



FAROE
LAW

**Helpful information on
taxation, VAT and customs duties
for operators involved in oil and
gas exploration on the Faroe Is-
lands**

Tax liability

In addition to the ordinary tax regime in the Faroe Islands, a special hydrocarbon tax regime governs taxation on all hydrocarbon activities carried out within the territory of the Faroe Islands relating to preliminary hydrocarbon investigations, the exploration for and exploitation of hydrocarbons, and related activities. The hydrocarbon tax regime thus extends the scope of ordinary tax liability legislation. As a consequence, anyone operating within Faroese territory (e.g., its territorial waters, sea bed, subsoil, and the Faroese continental shelf) and engaging in hydrocarbon or related activities is liable to pay a prescribed tax to the Faroese Treasury, even though said entity may not be subject to any tax liability pursuant to the ordinary tax regime.

If the hydrocarbon activity is only carried out offshore (i.e., beyond the territorial waters of the Faroe Islands) without any activity onshore, an operator is only subject to the Hydrocarbon Tax Act (HTA). If the operator is organized as a limited liability company, the tax rate is 18% of the net profit, provided the share capital of the company is DKK 80,000 or above. If the share capital is less than DKK 80,000, the tax rate is 49% of the net profit.

If the hydrocarbon activity is carried out onshore as well, the operator will be subject to both the HTA and the ordinary tax legislation. Such operators organized as limited liability companies pay tax at the same rates on total net profit as referenced above. An operating entity that is subject to the HTA and the ordinary tax legislation shall constitute a permanent establishment.

According to the ordinary tax legislation governing limited liability companies, a locally incorporated company will be deemed subject to taxation upon official registration in the Faroe Islands.

If the hydrocarbon activity is carried out via a branch, the owners/partners of the branch will be deemed subject to limited tax liability from the date of establishment of the branch.

Mobilisation and demobilisation carried out outside the territory of the Faroe Islands does not trigger tax liability.

Repatriation of profit and withholding tax

The tax rate on branch income is the same as that stipulated for company net profit. Employer taxes also apply to branches. No tax is withheld on transfers of net profits from a branch to a head office outside of the Faroe Islands.

A Faroese company distributing dividends to another company is obliged to withhold an 18% tax on dividends – no matter whether the recipient is a resident or non-resident. However, the obligation to withhold the tax does not apply to any dividend distributed to a parent company situated in the Faroe Islands.

If the recipient is a foreign company, the dividend-paying company has to withhold tax at a rate of 18%. If the recipient is a parent company and situated in a country where a double taxation treaty with the Faroe Islands is in effect, e.g., the Nordic countries, the withholding tax might be refunded, totally or partially.

Transfer pricing

The OECD principles regarding intra-group pricing are applied by the Faroese tax administration.

Companies are required to maintain adequate documentation that substantiates that intra-group transactions are conducted in accordance with arm's-length principles.

The ratio of equity/inter-company financing to external financing (commonly referred to as "thin capitalization") generally should not exceed 1:4. If the ratio exceeds 1:4, a portion of the interest expense is not deductible.

All transactions between related parties must be based on the "arm's-length" principle. The rule applies between related parties, no matter whether the transactions are between residents or non-residents.

Value-added tax (VAT), customs duties

VAT is a consumption tax on sales and is levied whenever a sale of goods and services occurs throughout the distribution chain within the Faroe Islands. VAT is also levied on the import of goods, but not, e.g., on vessels (rigs) above 5 GT. A standard rate of 25% is applied. VAT is intended to be borne by the final consumer of the goods and services. Thus, VAT paid by a VAT-registered entity is recoverable.

Foreign entities with activity in the Faroe Islands that is subject to VAT legislation have the same obligation as Faroese business entities to collect and pay VAT to the Faroese Treasury.

The VAT legislation stipulates that a transaction sale is subject to VAT if it occurs within the territory of the Faroe Islands, which for purposes of VAT is defined as the territory extending to a limit of 12 nautical miles. The region where the petroleum licences are located is currently outside the Faroese "VAT territory" and therefore not subject to the Faroese VAT Act.

Foreign companies, e.g., in the offshore oil sector, have the option of placing imported goods into a sanctioned VAT and customs-exempt zone. Using this procedure, companies are

exempted from having to pay VAT (and customs) on goods to be used eventually offshore.

Foreign businesses with activity subject to VAT liability in the VAT territory of the Faroe Islands are required to register with the VAT system administered by the Faroese tax authorities. This requirement may be satisfied by appointing a local VAT agent resident in the Faroe Islands.

Tax administration

Entities subject to taxation pursuant to the Hydrocarbon Tax Act shall use the calendar year as their income tax or fiscal/ accounting year.

