mispricing is not specifically mentioned in NOU 1989:14, but one can argue that it can be placed under several of the considerations mentioned above, and especially under evasion considerations. Since transfer mispricing is not mentioned in the report, a more detailed description is presented in this section. Most of the oil companies that are operating on the Norwegian shelf are multinational enterprises, meaning that they are active in many countries at the same time. Often there are a great deal of buying and selling internally in these companies (NOU 2000:18, p. 159), and this is what is called transfer pricing. As mentioned before transfer pricing occurs whenever two companies, who are owned by another company, with each of them being located in different countries, trade with each other (Nieckels, 1976, p. 4). When two *unrelated* companies trade with each other, they come together and negotiate a price for the product in question. The price reached is viewed as fair and set by the market. This is what is called the arm's length price (Tax Justice Network, 2013; United Nations, 1999, p. 9).

When a company owns subsidiaries in two countries it might set an artificially low price for tax purposes (i.e. the lowest overall tax rate) (Pugel, 2009, p. 355; Mullins, 2010, p. 388), like Hudson's (2000) example showed. E.g. if a multinational enterprise has its main offices in Norway, a subsidiary in Brazil and another subsidiary in Canada. The company produces a product in the subsidiary in Brazil, and sells it in Canada. Let's say the corporate tax rate in Brazil is 50% and 10% in Canada. Instead of pricing the product with the same amount in Brazil and Canada, the multinational sets a lower price when it sells the product to Canada from Brazil. Thereby it increases its profits by avoiding the high tax in Brazil. This is called transfer mispricing/transfer pricing manipulation/abusive transfer pricing (Tax Justice Network, 2013). The private sector parties want to maximize their profits, but this has a negative effect for the host country because their revenues will be minimized in this process (Stiglitz, 2007, p. 23). The potential to set a lower price when selling between subsidiaries is high, and it is important to note, "(...) one-third of the world's international trade in goods occurs as intrafirm trade between units of the multinational enterprises located in different countries" (Pugel, 2009, p. 356).

As the example above explains, transfer mispricing is a strategy that can shift income from a high-tax area to a low-tax area even though the profits were earned in a high-tax country; the tax base is shifted out of the host country (Dunn & Mutti, 2000, p. 198; Dunning, 1981, p. 31; May, 2001, pp. 1595-1596; Pak, 2012, p. 8; Pugel, 2009, p. 355; Weiss, 1998, p. 171). The company sets prices on things that move between different units in the company. These include financial capital, finished products, components and materials. The multinationals sets a price on these various products and sells them to subsidiaries or affiliates. To increase profits for the multinational it strives to reduce global taxes paid (Pugel, 2009, p. 355). E.g. in 2011 the Norwegian Tax Administration found that multinational companies had tried to evade taxes of a total of 16.7 billion NOK by trading within the same company (Sættem, 2013). The former Norwegian Prime Minister, Jens Stoltenberg, stated that the government wants to close tax loopholes and also gain more insight into various tax havens (Dagens Næringsliv, 2013). In the resource sector there are many opportunities for transfer mispricing, and the oil industry serves as a good example. Oil goes through many processes: extraction or production, distribution, marketing and refining. Each of these can occur in different countries (Mullins, 2010, p. 389).

The arm's length principle is a conventional approach to deal with abusive transfer pricing. It says, "(...) a transfer price should be the same as if the two companies involved were indeed two unrelated parties negotiating in a normal market, and not part of the same corporate structure" (Tax Justice Network, 2013). It is endorsed by both the United Nations Tax Committee and the OECD, and used in bilateral negotiations between governments. It is not likely that the OECD will embrace a new approach, and they will probably uphold the arm's length principle in the future (The Economist, 2013).

In the propositions the Norwegian officials might point out that multinational enterprises, like oil companies, can trade between subsidiaries in other countries, and in so doing set a price that is lower than the market price. From the description above it is also likely that if transfer mispricing has been an important consideration the government will probably be responsible for setting an arm's length price. In addition to this they will have to supervise the transactions between subsidiaries in the companies that are operating on the Norwegian shelf.

2.1.7 Considerations that overlap

Efficiency considerations can overlap with fiscal considerations. Because even though efficiency considerations are aimed at making the extraction more effective, it might also

have an effect on fiscal considerations. If an oil company chooses to shut down activity before all the oil is pumped up because the taxation regime is designed in a way that does not make it profitable to continue production, this would have an effect on efficiency considerations, but also have a negative effect on fiscal considerations. The same pattern might also emerge at other wells on the shelf, so that wells are shut down prematurely on several places. Then the state would lose even more of the income.

Fiscal considerations can overlap with transfer mispricing considerations. This is logical since the state would lose a lot of the profits if the multinational oil companies had the opportunity to allocate profits to other countries with lower taxes. And this takes us over to allocation considerations. These considerations are aimed at providing a fair distribution of the profits. But if the oil companies set a price that is lower than a fair market price, it will have a negative effect on allocation considerations. Meaning that transfer mispricing considerations might overlap with allocation considerations.

Evasion considerations can overlap with both fiscal and transfer mispricing considerations. If a multinational oil company evades taxes on the Norwegian shelf, this would entail that the Norwegian state loses money. An example of this can be if an oil company places activity from other parts of the company on the Norwegian shelf, and receives tax cuts based on these costs. So by making the taxation regime less susceptible to evasive strategies, the Norwegian state would increase its profits from the oil industry. As I described over transfer mispricing is when the oil companies come together and set a price that is below fair market price, so that they can increase their profits from the shelf while the Norwegian state loses money. This means that transfer mispricing is an evasive strategy, and could have been labelled under evasion considerations.

2.2 Expectations

Based on the descriptions in section 2.1.1 to 2.1.6 I expect that:

- 1) If the tax regime is aimed at fiscal considerations, we would expect to find tax policies that will claim more of the profits for the Norwegian government.
- 2) If the tax regime is aimed at allocation considerations, we would expect to find changes that are aimed at making the distribution of profits from the extraction fairer.
- 3) If the tax regime is aimed at efficiency considerations, we would expect to find measures that makes extraction from the field more efficient.

- 4) If the tax regime is aimed at administrative considerations, we would expect to find changes to the regime that makes it easier to administer for both government tax officials and tax experts in the oil companies.
- 5) If the tax regime is aimed at evasion considerations, we would expect to find measures that are aimed at making it more difficult for the oil companies to evade the Norwegian taxation system.
- 6) If the tax regime is aimed at transfer mispricing considerations, we would expect to find an approach to the arm's length principle.

3 Method

In this chapter I will present what method is used to answer the question about how important transfer mispricing has been in the construction of the tax regime for petroleum in Norway. The first section is concerned with the case study, and what kind of case study this is. After this description I will discuss how the cases have been chosen, and potential problems with the selection strategy. The second section of this chapter focuses on how each case has been tested, i.e. how I have chosen to operationalize “importance”.

3.1 Case study

In this description I draw on Lijphart (1971), who divides case studies into six types: *atheoretical*, *interpretative*, *hypothesis-generating*, *theory-confirming*, *theory-infirming* and *deviant*. The first two have no theoretical value, and therefore I am not going to focus on them. The four other types all build theory. *Theory-confirming* and *theory-infirming* both test established generalizations, where the *theory-confirming* strengthens a generalization while the *theory-infirming* weakens it. *Deviant* case studies tests cases that are known to deviate from established generalizations, and are tested because the researcher wants to find out why they deviate. The *hypothesis-generating* case study does exactly what it says: it generates new hypotheses where no theory currently exists (Lijphart, 1971, p. 691-692). It is in this type of case study my thesis on transfer mispricing fits in, because knowledge is inadequate in the public sector (NOU 2009:19, p. 104) and it is not clear how extensive the problem with transfer mispricing really is (Dunning, 1981, p. 31). What I uncover in my analysis should therefore produce hypotheses that can be tested in future research.

To do this a qualitative contents analysis is chosen (Bryman, 2012, p. 392), meaning that which key elements have been important in the construction of the Norwegian tax regime for the petroleum sector will be established. These were presented in chapter two. Each case will be described and tested for which consideration was most important: fiscal, allocation, efficiency, evasion, administrative or transfer mispricing. After doing this I might be able to conclude how important transfer mispricing has been in the process of building the petroleum tax regime. To document the process in which officials in the Ministry partake, the project will analyse contents in publications from the Norwegian Finance Department and other relevant Ministries that have had an impact on changes to the petroleum taxation. I start with the first law, concerning the petroleum tax law, and make a timeline up to today, to show how

the system has evolved since the first law was passed in 1965. By using key documents concerning changes in the tax regime for petroleum, I might be able to identify if transfer mispricing has been an important motivation for changes, or if other considerations have been more important than transfer mispricing. The documents I have chosen to use are propositions that are *passed* by the Parliament. Propositions might offer much advice on how the tax system should be formed, but some of these proposals might not make it to the actual bill. This is why I have chosen to focus on proposals that actually are passed by the Parliament. The next step is to establish when the tax regime for petroleum has changed.

Over the years there have been many changes to the first law regarding the taxation of petroleum on the Norwegian shelf, passed in 1965 (Ot.prp. no. 47, 1964-1965). The first comprehensive law came in 1975 (Ot.prp. nr. 26, 1974-1975), and after this was passed I have identified 41 propositions concerning the petroleum taxation. All of these changes do not pertain specifically to the law passed in 1975, but also other laws that have an impact on the petroleum tax. I have gone through all these propositions, and eight of them are focused in the analysis chapter. These eight propositions have been selected:

- 1965: First instructions concerning taxation of underwater petroleum reserves (Ot.prp. no. 47, 1964-1965);
- 1975: First comprehensive law about taxation of underwater petroleum reserves (Ot.prp. nr. 26, 1974-1975);
- 1980: Additional sharpening of the petroleum tax (Ot.prp. nr. 37, 1979-1980);
- 1986: Revision of the petroleum tax (Ot.prp. nr. 3, 1986-1987);
- 1992: The petroleum tax reform (Ot.prp. nr. 12, 1991-1992);
- 2000: Evaluation of the petroleum tax law (Ot.prp. nr. 86, 2000-2001);
- 2010: Determining the price of gas (Prop. 126 LS, 2009-2010); and
- 2013: Changes in the tax law (Prop. 150 LS, 2012-2013).

These cases are chosen because they brought with them large changes to the petroleum taxation. It would have taken too much time to analyse all 43 propositions, and this is why I have chosen to focus on eight propositions that are spread over time. The remaining propositions are included in the appendix with a description of the largest changes and which consideration was most important in 15 of the proposition.

I have also evaluated other approaches of addressing the issue of transfer mispricing in the petroleum industry. A comparative approach could have been interesting. We could then have seen how two taxation regimes differ and argue that one of them has a better solution to transfer mispricing than the other. But comparing two taxation systems have several weaknesses. E.g. which assumptions are used is not neutral to what results we get, and the taxation rules constitute only a part of the regulation that forms the framework condition for activity on the shelf (Ot. prp. nr. 37, 1979-1980, p. 17).

3.2 Operationalizing importance

In each case/proposition the considerations presented in section 2.1.1 to 2.1.6 will be ranked from 0 to 3, where 0 means not important while 3 means very important. If a consideration is mentioned in a proposition, but not evaluated it will be given a ranking of 1. If a consideration is evaluated it will be given a rank of 2. This is done to get a better picture of how the importance of each consideration changes over time, and also to see which consideration is the most important in the construction of the Norwegian petroleum tax system. To have a clear demarcation between rank 1, rank 2 and rank 3, I will present the general information about each proposition. General information is in this regard meant how many pages the proposition is, and which chapters of the proposition are left out of the analysis because they include information that is not relevant to the testing. This is done to divide the propositions into percentages. If more than 50% of the pages in a proposition pertains one of the six considerations, that consideration is given a rank of 3. If a proposition focuses less than 50% on a consideration, but more than 10% it is given a rank of 2. If the pages in a proposition contains less than 10% of a consideration, but is mentioned it is given a rank of 1.

It can be difficult to say that one consideration is more important than the other. This is especially difficult when two considerations overlap, and in these cases several considerations can get a ranking of 3 in one proposition. In chapter five a figure and a table will be presented that will show how the importance of each consideration change over time. An index of the importance of each consideration over the entire period is also included in this section.

The testing of each case could have been done in another way. E.g. counting how many times each consideration is mentioned in the propositions, and then see what consideration is referenced the most times in each case. But I have chosen this test because the considerations might overlap, and this requires a thorough examination of all the changes in every proposition.

3.2.1 Overview of rankings

0 – not mentioned,

1 – less than 10% of the pages in the proposition concerns one of the considerations, but is mentioned in the proposition,

2 – less than 50% of the pages in the proposition concerns one of the considerations, but more than 10%,

3 – more than 50% of the pages in the proposition concerns one of the considerations in the proposition.

4 Analysis

In this chapter I analyse eight propositions concerning changes to the petroleum taxation. I will track changes to the petroleum taxation, and evaluate which consideration is most important in each tax regime. In section 4.1 to 4.8 each case/tax regime will be presented and tested.

4.1 Attracting activity – 1965

The first regulations concerning petroleum taxation were given in ot.prp. nr. 47 (1964-65), *Om lov om skattlegging av undersjøiske petroleumsforekomster*. This proposition is seven pages in length, but only five of these pages provide information about why the regime was organized in this way. This means that if a consideration is mentioned in more than 0.5 pages it will be given a rank of 2 on the importance scale, since 0.5 pages is 10% of 5 pages. If a consideration is evaluated in more than 2.5 pages it will be ranked as 3, since 2.5 pages is 50% of 5 pages. More than 50% of the pages in the proposition concern efficiency considerations. Less than 10% of them concern fiscal considerations. Transfer mispricing, administrative, evasion and allocation considerations are not mentioned in this proposition.

