

Supporting investment: a consultation on the North Sea fiscal regime

November 2008



HM TREASURY



HM Revenue
& Customs

Supporting investment: a consultation on the North Sea fiscal regime

November 2008

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Subject of this consultation:	The North Sea Fiscal Regime – the Government’s proposed changes following the latest round of engagement with stakeholders. See paragraph 1.17 for more details.
Scope of this consultation:	This consultation outlines a second set of proposed reforms to the Regime, building on those announced at Budget 2008, and asks for stakeholders’ comments on these proposals.
Impact Assessment:	An Impact Assessment is attached at Annex A.
Who should read this:	The consultation is aimed specifically at companies engaged in hydrocarbon recovery in the North Sea or who may become so engaged in the future, and companies considering the re-use of North Sea infrastructure for other purposes, such as carbon capture and storage. We are keen to hear industry’s views on all aspects of the proposed changes.
Duration:	The consultation will run from the 24 th November 2008 to the 13 th February 2009
Enquiries:	Rob Douglas, Head of North Sea Taxation 020 7270 5000, robert.douglas@hm-treasury.gsi.gov.uk
How to respond:	Rob Douglas, Head of North Sea Taxation 020 7270 5000, robert.douglas@hm-treasury.gsi.gov.uk
Additional ways to become involved:	We are keen to have face-to-face meetings with any companies that have comments on the issues discussed in the consultation document. Please contact Rob Douglas at the details above to arrange a meeting. We will not be publicising the consultation more widely as it covers technical tax matters of most interest to the companies affected.
After the consultation:	A Summary of Responses document will be published in due course.
Getting to this stage:	A summary of previous changes and decisions can be found at Annex C, whilst an overview of the existing North Sea Fiscal Regime can be found at Annex E.
Previous engagement:	Consultation with individual companies and with the industry’s representative bodies has been ongoing since PBR 2005.

1

Introduction

1.1 Managing the challenges of security of supply and tackling climate change in a world of uncertain oil and gas prices, increasing global energy demand and the finite nature of the world's oil and gas reserves is a key issue for all governments. The Government remains committed to moving towards a low carbon economy. However, while low-carbon energy solutions are developed, oil and gas will continue to play a central role and the Government has a clearly stated objective to maximise the economic recovery of the UK's oil and gas resources.

1.2 The Government has twin objectives for the North Sea fiscal regime : to promote investment and production whilst striking the right balance between producers and consumers and ensuring a fair return for the UK taxpayer from the UK's national natural resources. The Government believes that, overall the fiscal regime successfully strikes that balance at the present time and ensures that both producers and consumers benefit appropriately from the production of the UK's oil and gas reserves. As stated in the 2005 Pre-Budget Report the Government is clear that there will be no further increases in North Sea oil taxation during the life of this Parliament.

1.3 Through to the end of 2007 production of oil and gas from the UK Continental Shelf (UKCS) has totalled some 38 billion barrels of oil equivalent (boe). Although total oil and gas production from the UKCS peaked in 1999, the UK still has substantial oil and gas resources. The Department for Energy and Climate Change (DECC)¹ estimate that between 17 and 20 billion boe remain to be recovered.²

1.4 Although the UK is now a net importer of both oil and gas, indigenous production will continue to play a vital role in meeting the UK's energy demand for many years to come. The UKCS is expected to produce around three quarters of the UK's oil requirements and two thirds of its gas requirements in 2010³; thereby playing an important part in the UK's security of supply picture.

1.5 The Government recognises the important associated benefits that a continuing healthy UK oil and gas industry brings to the country, including its impact on the balance of trade, the employment it supports directly and indirectly (which industry estimates to stand at 350,000⁴) and the skills, expertise and cutting edge research and development it engenders.

1.6 The oil and gas sector also has the potential to make an important contribution to the wider future of the North Sea and the UK's response to the challenges presented by climate change. Carbon capture and storage, gas storage and offshore wind farms can all utilise the skills, experience and, in some cases, the infrastructure previously employed in extracting oil and gas.

¹ The relevant functions of BERR (Department for Business, Enterprise and Regulatory Reform), previously with DTI (Department for Trade and Industry) prior to July 2007, were transferred in October 2008 to DECC (Department of Energy and Climate Change). All references to the organisation in this document are under its new name.

² Source – https://www.og.berr.gov.uk/information/bb_updates/chapters/Table4_7.htm

³ Source – https://www.og.berr.gov.uk/information/bb_updates/chapters/Section4_17.htm

⁴ Source – <http://www.oilandgasuk.co.uk/issues/economic/econ08/main/industry-6.cfm>

1.7 The underlying geology and future oil and gas prices remain the dominant drivers of investment, and hence, ultimate recovery levels. However, the Government has a crucial role to play in ensuring that the fiscal and regulatory regimes help deliver the best possible future for the UKCS.

1.8 On the regulatory side, DECC, working closely alongside industry through the high level joint PILOT forum⁵, has made significant progress in ensuring that the UKCS has the correct regulatory and commercial environment to encourage further investment and exploration. Examples of work in this area include the introduction of the 'promote' licence⁶, the 'Fallow' exercise and the 'Stewardship' initiative.