Generally, the income period for companies follows the accounting year, which has to be no longer than 12 months, except the first accounting year may vary from 6 months up to 18 months.

A company must submit a tax return no later than 1 July of the year following the end of the company's fiscal or accounting year. Thus, if the accounting year ends on, e.g., 31 January, the tax return has to be filed no later than 1 July the following year.

There is no obligation to pay corporate tax in advance.

Employee-related issues

Crewmembers only undertaking work on a rig are deemed subject to taxation only under the HTA. Consequently, they are considered to be working for an employer who is deemed not to be a resident of the Faroe Islands. These crewmembers are required to pay an income tax to the Faroese Treasury based on a rate of 35% of gross earned wages. In calculating the taxable income, the taxpayer is not entitled to any deductions.

The company operating the rig may deduct such paid wages as an expense in calculating the taxable net profit of the company.

The tax liability of companies and crewmembers may depend on relevant tax treaty provisions, e.g., Article 21 of the Nordic Tax Treaty.

Wage earners undertaking work on an onshore support base located on the Faroe Islands will be deemed subject to both the Faroese HTA and the ordinary tax regime. In this situation, different tax rates may apply depending on whether the taxpayer has a full or limited tax liability to the Faroe Islands. Wage earners subject to full tax liability may pay a tax of up to 50% on their calculated taxable income, according to a progressive

scale. Wage earners subject to a limited tax liability may be taxed up to 42% of their gross incomes.

Individuals deemed domiciled in the Faroe Islands, or who stay in the Faroe Islands for 180 days or more within a 12-month period are considered subject to full taxation liability.

Individuals temporarily employed in the Faroe Islands for a period of less than 180 days within a 12-month period are subject to tax in the Faroe Islands (limited tax liability) on all income derived from Faroese sources.

Employee-related issues

A sample tax computation

Listed below is an example of a tax computation regarding a fully tax liable wage earner with two children with domicile in Tórshavn. The computation is for guidance purposes only.

*) Income tax may not exceed a tax ceiling of 50% of taxable income.

Amounts are in DKK.

Base Gross Salary		1,000,000.00
Less contribution to pension scheme		-50,600.00
Taxable income		949,400.00
Municipal Tax:		
Taxable income	949,400.00	
Less a fixed deduction (as no municipal tax is imposed for taxable income below DKK 30,000)	-30,000.00	
	919,400.00	
Tax levied by Tórshavn Municipality (19.75%)	181,581.50	
Deduction for two children	-11,000.00	
		170,581.50
Church Tax (0.6% of 919,400) – (applicable only to members of the state-supported Lutheran Church)		6,435.80
National Tax:		
Taxable income	949,400.00	
Tax on income up to 250,000	38,500.00	
Tax on income in excess of 250,000 (33%)	230,802.00	
Deduction for two children	-11,000.00	
		258,302.00
Computed Tax*)		457,319.30
Supplemental Contributions:		
Labour Market Pension Fund (AMEG) contribution:		
Paid by the employee: 1.75% of 949,400		16,614.50
Unemployment insurance fund (ALS) contribution:		
Paid by the employee: 1% of 1,000,000		10,000.00
Fund for family leave (BAS) contribution:		
Paid by the employee: 0.62% of 1,000,000		6,200.00
Total Obligation:		
Total paid on gross earnings of 1,000,000.00 DKK		490,133.80

Social security contributions

Individuals working in the Faroe Islands for a Faroese domiciled employer, or a foreign employer who carries out activities through a permanent establishment in the Faroe Islands, or abroad on an assignment with a Faroese employer are deemed liable to contribute to the unemployment insurance fund (ALS) and to the fund for family leave (BAS), provided that they are deemed subject to taxation in the Faroe Islands as qualified domiciled residents. Fully tax liable individuals who are not resident in the Faroe Islands may apply for an exemption to the requirement to contribute to the fund for family leave (BAS). Contributions to the unemployment insurance fund (ALS) and the fund for family leave (BAS) are mandatory for the employer.

For the employer, as well as the employee, contributions to the above referenced funds are calculated on gross taxable remuneration. In-kind income is not included. For the employer, the contributions have to be paid along with the wage payment. For the employee, the contributions are withheld along with the personal taxes at the time of wage distribution. The rates for 2009 for both employers and employees are 1% to ALS and 0.62% to BAS. The contributions are tax deductible for employers.

All persons subject to taxation in the Faroe Islands, both resident and non-resident, and all resident employers and foreign employers who carry out activities through a permanent establishment in the Faroe Islands, and who pay wages have to contribute to the compulsory Labour Market Supplementary Pension Fund (AMEG). The contribution of an employee is calculated on taxable income. The contribution of an employer is calculated on the basis of paid out wages. The rate for both employers and employees for 2009 is 1.75%.