The Norwegian fiscal system was from the onset based on neighbouring states, like the United Kingdom, Holland and West Germany. Throughout this proposition the United Kingdom's tax regime was used as an example, and officials in Norway agreed that taxation levels and royalties should be close to the UK levels (Ot.prp. nr. 47, 1964-1965, p. 2). This indicates that the government wanted to have a similar taxation system as in other North Sea states. This would make the Norwegian part of the North Sea just as interesting as other parts of the shelf, since the Norwegian taxation would not refrain the oil companies from searching and operating on the Norwegian shelf. The taxation system was in other words constructed so that it would attract activity on the shelf, and thereby increases the efficiency. With more companies operating on the shelf, the government would also have more alternatives when it came to awarding licenses to oil companies.

This proposition from the Ministry of Finance and Customs, which was approved April 9 1965 by the Parliament, builds on recommendations from a committee that suggested rules about exploration and extraction of underwater natural deposits. This committee pointed out three things that made the Norwegian part of the North Sea more challenging to operate in

than other parts of the North Sea: (1) the Norwegian shelf was on a lower depth than the North Sea shelf in general, which could have made it harder to extract the oil, (2) the Norwegian shelf was further away from findings on Holland's shelf and (3) the Norwegian trench could have made it difficult to bring ashore the oil through pipes (Ot.prp. nr. 47, 1964-1965, p. 2). These uncertainties made the committee conclude

“(…) the Norwegian continental shelf could easily seem like a less interesting area than the continental shelf of the Netherlands, West Germany and the United Kingdom. The tax load in Norway should therefore be adjusted to the tax load in the other North Sea states” (Ot.prp. nr. 47, 1964-1965, p. 2, own translation).

At this time it was important the oil companies made investments in exploring the subsurface of the Norwegian shelf, and high taxes could have refrained them from doing so. Norway was not the only country with potentially large oil reserves in the North Sea. If the Norwegian tax was much larger than taxes introduced by e.g. the United Kingdom or Denmark, the oil companies might have prioritized exploration in those areas instead. E.g. in the United Kingdom the production based taxation was 12.5%. In percentage the Norwegian fee was lower, but it is hard to compare these figures because the UK had very favourable depreciation rules. It was also agreed to have an income tax of 15%, with $\frac{3}{4}$ to the tax equalization fund and $\frac{1}{4}$ to the municipality where the tax was assessed. It is interesting to note that this tax rate usually was larger in Norway at that time, but the committee had used tax assessment in the shipping industry as a basis for this tax. This tax was also lower than the UK income tax (Ot.prp. nr. 47, 1964-1965, pp. 1-3). The committee therefore proposed “(…) the income tax for the companies etc. that are mentioned here, should partly be calculated after other and lower tax rates than usual” (Ot.prp. nr. 47, 1964-1965, p. 3). In the long term these lower taxes could have had positive effects on the fiscal terms as well, since the government would have the opportunity to increase the taxation when the fields were fully developed.

In this proposition, which is the first recommendation concerning taxation of underwater petroleum reserves, the government focuses on attracting activity to the shelf, meaning that efficiency considerations were very important. This evaluation is based on the fact that taxes were set lower than usual and that it was considered to be more challenging to extract the oil in the Norwegian territories than in other parts of the North Sea. The Norwegian government had to have a taxation system that did not refrain the oil companies from investing in their

part of the North Sea. The proposition also shows that fiscal considerations were taken into account, since a production-based taxation gives the government revenue from the onset, since it is not dependent on the operations making a profit. The issue of transfer mispricing is not mentioned in this proposition, even though the regime is organized with a profit based taxation that makes it easy for the oil companies to evade Norwegian taxes. Since this was the first tax law for petroleum passed in Norway, one can argue that the officials wanted to make it as simple as possible both for the taxpayer and the tax collector. There might also have been a lack of information concerning transfer mispricing in this time period, which Hudson's (2000) example from the 1960's shows.

Transfer mispricing considerations are not mentioned in this proposition. These considerations are therefore given a rank of 0 on the importance scale. Allocation, administrative and evasion considerations are not mentioned in the proposition. These considerations are given a rank of 0 on the importance scale. Findings from this proposition indicate that efficiency considerations were the most important, and that fiscal considerations also had an impact. Since more than 50% of the pages (pp.1-3) in the proposition are about efficiency considerations these are given a rank of 3. Fiscal considerations are given a rank of 1 on the importance scale, since less than 10% of the pages (p. 2) are about these considerations. Fiscal considerations are mentioned indirectly seeing as the production based taxation is implemented, which gives revenue to the state from the onset.

Table 4.1 Ranking of considerations (1965)

Fiscal	1
Allocation	0
Efficiency	3
Evasion	0
Administrative	0
<i>Transfer mispricing</i>	0

4.2 Securing profits – 1975

The second case that is focused in this thesis is ot.prp. nr. 26 (1974-1975), *Om lov om skattlegging av undersjøiske petroleumsforekomster m. v.* This proposition is 60 pages in length, but the 20 last pages is an appendix, and this does not contain information about why the taxation regime is changed. In chapter six (pp. 28-30) the proposition addresses tax arrangements that are under evaluation, and is therefore not a part of my analysis. In chapter

nine (pp. 34-40) the new paragraphs are commented, but it does not provide any new arguments about changes in the regime. The main focus is therefore from page three to page 28 and page 30 to page 32 (29 pages in total), since these pages contain the most essential information about the regime change in 1975. This means that if a consideration is mentioned in more than 2.9 pages it will be given a rank of 2 on the importance scale, since 2.9 pages is 10% of 29 pages. If a consideration is evaluated in more than 14.5 pages it will be ranked as 3, since 14.5 pages is 50% of 29 pages. Over 50% of these pages concern fiscal considerations. Transfer mispricing, evasion, administrative and efficiency considerations are covered in more than 10% of the pages. Allocation considerations are mentioned.

In 1975 the Norwegian government made large changes to the taxation of petroleum. In Ot.prp. nr. 26 (1975), the Finance Ministry argued that the Norwegian government had to evaluate special measures in order to provide the Norwegian society with a larger portion of the proceeds, because the increase in the oil price since autumn 1973 had created a higher profit for the corporations operating on the Norwegian shelf (Ot.prp. nr. 26, 1974-1975, p. 3). The government also asserted that the state, through Statoil, should have a bigger role on the Norwegian shelf (Ot.prp. nr. 26, 1974-1975, p. 12). This suggests that fiscal considerations were important in 1975, since measures were taken to secure more of the profits.

There is also a large focus on how the price for petroleum is set. At this time the host countries determined a fixed price for oil for tax purposes. This price was referred to as “the posted price”. From 1960-1970 it was set to \$1.80 per barrel of Arabian light oil, even though the market price fell to \$1.25 per barrel. During this decade the countries’ profits increased with about 10 cents per barrel. This changed in 1971, when the oil companies and a few of the host countries agreed to “the Teheran agreement”, which included stipulations saying that there were to be yearly increases in the posted price up to 1975. In February 1971 the price for Arabian light oil was set to \$2.18. In another agreement signed in 1972 called “the Geneva agreement”, the posted price was to be adjusted every month and not every quarter, because of the devaluation of the dollar. Both these agreements conducted to regular increases in the posted price up until October 1973 (Ot.prp. nr. 26, 1974-1975, p. 6).

During the summer and fall of 1973 there was a shortage of crude oil on the world market, which made the difference between the world market price and the posted price set by the host countries smaller. There were attempts by the host countries at trying to negotiate the price with the oil companies, but without any results. The Gulf States in OPEC (Organization

of the Petroleum Exporting Countries) then announced that the posted price was to be increased with 70% (\$5.12 for a barrel with Arabian light oil). The intention of this increase, according to the Gulf States, was to re-establish the ratio between the posted price and the world market price that existed when the Teheran agreement was signed. But the war in the Middle East (which broke out October 6th 1973) and the Arabian oil embargo resulted in an even higher price for crude oil, so OPEC once again increased the posted price to \$11.65 in December 1973 (Ot.prp. nr. 26, 1974-1975, p. 6). This shows that this was a tumultuous time in regards to pricing oil. Compared to the preceding decade, when there were only small fluctuations, the oil price went through enormous changes in a very small time period. The heavy focus on how the oil price was set, indicates that fiscal considerations and transfer mispricing might have been higher on the agenda than in the 1965 legislation. Because of the exceptional increase in the oil price the Norwegian government decided to introduce surtax. It is argued in the proposition that more of this additional income should go to the Norwegian society. After all, the income generated is from natural resources owned by the Norwegian state (Ot.prp. nr. 26, 1974-1975, p. 21). This change suggests that fiscal considerations were important at this time, since the Norwegian government wanted to capture more of the profits.

Efficiency and allocation consideration were evaluated before the surtax was implemented, because an additional tax could have had negative effects on both of these considerations. If the tax is set too high it could have refrained oil companies from investing in petroleum extraction on the Norwegian shelf, which is negative for efficiency considerations. An increase in the taxation could also affect the fair allocation of the profits between the Norwegian state and the oil companies. Measures were therefore taken to stimulate the oil companies to search for and extract oil. E.g. the revenues from less profitable fields were to be levied a lower tax than profitable fields (Ot.prp. nr. 26, 1974-1975, p. 21). This can also be seen in connection with the clear statement that on the long term the Norwegian policy was to extract oil from fields that were marginally profitable, even though this would mean that the state's income from the field would be small (Ot.prp. nr. 26, 1974-1975, p. 12). But the proposition clearly express that fiscal considerations were the most important motivating factor for implementing the surtax: "A factor in this case is that this concerns profits from the exploitation of nature resources that are the Norwegian state's property" (Ot.prp. nr. 26, 1974-1975, p. 21, own translation).

Up to this point in time the taxation of petroleum on the Norwegian shelf was built on the results displayed in the oil companies' accounts (Ot.prp. nr. 26, 1974-1975, p. 14); the tax authorities in Norway had to rely on the prices the oil companies had put down in their accounts, even when the transaction of raw oil was to a refinery owned by the same company. The risk that the oil company sets a lower price in this case is very high since it wants to maximize its profits. Also if the tax rates in Norway are higher than in other countries, this could tempt the multinational companies to transfer profits to parent or sister companies in other countries, and expenses from these companies to the Norwegian company to achieve a lowest possible tax rate (Ot.prp. nr. 26, 1974-1975, p. 13). As a consequence of this, a norm price system was introduced by *Lov om skattlegging av undersjøiske petroleumforekomster mv. [petroleumsskatteloven]* in 1975. The proposition clearly states "The government has come to the decision that it is necessary with an administrative determination of the prices or values that should base the calculation of the companies profits when selling extracted petroleum" (Ot.prp. nr. 26, 1974-1975, p. 4, own translation) and that "(...) the norm price is not implemented to provide the Norwegian state extra tax revenues with an artificially high price, but to solve the control and administrative concerns that would have arisen if the regime stayed the same" (Ot.prp. nr. 26, 1974-1975, pp. 15-16, own translation). Transfer mispricing and evasion considerations were clearly important issues in 1975.

According to this law (§4), the norm price has to correspond to what petroleum could have been traded for between independent parts in a free market. With independent parts is meant buyers and sellers who mutually don't have common interests that could have influenced an agreed upon price. At valuation the parts should consider inter alia achieved and noted prices for petroleum for the same or corresponding type with necessary adjustments for differences in quality, transportation costs etc. to the North Sea area or other current markets, delivery period, payment period and circumstances besides, achieved and noted prices for petroleum products with necessary adjustments for processing etc. and other comparable prices or valuations that exists. Whether the agreements are between associated companies or other agreements where special circumstances or remaining conditions had to have had influence for the pricing is to be considered. The norm price can be determined as a common price for petroleum that is extracted in a fixed term. The Ministry can determine closer guidelines that are to be followed in the pricing and can in each case decide that the determined norm price is not valid (Petroleumsskatteloven (1975), §4).

Before the norm price is determined, all the affected parts have to be notified and given the opportunity to comment based on rules set by the Ministry. If the pricing is handed over to a subordinate agency, each part has a right to demand that the Ministry reviews the determined price. In connection with this kind of review the parts can demand that the pricing is submitted to a committee of experts so that they can give a statement about the pricing if it is obviously unreasonable before the Ministry approves the pricing (Petroleumsskatteloven (1975), §4). The norm price for petroleum was to be set quarterly (Ot.prp. nr. 26, 1974-1975, p. 16). Furthermore, the Public Administration Act is valid when treating cases after this paragraph. The Ministry determines closer stipulations about the administrative procedures and appointing the expert committee, and during which can do necessary exceptions from the Public Administration Act's ordinary stipulations (Petroleumsskatteloven (1975), §4).

The proposition states, "The implementation of the norm price system entails, as mentioned, large administrative advantages" (Ot.prp. nr. 26, 1974-1975, p. 15, own translation). Because the Norwegian officials also evaluated other alternatives to deal with the problem of transfer mispricing. E.g. that they could inspect every transaction between the companies operating on the shelf, but the norm price system is argued to be a much easier system than if the tax authorities for each transaction had to evaluate if there was a common interest, and if the price was affected by this relationship (Ot.prp. nr. 26, 1974-1975, p. 13). This shows that the norm price system would have positive effects on the administrative part of setting the price for oil, because the other alternative would have demanded too much of the Norwegian tax authorities.