The discussions on the North Sea⁷ fiscal regime

1.9 In order to ensure that the North Sea fiscal regime is appropriate for the remaining life of the UKCS, the 2005 Pre-Budget Report announced that the Government would undertake discussions with the oil and gas industry to examine any perceived wider structural concerns. These discussions were to cover any area of the fiscal regime which either the Government or industry felt could potentially undermine ongoing stability, and impact on the Government's objective to maximise the economic recovery of the UK's oil and gas resources.

1.10 The initial round of discussions lasted from January 2006 through to September 2007 and provided a framework within which UKCS stakeholders could discuss any aspects of the fiscal regime with officials from HM Treasury (HMT), HM Revenue & Customs (HMRC) and DECC.

1.11 At the 2006 Pre-Budget report the Government announced the creation of the joint Government and industry 'Change of Use' working group to examine the fiscal impact of the current tax regime in relation to the change of use of oil and gas infrastructure, for example to carbon capture and storage.

1.12 At Budget 2007 the Government published *The North Sea fiscal regime: a discussion paper*⁸. This paper summarised the contributions received and set out the conclusions that the Government had drawn from the initial phase of discussions about where change might be necessary. It also outlined criteria for assessing potential options and used these to form the basis for further, more focused discussions with stakeholders through to the end of September 2007.

1.13 Following the 2007 Pre-Budget Report the Government published two further documents. The first, *Platform for change*⁹, reported back from the 'Change of Use' working group and set out how the existing North Sea fiscal regime would treat change of use projects and highlighted a number of areas that the Government wished to explore with industry where change might be desirable in order to facilitate such activity.

1.14 The second, published in December 2007, was *Securing a sustainable future: a consultation on the North Sea fiscal regime*¹⁰. This consultation document built on the previous discussion paper and set out a number of proposals for changes to the North Sea fiscal regime and invited stakeholders to comment on those. A final announcement on these proposals¹¹ was made at Budget 2008, with legislation being enacted in Finance Act 2008.

⁵ Further details on the PILOT forum can be found at, www.Pilottaskforce.co.uk

⁶ Further details on this, and the other examples listed can be found at: <https://www.og.berr.gov.uk/upstream/index.htm>

⁷ In the context of the fiscal regime the term "North Sea" is used to refer to the whole of the UKCS and to all upstream oil and gas activity undertaken within that area – not just that within the generally understood geographical confines of the "North Sea".

⁸ Available from http://www.hm-treasury.gov.uk/north_sea_fiscal_regime.htm

⁹ Available from <http://www.hmrc.gov.uk/oto/change-of-use.htm>

¹⁰ Available from: http://www.hm-treasury.gov.uk/consult_northsea_future.htm

¹¹ All the changes to the fiscal regime and decisions set out in these documents are summarised in Annex C.

1.15 The consultation document also recognised that there was a range of outstanding issues that still needed to be debated fully with stakeholders, and to that end announced that the Government would be consulting on those issues through to the end of June 2008.

1.16 As previously, a large number of UKCS stakeholders have participated in these discussions¹², which in practice continued well beyond the end of June 2008. The Government reiterates its thanks to all the companies, organisations and individuals who have been involved in the process for their contributions. The Government recognises the expertise that those in the industry have and continues to believe that the best future for the UKCS can be achieved through close co-operation and discussion.

The North Sea fiscal regime: The Government's current conclusions

1.17 This consultation document builds on the process outlined above. It:

- summarises the discussions held over the past year;
- sets out the conclusions that the Government has drawn from this process;
- outlines a second set of proposed reforms to the fiscal regime, building on those announced at Budget 2008; and
- sets out how further engagement on the future of the North Sea fiscal regime should be taken forward.

1.18 The proposed further reforms to the North Sea fiscal regime are set out in chapters 4, 5 and 6 – focusing respectively on incentives, change of use and the Petroleum Revenue Tax (PRT) and taxation of chargeable gains regimes respectively.

1.19 It is intended that, if confirmed in light of the present consultation, these changes will be finalised at Budget 2009 and legislated in Finance Bill 2009. Consultation stage impact assessments for the PRT and chargeable gains proposals are at Annex A. Where possible, draft legislation for these measures will be published on the HMRC website prior to the publication of Finance Bill 2009 to allow interested stakeholders a chance to comment.

1.20 Comments on this package are invited from stakeholders by 13 February 2009. Contact details are provided at the end of Chapter 7.

¹² A list of all those bodies which have fed into this latest round of discussions since December 2007 can be found at Annex E. This list shows both those with whom Government had face-to-face discussions and those who have submitted written submissions.

2

The current regime

2.1 Profits arising from the extraction of oil and gas in the UKCS potentially fall within two fiscal regimes: petroleum revenue tax (PRT) and ring-fence corporation Tax (RFCT), which also incorporates supplementary charge (SC). Overall, these are known as the 'North Sea fiscal regime'. A range of reforms were made to the regime in Budget 2008, having been initially set out for consultation in *Securing a sustainable future* published in December 2007. These reforms were enacted in Finance Act 2008 (FA 2008). The brief description of the North Sea fiscal regime set out below includes those changes. The FA 2008 changes themselves are also listed in Annex C.