Current double taxation treaties do not permit a deduction for contributions to the unemployment insurance fund or the Labour Market Supplementary Pension Fund.

For the employee, the contributions are paid when other taxes are withheld upon receipt of a wage distribution. For the employer, the contributions have to be paid no later than 1 April of the year following when the tax was due.

Reporting paid out wages, tax withholding, payment of withheld taxes to the local tax authorities and submission of tax returns.

According to Faroese tax legislation, an employer is not permitted to pay any wages directly to the wage earner. Wages must be transferred via an approved Faroese clearinghouse (i.e., a Faroese bank or financial institution, or the Faroese post office bank). This means that an employer does not have any trustee or fiduciary responsibility to withhold tax or other deductions for the Faroese tax authorities. An employer is only required to transfer wages to an approved clearinghouse. This duty is deemed fulfilled when an employer delivers the payroll list to one of the several clearinghouses, and, at the same time, ensures that sufficient monies are on deposit with the respective clearinghouse to cover the gross wages to be paid out. The clearinghouse thereafter ensures that the relevant information about each wage earner is reported to the tax authorities, whereupon calculations are made as to how much tax shall be deducted from the actual wage paid.

Before an employer pays any wages, the employer must register with the tax authorities as an employer in the Faroe Islands and obtain an enterprise or employer number, a so-called "vinnu" or "V" number, which shall be provided on each payroll list.

Before a wage earner can receive any wages for work, the wage

earner must register for tax withholding. Wages can only be paid if the wage earner has a personal registration number, a so-called "persón" or "P" number. Wage earners must ensure that they are registered with the tax authorities. Individuals registered with the Faroese National Registry will have an assigned P-number and will most likely be registered with the tax authorities. Individuals who are only present in the country for a limited time will be issued a special tax number by the Faroese tax authorities.

Crewmembers only undertaking work on a rig and who are subject only to taxation pursuant to the HTA, are not required to submit a tax return, if their employer is not domiciled in the Faroe Islands.

Most individuals no longer need to submit a personally completed tax return. Individuals who are only paid A-income (income from an employer) receive a personal tax return in February of each year that is based on data compiled by the Faroese tax authorities for the previous tax year. If the figures are correct, no action on the part of the individual taxpayer is required. If the information is incorrect, the individual taxpayer returns the corrected tax return and the tax authorities generate an approved tax return. However, in principal, everyone remains obliged to submit a personal income tax return.

Registration and reporting requirements under the Hydrocarbon Tax Administration Act (HTAA)

According to the Hydrocarbon Tax Administration Act (HTAA), a licensee is fully liable for taxes not paid by any subcontractors (and/or their employees), directly or indirectly working for the licensee.

The licensee is required to provide the Faroese tax authorities with information about any contracts (written or verbal) with subcontractors, e.g., rig operators, working directly or indirectly for the licensee, as well as relevant information about any employees hired by said subcontractors.

Companies have to submit tax returns no later than 1 June of the year following the end of the accounting or fiscal year. The tax regime, in practice, is based on self-assessment. The tax authorities automatically levy the tax assessment on the basis of the submitted tax return. The tax authorities, however, reserve the right to audit any tax return. The company tax must be paid in three equal instalments in October, November and December of the year following the end of the fiscal year.

On its own initiative, a licensee is required to compile and submit to the Faroese tax authorities the relevant information about subcontractors and their employees as stipulated in the HTAA.

On their own initiative, subcontractors shall provide the relevant licence holder with information about any contracts of employment that they enter into with natural persons or corporations, etc. The nature of such information includes, but is not limited to, the nature of the work, the name of the person(s) or company carrying out the work, the company registration number (if any), time and place of the performance of the work, the contract amount, the expected total wages to be paid, as well as copies of written contracts of employment, if any.

An employer subject to the hydrocarbon tax regime shall, on its own initiative, provide the relevant licence holder with information about individuals employed by it and who carry out work within the territory of the Faroe Islands. This duty of disclosure includes, but is not limited to, the following information: the names of all employees, dates of birth, personal identification number (if any), residence address, and tax domicile; the employer's name, as well as any company registration number, place of work, nature of work, and duration of the task for which the work is directly connected.

Said information shall be submitted to the Faroese tax authorities no later than 14 days after the work has been initiated.



Please contact



Eyðfinnur Jacobsen
Attorney-at-Law, Partner

Faroese legal matters,
among these:

Tax and duties law

Oil and gas laws

Aviation

Mail: eyj@faroe-law.fo

Phone: +298 35 99 00

Mobile: +298 21 99 02

AARHUS

COPENHAGEN

NUUK

TÓRSHAVN

MOSCOW

KIEV