The possibilities of transferring deficits to the Norwegian shelf, so that the deficits could have been deduced in future profits, are minimized in the proposition. This is done to ensure that the government can have sufficient control with the use of the petroleum profits in Norway (Ot.prp. nr. 26, 1974-1975, p. 20). It was also important that the system is not too complicated and labour-intensive. This is especially important for a small country like Norway that cannot compete with the staff of experts the multinational companies have on this area (Ot.prp. nr. 26, 1974-1975, p. 13). Since this is an evasive strategy from the oil companies, these rules indicate that evasion considerations were important.

There are several depreciation rules in the legislation from 1975. E.g. deficits in the first years of production will be deduced in future profits (Ot.prp. nr. 26, 1974-1975, p. 19-20). These rules are positive for the oil companies, because they can operate on the shelf even with a

deficit. Petroleum extraction is an industry that requires a lot of patience from both companies and host countries. Depreciation arrangements from the host country provide the extractor with additional incentives to continue searching for and extracting oil, and they secure an efficient use of the resource. This indicates that efficiency considerations were important at this time.

All in all there were two major changes in the proposition from 1975: the Ministry implemented a surtax and constructed the norm price system. Fiscal considerations were the most important motivating factor for implementing the surtax, which is stated in the discussion concerning other considerations:

(...) firstly the desire of securing the Norwegian state a reasonable part of the profits from petroleum extraction on the long term. Secondly the desire that the increases in the states tax incomes should come fairly soon. And thirdly the desire of creating tax arrangements that is clear and easy to administer. The proposition that is laid forward shows signs that the two last elements after an overall evaluation has had to stand back (Ot.prp. nr. 26, 1974-1975, p. 21, own translation).

The second major change was the implementation of the norm price system. It was implemented because of the administrative and control concerns that would have arisen if the regime stayed the same (Ot.prp. nr. 26, 1974-1975, pp. 15-16). This indicates that transfer mispricing, evasion and administrative considerations were the motivating factors for introducing norm prices. Allocation considerations are mentioned, but changes were not made because of these considerations. The government introduced depreciation rules in order to increase efficiency on the shelf.

Allocation considerations are given a rank of 1, since these are mentioned on page 19 in connection with the implementation of the surtax. Efficiency considerations are given a rank of 2. These were addressed on page 19-20 and page 32. The implementation of the norm price system is addressed on page 14-19, which is more than 10%, but less than 50% of the pages in this proposition. This system was introduced to solve control and administrative concerns that existed in the former regime in connection with transfer mispricing. This means that administrative, evasion and transfer mispricing considerations are given a rank of 2. Fiscal considerations are covered in more than 50% of this proposition, and are the most important consideration. These considerations are addressed from page five to page 13 in connection

with the dramatic price increases in this time period, and in the discussion about the surtax on page 19 to page 23. Hence I have ranked this consideration as a 3 on the importance scale.

Table 4.2 Ranking of considerations (1975)

Fiscal	3
Allocation	1
Efficiency	2
Evasion	2
Administrative	2
<i>Transfer mispricing</i>	2

4.3 Additional sharpening of the petroleum tax – 1980

The third case that is focused in this thesis is ot.prp. nr. 37 (1979-1980), *Om lov om endring i lov av 13. juni 1975 nr. 35 om skattlegging av undersjøiske petroleumforekomster m.v.* This proposition is 61 pages in length, but the last 8 pages is an appendix, and do not contain information about why the taxation regime is changed. A section of chapter 5 (pp. 31-35) addresses tax arrangements that are under evaluation, and is not a part of my analysis. In chapter nine (pp. 48-53) the proposition comment on the paragraphs in the petroleum taxation, but it does not provide any new arguments about changes to the regime. The main focus is therefore from page three to page 31 and page 35 to page 47, since these pages contain this information. In total there are 42 pages that are analysed. This means that if a consideration is mentioned in more than 4.2 pages it will be given a rank of 2 on the importance scale, since 4.2 pages is 10% of 42 pages. If a consideration is evaluated in more than 21 pages it will be ranked as 3, since 21 pages is 50% of 42 pages. None of the considerations are addressed in more than 50% of the pages. More than 10%, but less than 50% of the pages concern fiscal considerations. Efficiency, administrative, transfer mispricing, evasion and allocation considerations are mentioned.

The legislation from 1975 was changed in 1980 and, just like in 1975, many of the changes were made because of the sudden rise in the oil price. Tax rules often reflect the current price situation and prospects at a certain time. This seems also to be true for the petroleum industry, since the taxation system went through changes both in 1975 and 1980 because of an increase in the oil price (Ot.prp. nr. 37, 1979-1980, p. 3).

OPEC had a very dominant role when it came to setting the price for oil in this time period, and this also affected the price of oil from the North Sea-area. In 1975 the price of Arabian light oil, which was the reference oil for OPEC's price setting, was set to \$10.50 per barrel, increasing to \$11.50 at the end of that year. From January 1977 to the turn of the year 1978-1979 the reference oil price was set to \$12.70. There were only minor increases in the price of Arabian light, and the oil price was quite stable in this period. This situation changed during the fall of 1978, when there was a tightening in the market for crude oil. Several developments triggered this rise. E.g. the revolution in Iran in the winter of 1978-1979, forced the country to reduce its production of crude oil from 5.5 million barrels per day in September 1978 to 2.4 million barrels in December 1978, and to below one million barrels per day in January and February 1979. Since Iran had to reduce its production with about 4.5 million barrels per day, and the winter in Europe and North America was very cold, it led to a shortage in the supply of oil. The demand was then especially turned to the type of oil that was extracted in the North Sea and North Africa, which both are lighter petroleum qualities with low levels of sulphur (Ot.prp. nr. 37, 1979-1980, pp. 10-11).

A few countries in OPEC increased their production to compensate for the lower production in Iran. Saudi Arabia temporarily increased their production limit from 8.5 million barrels per day to 9.5 million barrels per day. Production also increased in Iraq, Kuwait and Nigeria, but the pressure in the oil market continued. The shortage of crude oil therefore conducted OPEC to increase the reference oil price. The price was first raised to \$13.34 from January 1st 1979, and was to be increased gradually to \$14.54 in the fourth quarter of 1979. But this price was set already in April 1979, much sooner than first intended. At the OPEC price meeting in June 1979 the price was yet again increased. The reference price for petroleum was then set to \$18, with an upper limit of \$23.50 for the most valuable qualities, but this limit was breached in October when several OPEC countries set a price of \$26.27 for these types of oil. This development in the price continued throughout 1979, with many OPEC countries deciding to break with the prices set by OPEC and set their own price for oil. Most of the member states from the Middle East increased their prices to \$26 at the end of 1979. This shows that the oil price went through several increases, and e.g. Saudi Arabia increased the price of crude oil with 105% from December 1978 to December 1979 (Ot.prp. nr. 37, 1979-1980, p. 11). The value of Norwegian petroleum was largely based on prices on similar crude oils from the OPEC countries, so the same development was found in the Norwegian norm price. In the fourth quarter of 1978 the norm price was set to \$14.29 per barrel. It increased to \$27.50 in

the fourth quarter of 1979. So in a year it had almost doubled (Ot.prp. nr. 37, 1979-1980, p. 15).

If the Norwegian taxation system had not changed, the oil companies would have been granted very high revenues because of the high oil price. This is also the reason why the tax law from 1975 was changed in 1980 (Ot.prp. nr. 37, 1979-1980, p. 35). The Ministry of Petroleum and Energy made a prognosis over the six next years (1980-1985) that depicted how much more the government would earn if the new taxation system were implemented compared to if it stayed unchanged. Operating with a petroleum price of \$33 per barrel and a nominal price increase for petroleum of 10% per year, the prognosis showed that the Norwegian state's profits would increase with 12.3% and the oil companies' profits would decrease with 32.5% (Ot.prp. nr. 37, 1979-1980, p. 37). In particular the officials decided to raise the surtax. It had remained unchanged since its implementation in 1975, when it was set to 25%. So in 1980 it was raised to 35% (Ot.prp. nr. 37, 1979-1980, p. 30). It was necessary for the government to take care of Norwegian interests by sharpening the taxation of petroleum on the Norwegian shelf (Ot.prp. nr. 37, 1979-1980, p. 35), and thereby securing more of the profits. This indicates that fiscal considerations were important in 1980. It seems like the oil price in the world market clearly affects when changes are made in the Norwegian taxation system.

The increased surtax could have had implications for efficiency considerations. When the total tax on petroleum increases it could have refrained the oil companies from investing in fields that were profitable under the initial taxation system. Because under the new regime with increased taxes, the fields would no longer be commercially exploitable. This is addressed in the proposition, but the Ministry of Petroleum and Energy and the Ministry of Finance did not think that a tax increase would affect the development on the Norwegian shelf (Ot.prp. nr. 37, 1979-1980, p. 41). They base this evaluation on the fact that the increased oil price would also improve the oil companies' profitability of developing new fields:

The two Ministries are aware that the new tax proposals will reduce the profitability of developing new fields. On the other hand the increase in the real price for petroleum from 1978 to 1980 has to a great extent improved the profitability of developing new fields. The cost estimations the companies now can do after the new tax rules, might seem more favourable than cost estimations made in 1978, and partly in 1979, based on the old tax rules (Ot.prp. nr. 37, 1979-1980, p. 5, own translation).

Transfer mispricing is mentioned, since the norm price system is evaluated. In particular the petroleum price council wanted the Ministry of Petroleum and Energy and the Ministry of Finance to consider a change in the legislation text, so that there would be no doubts about how the legislation is to be understood. But no changes were made in this question because the two Ministries believed that the original legislation provided clear guidelines for the oil companies (Ot.prp. nr. 37, 1979-1980, p. 24). All in all there were not made any changes to the norm price system since the Ministries considered “(...) the current set of rules about norm prices will still fill its function in the determination of a correct and appropriate basis for the taxation” (Ot.prp. nr. 37, 1979-1980, p. 25, own translation). But some issues were addressed. E.g. the development preceding the proposition was that the amount of oil in the world trade that was sold between unrelated international oil companies had been decreasing. This could have made it challenging to set a correct price, since price information in this part of the market had become less comprehensive and less representative, but steps were not taken to improve this situation (Ot.prp. nr. 37, 1979-1980, p. 25). The proposition also notes “The tax assessing of large oil corporations is a very extensive task. It regularly concerns multinational corporations that are assisted by experts on all relevant areas like law, economy, accounting etc.” (Ot.prp. nr. 37, 1979-1980, p. 45, own translation).

Transfer mispricing considerations are given a rank of 1 on the importance scale, since these are only mentioned on page 24 to page 25. Efficiency considerations are mentioned in the discussion concerning the increased surtax on page 41, and given a rank of 1. Evasion considerations are mentioned on page 21 and page 22 in connection with the distribution of profits and expenses between the shelf and the municipality. Administrative considerations are discussed on page 44 to page 46. More specifically this discussion concern how difficult it is to tax large oil companies with their considerable expertise on areas like economy and law, and that the oil tax office should be allowed to hire experts on these areas. Fiscal considerations are the most important considerations in this proposition. These considerations are addressed in more than 10%, but less than 50% of the pages, and are hence ranked as 2 on the importance scale. As in 1975 fiscal considerations are discussed on page 9 to page 13 in connection with the price increase in this time period, and on page 30 concerning the surtax rate. None of the considerations are ranked as 3.

Table 4.3 Ranking of considerations (1980)

Fiscal	2
Allocation	1

Efficiency	1
Evasion	1
Administrative	1
<i>Transfer mispricing</i>	<i>1</i>

4.4 *Inciting to more activity on the shelf – 1986*

The fourth case that is focused in this thesis is ot.prp. nr. 3 (1986-1987), *Om lov om endring i lov av 13. juni 1975 nr. 35 om skattlegging av undersjøiske petroleumsforekomster m.v.* This proposition is 35 pages in length. My analysis is focused on page three to page 20 and page 24 to page 33, since chapter six (pp. 21-23) discusses tax arrangements that are under evaluation and the two last pages contain the same information as the preceding pages. In total there are 28 pages that are analysed. This means that if a consideration is mentioned in more than 2.8 pages it will be given a rank of 2 on the importance scale, since 2.8 pages is 10% of 28 pages. If a consideration is evaluated in more than 14 pages it will be ranked as 3, since 14 pages is 50% of 28 pages. None of the considerations are addressed in more than 50% of the pages, but more than 10% of the pages concerns efficiency considerations. Transfer mispricing and administrative considerations are mentioned in the proposition. Fiscal, allocation and evasion considerations are not evaluated.

Efficiency considerations were important in 1986, and changes to the taxation system were once again provoked by the world market price for oil. From 1980 to 1985 the oil price was decreasing insignificantly, but in the first quarter of 1986 it decreased dramatically from \$27.5 to \$9 (Ot.prp. nr. 3, 1986-1987, p. 4). There are several factors that lead to this decrease, but one explanation is that the high price level at the end of the 1970s contributed to a more effective extraction of oil, and also increased development of other energy sources. In addition to this the demand for oil outside state-trading countries decreased with 13%, and oil's part of the total energy consumption fell from 52% to 45%. This development increased the uncertainty about the future price expectations (Ot.prp. nr. 3, 1986-1987, p. 8) and made the Norwegian government reconsider its taxation system (Ot.prp. nr. 3, 1986-1987, p. 11).

The officials did not think that the production on the Norwegian shelf would be affected by the price decrease in the short term, but if the oil companies expected the oil price to rise they could have found it more profitable to delay the extraction. This would have had negative effects on efficiency considerations. Even more concerning for efficiency was the fact that

low oil prices could have influenced the oil companies' decisions to close down fields early. Because as production on a field decreases, the operating costs per barrel of oil produced will increase. The oil companies are then forced to close down production prematurely when the oil price is low. Furthermore the price decrease could have refrained the oil companies from investing in new fields on the shelf. The taxation system therefore had to be tailored in a way that kept the oil companies' future investments up. This is specifically stated in the proposition: "The future expansion level will then in a large degree be dependent on the new framework conditions the companies are offered in the form of changed taxation rules" (Ot.prp. nr. 3, 1986-1987, p. 11 own translation).

The Norwegian government implemented many changes that were supposed to make it more beneficial to invest on the shelf. E.g. the depreciation rules were changed, so that depreciation could start in the first year of investment. In the former regime this was not possible until the field was in production, and this weakened the profitability for new projects after tax. This change was therefore made because of efficiency considerations (Ot.prp. nr. 3, 1986-1987, p. 15). The government also implemented a production remuneration based on the gross value for new petroleum production (Ot.prp. nr. 3, 1986-1987, p. 16).

The non-taxable income was removed for investments after January 1st 1987. This change was made in connection with the new depreciation rules, because when depreciation could start in the first year the non-taxable income would have counteracted the governments desire to encourage increased cost consciousness from the oil companies' side. This implies that this change was made because of efficiency considerations. In addition to this the non-taxable income had been a very labour-intensive element for the tax authorities. By removing it, the government made the taxation system easier, which also indicate that administrative considerations were important when the non-taxable income was removed (Ot.prp. nr. 3, 1986-1987, p. 15-16).

Preceding this proposition, the foreign oil companies had to support the state's economic risk in the searching phase. This entailed that all the other companies' costs were doubled in the searching phase compared to the size of their share. This arrangement was changed, so that the state had to support its own economic risk in the searching phase in the future. The motivation for this change was that the oil companies would apply for field participation if this arrangement were changed. The former design had a negative effect for the companies when they evaluated if they were to participate on a field or not. "When a company evaluates

if it is to apply for participation on a block or not, the supporting commitment would have a negative effect on the decision” (Ot.prp. nr. 3, 1986-1987, p. 18, own translation). Calculations made by the Ministries showed that if the oil companies did not have to support the state’s economic risk, they would reduce their costs in the four-year period between 1987-1990 with 1.3 billion NOK and 1.9 billion NOK based on an oil price of about \$13 and \$18 per barrel (Ot.prp. nr. 3, 1986-1987, pp. 18-19). “The abolishing of the support arrangement for the foreign oil companies might reduce this distortion in the current system” (Ot.prp. nr. 3, 1986-1987, p. 19, own translation). This means that this change also was made because of efficiency considerations.

The production-based taxation was a part of the initial tax legislation from 1965, and had over the years been changed a few times. In 1965 it was set to 10%, but for extraction permits after 1972 it varied between 8-16% depending on the how much was produced on each field. It was calculated on the basis of the value of extracted petroleum on the extraction areas ship off point. The production-based taxation could have made projects that were socially profitable, unprofitable for the oil companies after tax. Since the Norwegian government wanted to improve the framework conditions, the production-based taxation was set to zero for new fields (Ot.prp. nr. 3, 1986-1987, pp. 19-20). This indicates that efficiency considerations were important when officials set the production-based taxation to zero.

Allocation, evasion and fiscal considerations are not mentioned, giving them a rank of 0. Administrative considerations are evaluated on page 15 and 16, but this is not more than 10% of the pages. Transfer mispricing considerations are addressed on page 12, but the officials did not make any changes in the current system. Transfer mispricing and administrative considerations are therefore given a rank of 1. This proposition’s most important consideration was efficiency considerations. All changes were made so that the oil companies would continue to invest in the field. The government wanted to compensate for the low oil price. But efficiency considerations are not addressed in more than 50% of the pages, and are not given a rank of 3. They are discussed on page four and five in connection with the depreciation rules, on page 11 about the future activity level on the Norwegian shelf, and on page 15-16 about the non-taxable income. Efficiency considerations were evaluated on more than 2.8 pages, and hence these considerations are ranked as 2 on the importance scale. But it is important to note that without the changes that were made in this proposition the fiscal terms may have been weakened in the long term, since the state would have lost a lot of

money if the oil companies closed down fields early or decided to not extract oil on the Norwegian shelf.

Table 4.4 Ranking of considerations (1986)

Fiscal	0
Allocation	0
Efficiency	2
Evasion	0
Administrative	1
<i>Transfer mispricing</i>	<i>1</i>

4.5 The petroleum tax reform – 1992

The fifth case that is focused in this thesis is ot.prp. nr. 12 (1991-1992), *Om lov om endring i lov av 13. juni 1975 nr. 35 om skattlegging av undersjøiske petroleumsforekomster m.v.* This proposition is 58 pages in length. Part three (pp. 51-53) of the proposition is not analysed, since these pages discuss tax questions that are under evaluation. In part four (pp. 54-58) the proposition notes on the wording of the tax law. These pages include much of the same information as the preceding pages, and are not a part of my analysis. My main focus is turned to page five to page 50. In total there are 46 pages that are analysed. This means that if a consideration is mentioned in more than 4.6 pages it will be given a rank of 2 on the importance scale, since 4.6 pages is 10% of 46 pages. If a consideration is evaluated in more than 23 pages it will be ranked as 3, since 23 pages is 50% of 46 pages. None of the considerations are evaluated in more than 50% of the pages. Efficiency considerations are addressed in less than 50%, but more than 10% of the proposition. Transfer mispricing, fiscal, allocation and administrative considerations are mentioned, but not addressed in more than 10% of the proposition pages. Evasion considerations are not mentioned.

In 1992 the Norwegian shelf had grown to be more competitive on the international scene than earlier, both in regard to searching for new fields and development of existing fields. There was more interest for new licences, there were a lot of fields under planning (Ot.prp. nr. 12, 1991-1992, p. 16) and new fields were also under development (Ot.prp. nr. 12, 1991-1992, p. 11). “Compared to most areas in the world that are open for search activity, the Norwegian shelf stand as an attractive area” (Ot.prp. nr. 12, 1991-1992, p. 15, own translation). The Ministry evaluated in this proposition “(...) how one can achieve more exact

investment incentives and improve the use of resources with a reform of the petroleum taxation” (Ot.prp. nr. 12, 1991-1992, p. 6, own translation).

The taxation of petroleum is based on the ordinary corporate taxation, and in 1992 this law went through a reform. Changes made in this reform had negative effects on revenues from the petroleum sector, and that is why changes had to be made to the petroleum tax law. The most drastic change that was made in the ordinary taxation for corporations was that the tax rate on the companies’ profits was reduced from 50.8% to 28% (Ot.prp. nr. 12, 1991-1992, p. 5), but this was not necessary for the petroleum taxation. The Ministry therefore proposed that the surtax rate was to be set to 50% for petroleum (Ot.prp. nr. 12, 1991-1992, p. 26). It is not clearly stated in the proposition that the surtax is held at 50% because of fiscal considerations, but the government would have lost a lot of the revenue if the surtax had been decreased to 28%. This indicates that fiscal considerations had an impact on the government’s decision to hold the surtax rate at 50%.

In 1986 the government had introduced a production remuneration, but in 1992 it was removed. Initially this remuneration was introduced so that oil companies would find it interesting to invest in the oil extraction on the Norwegian shelf. But this part of the taxation system created differences in the tax-related treatment of the different fields on the shelf, which is negative for the efficient extraction of oil from the shelf since some fields are treated as more profitable than other fields. Furthermore this remuneration could have given large problems for the tax assessment authorities, especially in connection with the different forms of contracts with regards to borrowing and lending of gas. This question concerns the basis of calculation. The production remuneration was therefore removed because of administrative considerations and partly also because of efficiency considerations (Ot.prp. nr. 12, 1991-1992, p. 21).

In 1986 the government removed the non-taxable income, but in 1992 it was reintroduced. Since the production remuneration was to be removed many companies wanted the government to maintain some protection of their income against surtax by other arrangements, and the Ministry argued that this best was achieved by introducing the non-taxable income. Technically the Ministry suggested that 5% of the cost price for operating assets that are depreciated, was to be deducted in the surtax base for six years from the year the operating asset started depreciation (Ot.prp. nr. 12, 1991-1992, p. 22). This could provide the oil companies with an extra incentive to invest on the Norwegian shelf and could also

attract new activity. The reintroduction of the non-taxable income therefore indicates that efficiency considerations were important.

One of the reasons why the non-taxable income was removed in 1986 was that it made the taxation system more difficult. This is also addressed in the proposition from 1992, but the Ministry argues that since the rules for transferring and distributing the non-taxable income between owners and users of pipelines were abolished in 1986, the effects on administrative considerations would no longer be as negative as before (Ot.prp. nr. 12, 1991-1992, p. 22). This makes sense, since the tax authorities would have fewer rules to follow when they calculated the non-taxable income.

Changes made to the production-based taxation and the arrangement where foreign oil companies had to support the state's economic risk in the searching phase in 1986 are also addressed in this proposition. The officials use the same arguments in this proposition as they did in 1986: that the production-based taxation has a negative effect on decisions to close down fields, which could have led to fields being closed down prematurely, and that the production-based taxation should still be set to zero. Supporting the state's costs in the searching phase created an unnecessary unequal treatment of the corporations operating on the shelf, since foreign oil companies had much higher costs than the national oil companies because they had to support the state's costs. Both these arrangements are therefore upheld in this proposition, but the officials decided that oil companies operating on permits given before 1987 also should not need to support the state's costs in the searching phase (Ot.prp. nr. 12, 1991-1992, pp. 27-28). As in 1986 these arguments indicate that efficiency considerations were important. This is also stated in the proposition: "These changes entail that one gets a taxation system that is more neutral, i.e. it affects the companies' economic disposals to a lesser degree" (Ot.prp. nr. 12, 1991-1992, p. 33, own translation) and "The Ministry means that the consideration to an efficient extraction of oil and gas resources is best taken care of in a taxation system where profitability after and before tax corresponds" (Ot.prp. nr. 12, 1991-1992, p. 33, own translation).

The norm price system is mentioned in the proposition, but there is only a general description of how the system works (Ot.prp. nr. 12, 1991-1992, p. 41). The Ministry notes that:

Norm price regulated sales raises relatively few questions, but there have been registered problems in connection with deals about increased credit period, costs that are not assumed to be deducted in the norm price

decision and quality compensation for compound oil (Ot.prp. nr. 12, 1991-1992, p. 41).

But there was not made any changes to the current solution. Since transfer mispricing considerations are only mentioned in the proposition they are given a rank of 1 on the importance scale.

The most important consideration in this proposition is efficiency considerations. The government wanted to improve efficiency for the oil companies, by making it more attractive to invest on the Norwegian shelf. Removing the production-based taxation did this. This is discussed on page 27. The foreign oil companies and national oil companies would operate on more equal terms, since the arrangement where the foreign oil companies had to support the state's costs in the searching phase was removed, and made it more attractive to invest on the Norwegian shelf. This is discussed on page 21-22, page 28 and on page 33. Efficiency considerations are addressed in less than 50% of the proposition pages, and are ranked as 2 on the importance scale. Administrative considerations are also evaluated in the proposition; the production remuneration was removed partly because it was a very complex arrangement to handle for the tax officials. Administrative considerations are given a rank of 1 on the importance scale, since these are only mentioned on page 21. Fiscal considerations are not directly mentioned in the proposition, but if the surtax had decreased to 28% the government would have lost a lot of revenue from the petroleum sector. The decision to hold the surtax rate at 50% therefor indicates that fiscal considerations had an impact. Fiscal considerations are given a rank of 1 on the importance scale. Evasion and allocation considerations are not mentioned in this proposition, and are given a rank of 0 on the importance scale.

Table 4.5 Ranking of considerations (1992)

Fiscal	1
Allocation	0
Efficiency	2
Evasion	0
Administrative	1
<i>Transfer mispricing</i>	<i>1</i>

4.6 A neutral petroleum taxation – 2000

The sixth case that is focused in this thesis is ot.prp. nr. 86 (2000-2001), *Om lov om endringer i lov 13. juni 1975 nr. 35 om skattlegging av undersjøiske petroleumforekomster mv.*

(petroleumsskatteloven). This proposition is 46 pages in length, but my main focus is from page five to page 46. In total there are 42 pages that are analysed. This means that if a consideration is mentioned in more than 4.2 pages it will be given a rank of 2 on the importance scale, since 4.2 pages is 10% of 42 pages. If a consideration is evaluated in more than 21 pages it will be ranked as 3, since 21 pages is 50% of 42 pages. Evasion considerations are discussed in more than 50% of the proposition. Fiscal, efficiency and administrative considerations are mentioned. Transfer mispricing and allocation considerations are not mentioned in this proposition.

In October 1999 the Ministry of Finance sat down a committee that evaluated the petroleum taxation. This committee delivered their findings in NOU 2000:18 *Skattlegging av petroleumsvirksomhet*, where they pointed to several weaknesses in the current taxation system for petroleum. It is based on their recommendations that the regime went through many changes in 2000. Two important objectives with these changes was to prevent the oil companies from undertaking activity on the shelf that was not socially profitable (Ot.prp. nr. 86, 2000-2001, p. 20), and that the oil companies could operate on more equal terms on the Norwegian shelf (Ot.prp. nr. 86, 2000-2001, p. 40). But it is important to point out that the solutions to transfer mispricing, the norm price system, was not evaluated by this committee (NOU 2000:18, p. 8).

One change that was made in this proposition was that the allocation rule concerning financial posts was changed. In the former regime the companies that were active in both Norway and in another country, could spread their debt interests between the two tax districts. That is income from extraction on the Norwegian shelf and the extraction companies' income from other activity. This allocation rule led the companies to allocate the debt interests to the shelf tax district. This was done because the payoff before tax on the shelf was much higher than in other activity, and the income from other activity was low because the subsidiary company rarely returned profits to the shelf company. The debt interest could then be subtracted based on a tax rate of 78% instead of 28% in the tax regime on land. This rule meant that the shelf company had lower financial costs than other companies on activity outside the shelf. Companies could then be tempted by tax motives to place other activity to the shelf company (Ot.prp. nr. 86, 2000-2001, p. 6). The proposition notes,

The unequal division of financial costs undermine the tax base on the shelf. The rule leads the shelf company to have lower costs than other

companies with activity outside the shelf. The allocation rule gives strong tax motives to place other activity into the shelf company. The financing advantage is a tax related subsidy that gives the shelf companies a definite advantage compared to the competition. The allocation rule makes it possible to undertake investments, establishments or purchases that are corporately profitable, but not socio-economic (Ot.prp. nr. 86, 2000-2001, p. 23, own translation).

The difference between taxation levels in the land tax regime and the tax regime on the shelf made it very important where an income or expense was deducted. Furthermore the shelf companies' foreign activities had increased over the years, and many of them had placed activity that was not related to the Norwegian shelf in the Norwegian extraction company (Ot.prp. nr. 86, 2000-2001, p. 24-25). In addition to this the former allocation rule made investments corporately profitable, but these were not socially profitable (Ot.prp. nr. 86, 2000-2001, p. 23). The new rule entailed that an extraction company's overall financial costs were to be allocated between the land tax district and the shelf tax district, based on the value of the tax related depreciation in the two tax districts (Ot.prp. nr. 86, 2000-2001, p. 6). This indicates that evasion considerations were important motivating factors for this change, since the government wanted more control over where the oil companies had their activity and if this activity was related to operations on the Norwegian shelf.

The new rule meant additional work for the tax administrators in the government and in the oil companies. The governments tax administrators had to control if the information given by the oil companies was correct, and tax administrators in the oil companies were required to provide documentation about where funds were allocated (Ot.prp. nr. 86, 2000-2001, p. 44). This meant that administrative considerations were devalued in this proposal, in the sense that the workload increased for both the state tax officials and tax experts in the oil companies. It was more important for the government that the oil companies operated on equal terms, and that new oil companies could be attracted to apply for licenses on the Norwegian shelf.

When a company evaluated if it was to apply for licenses on the Norwegian shelf it was important for the state to consider how long it would take before the company could be taxed and deduct its expenses. This meant that the companies that already had a taxable income had an advantage, and new companies could then have refrained from applying for licenses. The Ministry therefore permitted companies to carry their losses forward, and thereby place the companies on equal terms. This change was implemented to get new actors on the Norwegian shelf (Ot.prp. nr. 86, 2000-2001, p. 6). With more companies competing for licences the state

was improving efficiency on the shelf, and also increasing the government’s revenue. This indicates that efficiency considerations were a motivating factor for this change. In the former system the government had fewer companies to choose from, but with more companies competing for the same licenses the revenue from the shelf to the government could have increased, since the government most likely would pick the oil company that gave the most of the profit to the state. This indicates that fiscal considerations also were important in this change.

In the former regime the companies could deduct 50% of their deficits on the income from the shelf. This opportunity was removed because the government wanted to protect the petroleum taxation (Ot.prp. nr. 86, 2000-2001, p. 6). Furthermore the Ministry implemented a limitation in the opportunity to activate interest expenses as a cost price for the operating asset that is deducted after §3b in the petroleum tax law. The government wanted a more coherent set of rules, so the allocation of financial posts between shelf and land were to happen before the interest was activated (Ot.prp. nr. 86, 2000-2001, pp. 6-7).

Transfer mispricing is not mentioned in this proposition. Hence I have ranked this consideration as a 0 on the importance scale. Allocation considerations are not mentioned in this proposition and are therefore given a ranking of 0. Since efficiency, administrative and fiscal considerations are mentioned in the proposition these considerations are given a ranking of 1. Efficiency and fiscal considerations are mentioned on page 6. Administrative considerations are mentioned on page 44, in connection with what consequences the new rules about allocation of financial posts would have for the tax officials. The most important consideration in this proposition was evasion considerations. This evaluation is based on the fact that one of the changes were made to prevent the oil companies from allocating activity to the Norwegian shelf that was not tax deductible on the shelf, which is discussed from page six to page eight, page 14 to 16 and page 23 to page 37. Evasion considerations are addressed in more than 50% of the proposition and are ranked as 3 on the importance scale.

Table 4.6 Ranking of considerations (2000)

Fiscal	1
Allocation	0
Efficiency	1
Evasion	3
Administrative	1
<i>Transfer mispricing</i>	<i>0</i>

4.7 Determining the price of natural gas – 2010

The seventh case that is focused in this thesis is prop. 126 LS (2009-2010), *Endringar i skatte- og avgiftsreglane*. This proposition is 64 pages in length, but it addresses several changes to the taxation in general. Only one of the chapters contains information about changes to the petroleum taxation. The main focus is therefore from page 26 to page 36, since these pages contain this information. In total there are 11 pages that are analysed. This means that if a consideration is mentioned in more than 1.1 pages it will be given a rank of 2 on the importance scale, since 1.1 pages is 10% of 11 pages. If a consideration is evaluated in more than 5.5 pages it will be ranked as 3, since 5.5 pages is 50% of 11 pages. More than 50% of the pages in this proposition address transfer mispricing considerations. Fiscal, efficiency, administrative and evasion considerations are mentioned, but in less than 10% of the pages. Allocation considerations are not mentioned in this proposition.

“Gassforhandlingsutvalget” (the gas negotiation committee) had up until 2002 taken care of all sales of dry gas from the Norwegian shelf. The committee negotiated long term and neutral contracts, which then had to be approved by the Norwegian government. This arrangement created a clear demarcation between sellers and buyers of gas. The prices could therefore be used in the taxation of the companies. After 2002 the companies were themselves responsible for selling self-produced gas. This meant that the companies could sell to a subsidiary company, and set a price internally. This new situation therefore opened up the opportunity for transfer mispricing of natural gas. The oil companies had strong incentives to transfer most of the income from the Norwegian shelf to other parts of the company that were levied lower taxes, since there was a tax rate of 78% in the petroleum sector at this time (Prop. 126 LS, 2009-2010, pp. 26-27). This strong focus on this issue in the proposition indicates that transfer mispricing considerations were important.

The market for gas had grown over time, and companies that were liable to pay surtax in 2008 had gross revenues for dry gas and liquid natural gas of about 163 billion NOK, where 62 billion NOK were sales between subsidiaries. Here it is also interesting to note that after the oil companies were allowed to sell gas for themselves, internal sales increased from 4.2 billion NOK in 2002 to 61.8 billion NOK in 2008 (Prop. 126 LS, 2009-2010, p. 28). Natural gas was usually sold in large quanta, so that only small discrepancies from the market price

could have had large effects on tax incomes to the Norwegian state (Prop. 126 LS, 2009-2010, p. 28).

The oil companies were already instructed to give information about selling and buying oil to subsidiaries. They had a so-called filling requirement, meaning that the companies had to deliver a document that explained what kind of transactions there were between subsidiaries and the volume of these transactions. The Ministry believed that this arrangement did not provide the necessary guaranty to systematically collect the relevant market information that was needed for a tax control, since only sales between subsidiaries had to be documented to the government. The Ministry argued that sales between independent parties also had to be documented. Because if the government had information about pricing arrangements between subsidiaries and independent parties they could compare them, and this could refrain companies from selling gas at a lower price to subsidiaries, since the government had the opportunity to check if the price varied a lot between sales to subsidiaries and sales to independent parties (Prop. 126 LS, 2009-2010, pp. 28-29). The Ministry states that:

“Comparisons of prices and terms in transactions between independent parties and between subsidiaries is an important element in the evaluation of the conditions to adjust the income based on discretion are fulfilled and to determine the arm’s length price for subsidiaries (...)” (Prop. 126 LS, 2009-2010, p. 30, own translation).

In order for the tax authorities to have enough knowledge on the sales, the companies were required to provide a lot of information and these reports had to be delivered every quarter. Specifically they had to report whom the contract was between, when the arrangement was signed, the quantity of gas and how the price is set etc. If the companies did not deliver this report they were subject to a fine (Prop. 126 LS, 2009-2010, p. 34).

Changes made to petroleum taxation in this proposition indicate that transfer mispricing considerations were very important at this time. Since the system for selling gas had changed a lot over the years, the government felt that the current arrangement was not good enough. Transfer mispricing considerations are addressed in more than 50% of the proposition pages. All the analysed pages in this proposition concerns transfer mispricing considerations. Hence this consideration is given a rank of 3. Since the Norwegian state could potentially have lost a lot of revenue if they had not implemented changes to this part of the system, fiscal consideration also had an impact. In this regard the Ministry notes “If tax motivated internal pricing happens, the proposition will conduce to increased tax income from the extraction

companies” (Prop. 126 LS, 2009-2010, p. 35). Fiscal considerations are given a rank of 1 on the importance scale, since it is evaluated in less than 10% of the proposition pages. Administrative considerations and efficiency considerations are mentioned in the proposition. All of these are given a rank of 1. Allocation considerations are given a rank of 0 on the importance scale since these considerations are not mentioned.

Table 4.7 Ranking of considerations (2010)

Fiscal	1
Allocation	0
Efficiency	1
Evasion	1
Administrative	1
<i>Transfer mispricing</i>	3

4.8 The current regime – 2013

The eighth and last case that is focused in this thesis is prop. 150 LS (2012-2013), *Endringar i skatte-, avgifts- og tollovgivninga*. This proposition is 70 pages in length, but only one of the chapters contains information about changes to the petroleum taxation. The remaining chapters address changes to the taxation in general. The main focus is therefore from page 10 to page 16, since these pages contain information about the petroleum taxation. In total there are 7 pages that are analysed. This means that if a consideration is mentioned in more than 0.7 pages it will be given a rank of 2 on the importance scale, since 0.7 pages is 10% of 7 pages. If a consideration is evaluated in more than 3.5 pages it will be ranked as 3, since 3.5 pages is 50% of 7 pages. Fiscal considerations are addressed in more than 50% of the proposition pages. Transfer mispricing, administrative and efficiency considerations are evaluated in less than 10% of the pages, but are mentioned. Allocation and evasion considerations are not mentioned.

The most recent change to the petroleum taxation was in a proposition from May 7th 2013. Here the Ministry proposed a retrenchment in the non-taxable income from 7.5% to 5.5%. This meant that the oil companies had to carry a larger part of their investments. The Ministry argued that the oil companies would be more cost conscious and “(...) more of the risk of overspending would be transferred to the companies” (Prop. 150 LS, 2012-2013, p. 14). With this change the Norwegian government would increase its profits from the petroleum activity (Prop. 150 LS, 2012-2013, pp. 14-15), which indicates that this change was made because of

fiscal considerations. These considerations are evaluated in more than 50% of the proposition pages, from page 12 to page 16. Hence this consideration is ranked as 3 on the importance scale. There are not made any other changes in this proposition. Transfer mispricing and administrative considerations are mentioned in the proposition, and are given a ranking of 1. Transfer mispricing are mentioned on page 11 in connection with the norm price system. Administrative considerations are mentioned on page 15, about the extra work the new regulations would have on the tax officials. Evasion, efficiency and allocation considerations are ranked as 0 since they are not mentioned.

Table 4.8 Ranking of considerations (2013)

Fiscal	3
Allocation	0
Efficiency	0
Evasion	0
Administrative	1
<i>Transfer mispricing</i>	<i>1</i>

5 Discussion – The change over time

The main question in this thesis has been: How important has transfer mispricing been in the construction of the current Norwegian tax regime for the petroleum industry? By looking at the change over time I might be able to answer this question. To do this I will sum up which of the considerations have been most important in the propositions I have included in the analysis. This helps strengthen my argument about how important transfer mispricing has been over the years. In the appendix there is a description of all the propositions that concerns the petroleum tax. At the end of this section I will sum up which of the considerations are most important in these propositions, and see if this coincides with the findings in chapter four.

In order to have a similar system as Norway, expertise and integrity needs to be present. Or else simpler regimes are preferable (Osmundsen, 2010, p. 442). The Norwegian petroleum tax has been stable, even though the price of oil has risen in the recent years. Other countries, like the UK, have had several tax increases in the same period (Osmundsen, 2010, p. 437). This is a good strategy from the Norwegian government, because it should not introduce fiscal changes based on the fluctuations in the oil price. The tax base should be stable. This ensures interest from investors, and might also attract new ones (Nakhle 2010:114). The current petroleum tax system is based on the ordinary tax rules for land-based activity. Income from activity on the shelf has an ordinary corporate tax, which is 28%. An additional tax of 50% is also levied since the possibilities of return profits are very good. Therefore the marginal tax the corporations have to pay is 78% (Prop. 150 LS, 2012-2013, p. 11). In this regime it might have been easy for the multinational corporation to escape the high tax rate in Norway, because if two related corporations traded with each other, it would have been difficult for the tax authorities to evaluate if the price paid was the market price. But the norm price system that was introduced in 1975 is designed to stop transfer mispricing from happening on the Norwegian shelf. Let us have a closer look at which consideration has been most important over time.

Table 5.1 Overall ranking of each consideration

	Year								Sum
	1965	1975	1980	1986	1992	2000	2010	2013	
Fiscal	1	3	2	0	1	1	1	3	12
Allocation	0	1	1	0	0	0	0	0	2
Efficiency	3	2	1	2	2	1	1	0	12
Evasion	0	2	1	0	0	3	1	0	7
Administrative	0	2	1	1	1	1	1	1	8
<i>Transfer mispricing</i>	0	2	1	1	1	0	3	1	9

Table 5.1 indicates which of the considerations have been most important over the years. Here I have included all the propositions, and what rank each consideration received on the importance scale. At the far right side of the table there is a column called “sum”, where I have added up all the ranks each consideration has been given over the years. This is an index of the importance of each consideration over the entire period. This column shows that efficiency and fiscal considerations have been the most important consideration over time, since both of them have a sum of 12. But we can see that transfer mispricing considerations also have been important when changes have been made to the petroleum taxation, with a total of nine over the years. I will now go through each of the considerations and see what changes have been made over time.

As was mentioned above, efficiency considerations have been very important over the years. We can see that this consideration has been mentioned or evaluated in almost all of the propositions, and it has been the most important consideration in three of the propositions (1965, 1986 and 1992). In the proposition from 2013 efficiency considerations were given a rank of 0, but in the propositions from 1980, 2000 and 2010 this consideration is given a rank of 1. With a rank of 3 in 1965 and 2 in the remaining propositions, efficiency considerations end up with a total of 12. This consideration has the same sum as fiscal considerations.

It is especially in the first tax regime introduced by the Norwegian government that efficiency considerations played an important part. This regime was favourable for the oil companies, since there were only standard taxes. One reason for this was that the development of the oil in the North Sea was still uncertain at this point and it was geologically challenging to search/drill for oil in the area. To ensure that international oil companies would invest the officials could not have “super profit taxes”. The most important objective at this time was to attract investments from oil companies, and thereby increase the efficiency and profits from the shelf. But this was just an initial tax regime; the system has evolved, and gone through

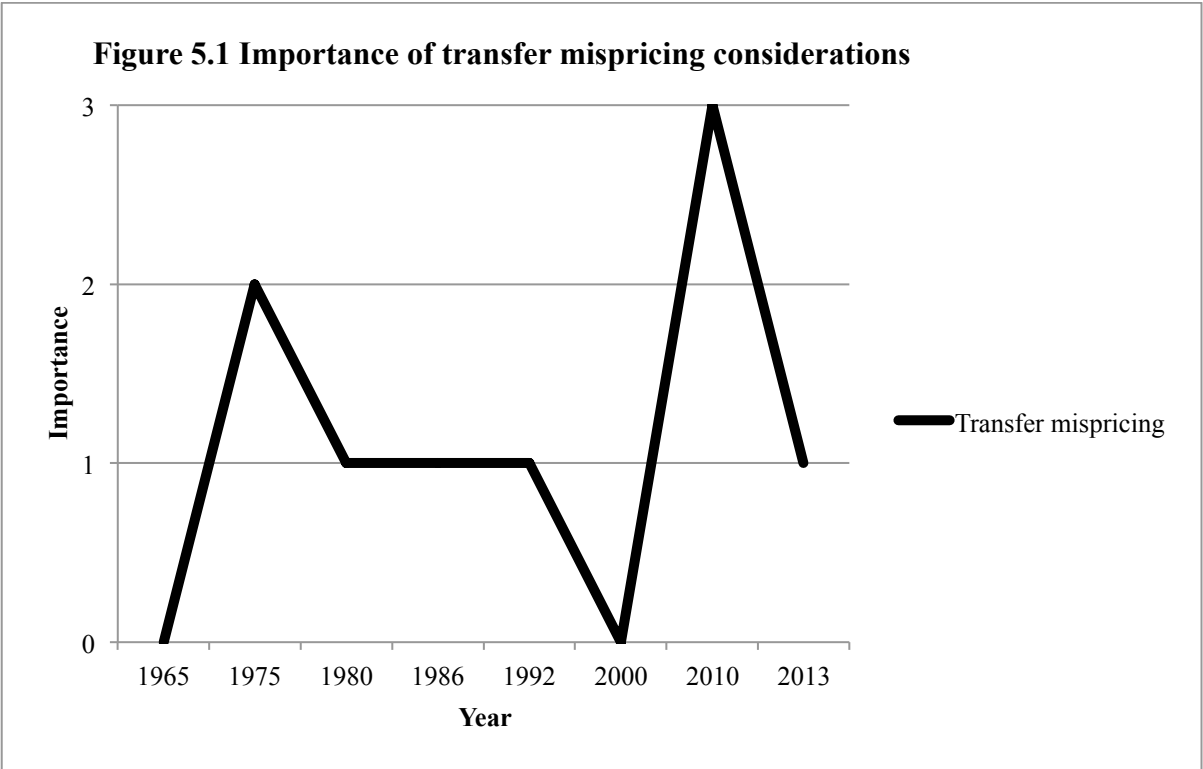
many changes. At the planning stage for a prospected oil field, the government has an incentive to offer a generous tax regime in order to attract activity from international oil companies. This often changes when production starts, and the government implement higher taxes for the oil. After investing in an oil field it is more profitable for the oil company to continue production than to close it down. This is what is called the “obsolescing bargain” (Broadway & Keen 2010:15). This seems also to be true for the Norwegian case, since fiscal considerations were the most important in 1975.

In the proposition from 1992, the government introduced the non-taxable income in part to attract new activity to the field, because asymmetric information can be a problem, since the oil company has a lot of expertise in the extraction of oil (costs, risks etc.) while governments might not. As Glomsrød & Osmundsen note: “Multinational oil companies may focus more on tax management than on petroleum resource management” (Glomsrød & Osmundsen 2005:3). In a situation with only one company interested in the oil the government might be in a bad position, but when there are a number of companies wanting to have the license to look for oil this will not be a problem (Humphreys, Sachs & Stiglitz 2007:5).

From table 5.1 we can see that fiscal considerations were very important in 1975 and 1980, since it has a ranking of 3 and 2 in these propositions. From 1986 to 2010 it was not the most important consideration when changes were made to the taxation system, since it has a rank of 0 in 1986, and 1 in the following propositions. However in 2013 it is given a ranking of 3, indicating that this has become more important in newer time. Fiscal considerations end up with a total of 12, which is as mentioned before a high total score. As my analysis results show fiscal considerations have played an important part in several propositions. In the tax regime introduced in 1975, which is the first comprehensive taxation law for the petroleum industry, the government wanted to secure more of the profits. This was done by introducing a surtax, and as time has gone by this tax has increased regularly. As I mentioned above the surtax rate is now on 50%, and it has not changed since 1992 (Prop. 150 LS, 2012-2013, p. 11).

Allocation, evasion and administrative considerations have not shown great importance. Allocation considerations are rarely mentioned or evaluated in the propositions I have chosen to focus in my analysis. This consideration ends up with a total of 2, since it is ranked as 1 in 1975 and 1980. These findings indicate that allocation considerations have so far not been important when changes have been made to the Norwegian petroleum taxation. Evasion

considerations have not been very important. These considerations are given a ranking of 3 and 2 once, but in the remaining propositions they are only given 1 or 0. Evasion considerations end up with a total of 7. It is especially in the proposition from 2000 that evasion considerations were important, with a ranking of three. This was in the connection with new rules regarding the allocation of financial posts. Even though administrative considerations have not been the most important consideration over the years, these considerations have been mentioned in all propositions except for 1965, and are also given a ranking of 2 in one proposition. Administrative considerations end up with a total of 8, which indicates that this has been more important than evasion and allocation considerations.



Since my main focus in this thesis is transfer mispricing I have included figure 5.1 to get a better sense of how the importance of it has changed over the years. Transfer mispricing considerations end up with a total of 9 on the importance scale. In 1975 and 2010 transfer mispricing had a strong focus, but in 1965 and 2000 these considerations were not mentioned. In 1980, 1986, 1992 and 2013 transfer mispricing considerations are mentioned. But there was not an evaluation about the current situation for this consideration. These findings indicate that transfer mispricing considerations have not been the *most important* consideration when changes have been made to the petroleum taxation system, but I argue that they have been important. Since its implementation in 1975, there have not been any

changes to the norm price system, but this does not mean that it has not been important. On the contrary, transfer mispricing seems to be a constant problem for host countries. The fact that the norm price system still is in place, and has not been changed, supports this argument.

One thing that might help uncover why transfer mispricing was not important at the time of the first proposition in 1965, was that before the mid-1960s there was no market price for oil, making it hard for the producer states to negotiate how much the oil corporations had to pay in taxes. Import quotas and government production determined the price of crude oil in the US. In other areas, crude oil was transferred within the firm to their own refinery, or traded between the large oil corporations. Tax paid to the producer countries was then calculated by using a benchmark called “posted price” that was set by the oil firms. The tax per barrel was set at 50% of that figure (Mitchell, 2013, p. 167-168). The oil corporations had a lot of power at this time, which Hudson’s (2000) example also showed.

The arm’s length price is, as mentioned earlier, the price set by two unrelated corporations. The norm price system introduced in 1975 is an approach to the arm’s length principle, and this principle says that the price should be the same as if the two companies were unrelated parties negotiating in a normal market (Tax Justice Network, 2013). This approach to dealing with transfer mispricing is endorsed by the OECD and the United Nations Tax committee, and it is not likely that they will embrace a new approach (The Economist, 2013). The norm prices are set by “Petroleumsprisrådet”, and are supposed to correspond with the prices two independent parties pay when trading with each other (Prop. 150 LS, 2013, p. 14; Woldseth & Syversen, 1978, pp. 5-7). “Petroleumsprisrådet” meets once every quarter to determine norm prices for the previous quarter (Olje- og Energidepartementet, 2013). If the sale price is higher than the norm price, it is tax-free. But if the sale price is lower than the norm price the corporation is levied a tax. Up to now norm prices have been set for propane and crude oil (Prop. 150 LS, 2013, p. 14). The Norwegian officials use guidelines provided by the OECD in this process, because (in effect) the norm price is the same as the arm’s length price endorsed by the OECD. In the Tax Act §13-1 it is pointed out that the guidelines on transfer pricing should be followed, as long as they fit (Skatteloven (2014), §13-1). This particular reference has been there since 2008 (OECD, 2013). I have not found any indications that the norm price system will be replaced with any other arrangements that could be used to escape the problems that are related to transfer mispricing.

Many argue that increased transparency in transactions between governments and multinational corporations is a solution to transfer mispricing. The Extractive Industries Transparency Initiative (EITI) is a coalition of governments and corporations that works to improve openness concerning revenues from extractive industries like oil. Governments disclose payments and taxes received from oil, mining and gas companies in an annual report from the EITI. Citizens can then control how much they actually receive from their natural resources (EITI 2013). Norway delivered its fifth EITI report December 20th 2012. This report contains information on how much oil corporations have paid to the state in 2012, and also how much each company has paid to the Norwegian government (Regjeringen, 2013b). A combination of this initiative and the norm price system seems like a good solution to controlling transfer mispricing.

As my analysis results show the Norwegian government has tried to organize the tax system in several ways over the years. From 1965 there was a tax based on how much oil was pumped; a so-called production-based taxation. From 1986 to 2000 this tax was phased out, and it is not a part of the tax on oil. There are many reasons why the production-based taxation was a part of the initial regime, but was faded out. Glomsrød & Osmundsen (2005, p. 2) assert that this tax is easy to administer, and this is probably why it was introduced in the first place. As the Norwegian tax regime has matured and the tax officials have obtained a lot of experience in taxing multinational oil companies, they have removed elements from the taxation that are non-neutral and force the oil companies to close down petroleum fields prematurely (Glomsrød & Osmundsen, 2005, p. 2). In NOU 2000:18 they point to this issue with the production based taxation. Saying that it can affect the decision to shut down fields as an alternative to continue the production. The committee indicated that this influence is modest, but that the companies' willingness to make additional investments in existing fields could be affected by this kind of taxation (NOU 2000:18, p. 153). Developing countries often use royalties to ensure that they get a share of the oil revenue immediately. It might take a lot of time to develop an oil field, meaning that the oil company does not have any profits in the first period of production. With production based taxation the developing country gets a share of the revenue from the onset (Johnston, 2007, p. 71). Some regard production-based taxes to be the simplest to administer (Calder, 2010, p. 320; Glomsrød & Osmundsen, 2005, p. 2; Radon, 2007, p. 104), making them very popular among developing countries. But it requires the government to have complex and sensitive equipment, because it has to monitor how

much oil is produced and the quality of the oil that is pumped up (Calder, 2010, p. 320), so there are challenges with this type of taxation as well.

Table 5.2: Most important consideration over time

Proposition	Consideration	Proposition	Consideration
Ot.prp. nr. 47 (1964-65)	<i>Efficiency</i>	Ot.prp. nr. 12 (1994-95)	<i>Fiscal</i>
Ot.prp. nr. 26 (1974-75)	<i>Fiscal</i>	Ot.prp. nr. 47 (1995-96)	<i>Not assigned</i>
Ot.prp. nr. 70 (1976-77)	<i>Not assigned</i>	Ot.prp. nr. 36 (1997-98)	<i>Not assigned</i>
Ot.prp. nr. 19 (1977-78)	<i>Not assigned</i>	Ot.prp. nr. 86 (1998-99)	<i>Administrative</i>
Ot.prp. nr. 27 (1978-79)	<i>Not assigned</i>	Ot.prp. nr. 86 (2000-2001)	<i>Evasion</i>
Ot.prp. nr. 60 (1978-79)	<i>Not assigned</i>	Ot.prp. nr. 16 (2001-2002)	<i>Efficiency</i>
Ot.prp. nr. 18 (1979-80)	<i>Administrative</i>	Ot.prp. nr. 34 (2001-2002)	<i>Administrative</i>
Ot.prp. nr. 37 (1979-80)	<i>Fiscal</i>	Ot.prp. nr. 84 (2001-2002)	<i>Not assigned</i>
Ot.prp. nr. 26 (1980-81)	<i>Not assigned</i>	Ot.prp. nr. 1 (2002-2003)	<i>Administrative</i>
Ot.prp. nr. 42 (1981-82)	<i>Fiscal</i>	Ot.prp. nr. 92 (2002-2003)	<i>Administrative</i>
Ot.prp. nr. 78 (1981-82)	<i>Evasion</i>	Ot.prp. nr. 1 (2003-2004)	<i>Not assigned</i>
Ot.prp. nr. 7 (1983-84)	<i>Efficiency</i>	Ot.prp. nr. 1 (2004-2005)	<i>Efficiency</i>
Ot.prp. nr. 19 (1983-84)	<i>Not assigned</i>	Ot.prp. nr. 1 (2005-2006)	<i>Transfer mispricing</i>
Ot.prp. nr. 60 (1983-84)	<i>Evasion</i>	Ot.prp. nr. 1 (2006-2007)	<i>Evasion</i>
Ot.prp. nr. 33 (1985-86)	<i>Not assigned</i>	Ot.prp. nr. 61 (2006-2007)	<i>Not assigned</i>
Ot.prp. nr. 3 (1986-87)	<i>Efficiency</i>	Ot.prp. nr. 59 (2007-2008)	<i>Not assigned</i>
Ot.prp. nr. 61 (1986-87)	<i>Not assigned</i>	Ot.prp. nr. 1 (2008-2009)	<i>Not assigned</i>
Ot.prp. nr. 12 (1987-88)	<i>Not assigned</i>	Ot.prp. nr. 95 (2008-2009)	<i>Not assigned</i>
Ot.prp. nr. 60 (1987-88)	<i>Not assigned</i>	Prop. 1 L (2009-2010)	<i>Not assigned</i>
Ot.prp. nr. 34 (1990-91)	<i>Efficiency</i>	Prop. 126 LS (2009-2010)	<i>Transfer mispricing</i>
Ot.prp. nr. 12 (1991-92)	<i>Efficiency</i>	Prop. 150 LS (2012-2013)	<i>Efficiency</i>
Ot.prp. nr. 64 (1991-92)	<i>Not assigned</i>		

From table 5.2 we can see that in 20 of the propositions I have not assigned any specific consideration. This is not done because it was not possible to conclude which of the six considerations were most important in these cases. Some of the propositions include technical changes, like in 1977 when misconceptions about the depreciation were clarified (Ot.prp. nr. 19, 1977-1978, pp. 1-2), but it is difficult to say if this was done because of administrative, efficiency or fiscal considerations. Other propositions contain information about taxation rules for foreign workers (Ot.prp. nr. 60, 1978-1979, p. 7), and it has been hard to pinpoint one of the considerations in these cases. This is the reason why as many as 20 propositions have not been assigned a consideration.

Table 5.3 Summary of most important consideration

<i>Efficiency</i>	8 propositions
<i>Administrative</i>	5 propositions
<i>Fiscal</i>	4 propositions
<i>Evasion</i>	4 propositions
<i>Transfer mispricing</i>	2 propositions
<i>Allocation</i>	0 propositions

If we take a closer look at table 5.2 we can see that many of the same considerations are important in the propositions in the appendix as in my analysis results. In table 5.3 I have made a summary of how many times each consideration has been the most important. In this summary I have also included the propositions in the appendix, and this strengthens my findings from table 5.1. We can see that efficiency considerations have also been important in many of the propositions included in the appendix. All in all we can see that efficiency considerations end up being the most important consideration in this table, since efficiency considerations have been the most important consideration in eight propositions. Administrative considerations have been the most important consideration in five propositions, and fiscal considerations have been the most important consideration in four propositions. Transfer mispricing has only been the most important consideration in two propositions. Allocation considerations are not the most important consideration in any of the propositions I have identified. But evasion considerations stand out, because these considerations have been important in three of the propositions in the appendix, while they were only the most important consideration in one of the propositions in my analysis. Evasion considerations might be more important than my results show, but there is no reason to believe that I would have reached a different conclusion about the importance of transfer mispricing.

6 Conclusion

Pak's study from 2012 found that from 2000 to 2010 over \$110 billion have disappeared through mispricing of crude oil in the EU and the US (Pak, 2012, p. 36). Because of the high tax level on the Norwegian shelf there are strong incentives for the enterprises to transfer incomes to a low-tax regime (NOU 2000:18, p. 159). But oil resources on the Norwegian shelf belong to the fellowship, and the surplus in this sector is important for the future financing of the welfare society. The tax system in the petroleum sector should therefore secure the extraordinary profit for the Norwegian people, since they are the owners of the resources (Prop. 150 LS, 2012-2013, p. 12). This is why I have turned focus to transfer mispricing in this thesis, which is a strategy that shifts income out of the host country (Glomsrød & Osmundsen, 2005, p. 3).

In this thesis I have tracked each change in the taxation of petroleum extraction on the Norwegian shelf from 1965 in an attempt to find more information about transfer mispricing, and how the Norwegian tax regime is built up in order to escape this problem. Norway was chosen as a case because it has been able to keep a large portion of the profits from the petroleum extraction within its borders. In 2007 it had 31% of its total income from the petroleum industry (Osmundsen, 2010, p. 435). By creating a typology with six considerations, and testing how important each of these have been in eight cases, I have tried to answer the question: how important has transfer mispricing been in the construction of the current Norwegian tax regime for petroleum? My findings show that transfer mispricing has not been the most important consideration when changes have been made to the tax regime. I find that efficiency and fiscal considerations have been the most important considerations. But transfer mispricing has been an important consideration for tax officials when they have made changes to the petroleum taxation system. This evaluation is based on the simple fact that the Norwegian tax officials have established a way of pricing petroleum, and supervising the transactions between the companies operating on the Norwegian shelf. The norm price system is the Norwegian approach to the arm's length principle, which is a principle that states that the price should be the same as if the two companies involved in the transaction "(...) were indeed two unrelated parties negotiating in a normal market, and not part of the same corporate structure" (Tax Justice Network, 2013). Tax rules often reflect the current price situation and prospects at a certain time, but the norm price system has not changed since its implementation in 1975 (Ot.prp. nr. 26, 1974-1975, pp. 15-16), and this fact

strengthens my argument that transfer mispricing is a problem that is constant over time, which requires there to be elements in the taxation system that controls transactions between the multinational corporations operating on the shelf. Based on findings in this thesis I conclude with this hypothesis: Transfer mispricing is not the most important consideration when changes are made in a petroleum tax regime, but it is a problem that is constant over time, and has to be dealt with if the host countries do not want to lose revenue from the petroleum extraction.

I chose to do a hypothesis-generating case study because there is very little theory on transfer mispricing and the evidence of it is impressionistic and partial (Dunning, 1981, p. 31). Furthermore I employed a testing where I ranked the importance of each consideration based on percentages of pages that was dedicated to each of them in eight propositions. The testing of each proposition could have been done in another way. E.g. instead of dividing the proposition into percentages, one could have counted how many times each consideration is mentioned in the proposition. The operationalizing of importance is not done in this way because in many of the cases the considerations are not specifically mentioned, and that meant that all of the propositions had to be read thoroughly in order to identify what consideration was most important in each case. In retrospect I see that the ranking could have gone from 0 to 5 instead of 0 to 3. The ranking I employed in my analysis made it easy to get a ranking of 1, since it only required that a consideration was mentioned in a proposition. The same goes for receiving a rank of 2, which required 10% of the proposition pages to contain information about a specific consideration. With a ranking from 0 to 5 it might have been easier to see if one of the considerations was more prominent than the others over time. The case selection could have had an impact on my results. The eight propositions I have chosen to focus on are spread across time, and might therefore give a sense of how important transfer mispricing has been in the construction of the current Norwegian tax regime for petroleum. But we would have had the best results if all the propositions had been analysed just as thoroughly as the eight I have selected, but this would have taken too much time and space.

Fiscal, allocation, efficiency, evasion and administrative considerations were chosen because an Official Norwegian Report (NOU 1989:14, p. 93) highlighted them as being important considerations in a tax regime. I added the transfer mispricing considerations because I wanted to turn focus to this problem. But this could have affected my results, since transfer mispricing might overlap with the other considerations. E.g. in the proposition from 2010

(Prop. 126 LS, 2009-2010, pp. 26-27) I have ranked transfer mispricing as 3 on the importance scale, while fiscal considerations are given a rank of 1. But if transfer mispricing had not been a consideration I might have given the other considerations a different rank. In this example it would have been logical to give fiscal considerations a rank of 3 instead of 1, since the change would have a positive effect on fiscal considerations. This is a problem with the testing I have chosen. But there are also some issues with the other considerations I employ in the analysis. Allocation considerations are supposed to make the distribution of the profits between the state and the oil companies fair, but my testing shows that they are rarely mentioned in the propositions. This might be because it is hard to identify these considerations in a proposition, since views of the oil companies are not included in most of the cases, and that makes it difficult to say that a change is made to make the distribution fairer. The propositions usually only contains the government's understanding of fair and this might not coincide with the oil companies' understanding of fair. Allocation considerations should therefore be evaluated from both sides in future research. But I argue that these concerns do not change my conclusion that transfer mispricing is a problem that is constant over time.

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Appendix

1977

In 1977 the government implemented new rules regarding taxation of foreign workers working on the Norwegian shelf. The oil companies were instructed to give information about all of their workers (Ot.prp. nr. 70, 1976-1977, pp. 12-13).

In 1977 the government also clarified misconceptions concerning the depreciation rules (Ot.prp. nr. 19, 1977-1978, pp. 1-2).

1978

In 1978 oil companies with extraction permits could not get deductions on the income tax assessment for covering future expenses on removing installations. This was due to the uncertainty at this time about what will happen when the concession time is over. The Ministry of Finance needed more time to evaluate this subject (Ot.prp. nr. 27, 1978-1979, p. 2).

1979

In 1979 the government changed the taxation rules concerning foreign workers on the Norwegian shelf (Ot.prp. nr. 60, 1978-1979, p. 7).

In 1979 the government opened up the opportunity for other public authorities to receive information about companies and persons that were taxable on the Norwegian shelf. This was done because the Ministry for Oil and Energy could not get this information from the tax board. It was necessary for the Ministry to have as much information as possible about the companies, to ensure that the estimates in the propositions to the Parliament about future taxes were to be correct (Ot.prp. nr. 18, 1979-1980, p. 11).

1981

In 1981 the government evaluated if there should be implemented rules about limitations in the right to deduct interest paid, but no changes were made at this time. The Ministry argued that the options they had had to be closely mapped out before they could take any decisions in this question (Ot.prp. nr. 26, 1980-1981, p. 48).

1982

In 1982 the transportation of petroleum through pipelines to Norway was taken in to the geographical sphere of the petroleum tax law. This was done because the plant that was under construction at Kårstø would not be subject to surtax. Activity on Norwegian soil was not under the petroleum tax laws sphere; this would mean that the Norwegian state could lose a lot of revenues. In addition to this the Ministry of Finance sharpened three other paragraphs in the tax law: the rules about conditional tax exemption, that the tax in instalments was no to be treated differently in the capital assessment than the advance tax and that “Oljeskattenemnda” (the oil tax board) could reassess the taxation of profits made before 1980 (Ot.prp. nr. 42, 1981-1982, pp. 1-4).

Specifications were given in 1982 about where financial profits and expenses should be allocated. The oil companies’ profits and expenses of variations in the exchange rate and interests were to be treated equally when it comes to choosing which taxation area they were allocated to. These types of financial profits would after this proposition be laid to the taxation regime on the shelf. The Ministry argued that this arrangement would lead to delimitation in the obligation to pay surtax to the state. This was more consistent with the initial conditions in the petroleum tax law (Ot.prp. nr. 78, 1981-1982, pp. 2-4). The Ministry also demanded the companies to appropriate to a reserve fund the activity that was taxable in Norway. In some tax agreements there were rules that gave a branch of a foreign company the right to claim deductions for dividend payments in the income that is taxed in Norway, as if the company was a Norwegian company. A reserve fund would make it easier for the tax officials to know if the oil companies were following the rules (Ot.prp. nr. 78, 1981-1982, p. 1).

1983

In connection with a water injection project on the Ekofisk field, the Ministry implemented temporary amendments to the petroleum tax law. More specifically the licensee could deduct investments in connection with this project earlier than the petroleum tax law had allowed. The companies would then receive their income faster, while the tax payments to the state would be delayed. This was done because there were a lot of risks involved in starting this project, since water injection was a new method. The government wanted to give the companies incentives to start the project (Ot.prp. nr. 7, 1983-1984, p. 2).

In 1983 the petroleum tax law went through a few changes that were aimed at making the depreciation rules easier to understand and practising (Ot.prp. nr. 19, 1983-1984, p. 7).

1984

The Ministry of Finance proposed in 1984 that property tax on installations or operating assets in connection with transportation of petroleum through pipelines could not be collected. The Ministry believed that the oil companies were levied a sufficient tax, and that the municipalities would benefit from the increased activity the oil industry brought with it. But there were not made any decisions to this matter in this proposition (Ot.prp. nr. 60, 1983-1984, p. 4). Furthermore the Ministry proposed measures that would make it easier for oil companies to reorganize their operations. This was done because the government implemented rules that ordered the oil companies to run their operations through a Norwegian based company. If a company has operations in both Norway and in its home country it makes tax assessment complicated for the Norwegian tax officials, because it is difficult to allocate the profits and expenses between the countries. The officials would have had to look at the companies' balance sheets abroad, but this could have been both legally and practically difficult. Practically difficult because the work would be very labour-intensive, and legally difficult since many countries have accounting acts and tax acts where the authorities are not allowed to disclose this kind of information (Ot.prp. nr. 60, 1983-1984, p. 5).

Evasion considerations are not specifically mentioned, but the proposition emphasises how difficult the tax assessment is for the officials in Norway when companies have operations in several countries: "In cases like this it might be difficult to divide the companies' profits and expenses between the different countries" (Ot.prp. nr. 60, 1983-1984, p. 5). The change was made out of administrative considerations, since it aims at making tax assessment easier for the Norwegian officials. But evasion concerns are the underlying problem that motivated this change in the current system. This was due to the large focus in the proposition on oil companies having subsidiaries in other countries, and that tax assessment is very difficult in these circumstances.

1986

In 1986 the Ministry of Finance addressed the issue concerning removal of devices and plants on the Norwegian shelf. More specifically the Ministry stipulated how the expenses from this were to be allocated between the state and the companies (Ot.prp. nr. 33, 1985-1986, pp. 3-4).

The Ministry had evaluated if the tax system could be used to allocate the removal expenses between the state and the oil companies, but this would affect the oil companies' cost consciousness. E.g. the companies could have been given tax-free allocations to cover this expense in the future. But it was not known how long a project would last, since new developments could prolong a field's durability. This would then require a specialized tax committee working with controlling how much the company would get tax-free and that the information given by the companies was correct. Using the tax system was not a realistic option (Ot.prp. nr. 33, 1985-1986, pp. 12). The Ministry settled on a solution where the companies are responsible of removing devices and equipment from the shelf. The government then covers its portion of the expenses through direct payments as the expenses accumulate. This alternative was chosen because the oil companies had a lot of expertise in this area, and it would not require a new extensive governmental system (Ot.prp. nr. 33, 1985-1986, pp. 14).

1987

New regulations concerning change of ownership on the shelf were implemented in 1987. These amendments were aimed at clarifying the tax-related issues that arise when ownership of a license is changed (Ot.prp. nr. 61, 1986-1987, pp. 4-5) and reduce the tax-related barriers that exist for ownership transfers (Ot.prp. nr. 61, 1986-1987, p. 12). Furthermore it was aimed at making the tax treatment equal for all kinds of ownership transfers (Ot.prp. nr. 61, 1986-1987, p. 11). In order to achieve these objectives the Ministry proposed that a transfer of ownership could not happen unless the King had given his consent to the tax-related effects. The King was also given the ability to modify the tax law (Ot.prp. nr. 61, 1986-1987, p. 22).

The Ministry implemented central tax assessment of oil companies without permanent connection to the kingdom. This was done to "(...) get a safer and quicker follow-up of this taxpayer group (...)" (Ot.prp. nr. 12, 1987-1988, p. 1).

1988

The complaints board increased to seven members, and was also given the opportunity to divide into two branches (Ot.prp. nr. 60, 1987-1988, p. 40). The motivating factor for this change was to reduce the case processing time for complaints about tax decisions after the petroleum tax act for companies that extract oil or transport oil through pipelines (Ot.prp. nr. 60, 1987-1988, p. 3). Changes made in this proposition were not expected to bring about any direct economic consequences (Ot.prp. nr. 60, 1987-1988, p. 4).

1991

The Ministry of Finance and Customs implemented a new arrangement where the companies working with extraction and transportation of petroleum could ask for binding prior statements from “Oljeskattenemnda” (the oil tax board) about the future taxation on a field (Ot.prp. nr. 34, 1990-1991, p. 22). One motivating factor for this arrangement was that it made it more predictable for the oil companies to invest on the Norwegian shelf, and this could increase the efficiency on the shelf (Ot.prp. nr. 34, 1990-1991, p. 8).

1992

In 1992 branches were placed on equal terms with Norwegian private companies with regard to calculating and paying dividend (Ot.prp. nr. 64, 1991-1992, p. 54). The Ministry of Finance and Customs argued, “The economic framework conditions for participants on the Norwegian shelf should to a great extent be the same however the activity is organized” (Ot.prp. nr. 64, 1991-1992, p. 39).

1994

The Ministry of Finance introduced a minimum capital rule, which was meant to limit the tax-related imbalance that made debt financing favourable for the extraction companies. This regulation could reduce the possibility the companies had of financing activity with loans since it set tax-based limits for deductions for financial costs. The tax assessment would be more demanding for the officials, since the rule would be a new element in the petroleum tax act. The Ministry argued that this additional work was necessary to secure that reduction in equity capital would not undermine the tax base in the petroleum sector (Ot.prp. nr. 12, 1994-1995, p. 20). The reason why the government wanted to reduce loan financing on the shelf was that this type of financing was only levied a tax of 28%, while financing with capital was levied a tax of 78% (Ot.prp. nr. 12, 1994-1995, p. 3).

1996

Changes were made to §10 in the petroleum tax act, which concerns transferring production facilities from the oil companies to the state (Ot.prp. nr. 47, 1995-1996, p. 3). This change addressed when the oil companies could claim deductions from removing production facilities on the shelf (Ot.prp. nr. 47, 1995-1996, p. 8). A few phrases in the petroleum tax act were also changed, so that they would be more clearly understood and not misinterpreted by the oil companies (Ot.prp. nr. 47, 1995-1996, p. 5).

1997

In 1997 the Ministry of Finance implemented special rules for taxing rented moveable production units, which were aimed at making tax treatment of owned and rented production units more equal. This change led to a more complicated taxation system, with more work for the tax officials (Ot.prp. nr. 36, 1997-1998, p. 24).

1999

The King had had the power of attorney to determine more detailed regulations or resolutions for the petroleum taxation, but this was changed in 1999. The Finance Ministry was given this power of attorney because many of the resolutions were very technical. This would make the system more effective, since all the regulations did not have to be presented in the cabinet meetings (Ot.prp. nr. 86, 1998-1999, pp. 3-4).

2001

The Ministry of Finance increased the depreciation percentage for pipelines and production equipment used in transportation and production of gas that was to be cooled down to liquid form in a new cool down plant. This was done to give the companies incentives to invest in this project (Ot.prp. nr. 16, 2001-2002, pp. 2-3).

In 2001 “Oljeskattekontoret” (the oil tax office) was given the responsibility of representing the state in lawsuits concerning tax assessment issues. The Finance Ministry had this role before 2001 (Ot.prp. nr. 34, 2001-2002, p. 14).

2002

In 2002 changes were made to the composition of “Oljeskattenemnda” (the oil tax board) (Ot.prp. nr 1, 2002-2003, pp. 47-48). The Ministry for Finance also proposed a geographical limit for certain depreciation arrangements in the petroleum tax law. In specific this entailed that depreciation rules for investments in Liquefied Natural Gas (LNG) plants could only be given if the plant was situated within a defined geographical area. This was necessary to specify because the EFTA surveillance authority meant that the current arrangement was government support, which is not allowed within EFTA (Ot.prp. nr. 84, 2001-2002, pp. 2-3).

The composition of “Oljeskattenemnda” (the oil tax board) was changed in 2002. There was not going to be *personal* substitutes anymore. If one of the permanent members of the board was away, any of the five substitutes could be called in (Ot.prp. nr. 1, 2002-2003, p. 47).

2003

The Ministry of Finance set aside the law concerning subsidies to remove equipment on the shelf. Instead the Ministry proposed that when activity that is levied surtax is ended, the state should pay the tax value of the uncovered deficit that comes from expenses of removing equipment on the shelf (Ot.prp. nr. 92, 2002-2003, p. 6). One of the reasons why it changed was that it was complicated to administer for both the government officials and the oil companies, since it was necessary to have other rules and systems for calculation and payment of the subsidies (Ot.prp. nr. 92, 2002-2003, pp. 12-13). The Ministry also proposed that when operations that are levied surtax are sold, the additional non-taxable income is transferred to the company that takes over the operations (Ot.prp. nr. 92, 2002-2003, p. 19).

A part of §6, concerning the Ministry's opportunity to give more detailed regulations on allocation of deductions for distributed proceeds, was removed in 2003. This was done because the rules about distributed proceeds were repealed in 1992, so it did not have any effect anymore (Ot.prp. nr. 1, 2003-2004, p. 167).

2004

In 2004 the Ministry of Finance implemented new tax regulations on the shelf, which were aimed at increasing the extraction of oil from existing fields. More specifically the Ministry wanted to decrease entrance barriers to the petroleum activity on the Norwegian shelf. They proposed a yearly payment from the state to companies that are not being taxed, based on the tax value of the searching expenses. The intention was that new actors could operate on equal terms with established companies (Ot.prp. nr. 1, 2004-2005, pp. 121-122).

2005

In 2005 the government removed the tax exemption on free meals for workers on the shelf (Ot.prp. nr. 1, 2005-2006, p. 26). In addition to this there were implemented new rules for gas sales. The Ministry of Finance proposed to introduce a voluntary system for binding prior statements from the oil companies for determining gas prices when companies sell to a subsidiary (Ot.prp. nr. 1, 2005-2006, p. 98). This change would give assurances to the government that the posted price coincide with the market price, and would also help Norwegian officials to take better decisions concerning production and sales of gas (Ot.prp. nr. 1, 2005-2006, pp. 112-113). A more detailed description of setting the price for natural gas can be found under section 4.7.

2006

The government changed the rules for net financial items in 2006. Net financial items mainly include interest costs and interest profits, and also exchange losses and exchange gains. The oil companies had strong incentives to finance activity on the shelf with loans instead of equity capital. This was because the tax rate for lender was 28%, while the tax rate for companies that were levied surtax had a tax rate of 78%. The oil companies could then achieve a tax advantage by financing the activity on the shelf with interest-bearing debt. The Ministry of Finance suggested that the interest charges and currency items on interest-bearing debt was to be treated separately, and that the deduction for interest charges in the income that was subject to the surtax was to be set directly based on the relationship between tax-related capital on the shelf and interest-bearing debt (Ot.prp. nr. 1, 2006-2007, p. 101). I.e. the rules had to be changed because of evasion consideration, so that the oil companies could not evade Norwegian taxes.

Furthermore there were made changes to the CO₂ fee levied on the Norwegian shelf (Ot.prp. nr. 1, 2006-2007, p. 119).

2007

In 2007 the law concerning the ability to mortgage on payments was sharpened. This change had no economic or administrative consequences (Ot.prp. nr. 61, 2006-2007, p. 29).

2008

In 2008 there were made changes to the payment arrangement for the petroleum tax. The tax had been paid two times, but was increased to six times each year in this proposition because the payments were very high and created uncertainty in the money market (Ot.prp. nr. 59, 2007-2008, pp. 14-15).

Changes were made so that if the oil company won a complaints case in “Oljeskattenemnda” (the oil tax board), “Oljeskattekontoret” (the oil tax office) would have to pay for the legal costs (Ot.prp. nr. 1, 2008-2009, p. 159).

The petroleum taxation lacked clear regulations about taxing properties that companies moved to another country. I.e. the Norwegian government had no legal authority to tax these assets. Companies therefore had strong incentives to move certain properties to other countries with lower tax rates, thereby evading the Norwegian tax (Ot.prp. nr. 1, 2008-2009,

p.50). An example of this is movement of business assets to another country's shelf or transferring rights to immaterial assets (e.g. patents) abroad (Ot.prp. nr. 1, 2008-2009, p. 38). But changes were not made at this time.

2009

In 2009 §9 in the petroleum tax act was repealed. This paragraph stated that the Ministry of Finance could approve that a company that was liable to taxation, could transfer its own tax position to another taxpayer, and that the proceeds from this transfer should be completely or partly be exempted from the income tax. §9 was repealed because §10 in the petroleum tax act addressed the same issue, and §9 was therefore superfluous (Ot.prp. nr. 95, 2008-2009, p. 12).

In 2009 the Finance Ministry proposed changes about regulations concerning companies that assume responsibility of an extraction permit from another company. These changes had no effects on revenues to the state (Ot.prp. nr. 95, 2008-2009, pp. 10-11).

2010

In 2010 the government dissolved the obligation to pay employers' contribution of services from foreign employees for work on foreign ships in connection with extraction and searching for petroleum (Prop. 1 L, 2009-2010, p. 88).