Petroleum Revenue Tax

2.2 PRT was introduced by the Oil Taxation Act 1975 and repealed by Finance Act 1993 for all fields given development consent on or after 16 March 1993. It therefore applies only to fields given development consent before that date.

2.3 There are around 100 such fields still producing in the UKCS, with around 75 companies having an interest in a PRT liable field. Of these fields, the majority (around 60) have never been profitable enough to pay PRT, due to the allowances and reliefs outlined below. In FA 2008 the Government legislated to give HMRC the power to remove fields that are unlikely ever to pay PRT from the PRT regime if those companies party to the licence in any such field so elect.

2.4 PRT is a field-based tax. Fields liable to PRT are currently charged at fifty per cent on their net income from extracting oil and gas in the UKCS. There are a number of reliefs and allowances that protect smaller and less profitable fields from paying this tax, which were intended to encourage investment in and exploration for such fields. The main allowances and reliefs are:

- **Safeguard** – is intended to guarantee companies a specific return on their capital before they have to pay PRT. Availability of relief is limited to a prescribed number of chargeable periods. Relief under safeguard is against a participator's PRT liability and is therefore applicable only once all expenditure and other reliefs have been taken into account in the PRT computation.
- **Oil Allowance** – ensures that for at least the first ten years of a field's life (and often for much longer), a substantial slice of production is free from PRT. Except for safeguard relief, oil allowance is given only after all other expenditure and reliefs have been allowed. The allowance is field-based in that if a participator has insufficient profits in a particular chargeable field to absorb the allowance, it is not carried back or forward by the company, but rather it remains available for later use in the field.

2.5 PRT is charged in respect of profits from oil (for most PRT purposes 'oil' includes gas and other hydrocarbon products) won under a licence issued by the Secretary of State for Energy and Climate Change. It is assessed on each participator in an oil field.

2.6 For PRT purposes, companies have to make a number of returns for what are termed 'chargeable periods'. There are two six-month 'chargeable periods' each year.

2.7 PRT can produce an assessable profit or an allowable loss. Where there is an allowable loss, this is carried forward to set against assessable profits from the same field in later periods

without time limit, unless the participator claims to have it carried back against earlier profits from the same field, again with no time limit.

2.8 If the field reaches the end of its productive life and decommissioning costs are incurred, to the extent that such costs are deductible for PRT purposes, any losses arising can be carried back for offset against profits from the field without limit, subject to the retention of the licence or within two chargeable periods of the relinquishment of the licence.

2.9 Any losses still unused termed Unrelievable Field Losses (UFLs) may be set against profits from another field owned by the same company (or an associate thereof) and are relieved in that field in the same way as other non-field expenditure.

2.10 As described above, major reforms in 1993, ended the PRT charge for any fields receiving development consent on or after 16 March 1993. Such fields are known as 'non taxable fields'. They are not liable to PRT and cannot generate any reliefs or surrender PRT reliefs or losses to those fields remaining subject to PRT.

2.11 PRT is deductible in arriving at profits charged to RFCT and SC (both described below) – a PRT paying field will therefore have a marginal tax rate of seventy five per cent.

Ring Fence Corporation Tax

2.12 Corporation tax on upstream oil and gas profits is levied at thirty per cent. It is subject to special rules, which were introduced in 1975 to ensure the UK gains the proper benefit from North Sea oil. The main purpose and effect of these rules is to stop profits from oil extraction activities and oil rights in the UK and UKCS being reduced for tax purposes by losses from other trading activities.

2.13 A 'ring fence' is placed around these profits and the normal rules, which would otherwise allow the profits to be reduced by losses from other activities carried out by the company, or from losses other than from UK oil extraction activities accruing to other companies in the same corporate group, are disapplied. The rules work by treating the ring-fenced activities as a separate trade, and then preventing trading losses being set against income from oil extraction activities or oil rights (and ring fence chargeable gains) except insofar as they are losses derived from such activities.

2.14 Virtually all capital expenditure incurred in the North Sea, including putting the plant and machinery in place, or in dismantling it at the end of the life of an oil field, now qualifies for one hundred per cent First Year Allowances (FYAs), allowing the cost to be written off for tax purposes in the accounting period in which the expenditure is incurred.

2.15 The general rules applying to capital expenditure incurred in a ring fence trade are set out below:

- **capital allowances:** There are 100 per cent FYAs for expenditure on plant and machinery for use wholly within a ring fence trade including, since FA 2008, long life assets (LLAs), (those with a useful economic life of at least 25 years) that previously received 24 per cent FYAs and then 6 per cent annual Writing Down Allowances (WDAs). 100 per cent FYAs were introduced in FA 2002; prior to this capital expenditure was treated in the same way as for a non-ring fence activity (25 per cent WDAs for most plant and machinery expenditure; 6 per cent WDAs for LLA expenditure).

- **decommissioning expenditure in the North Sea:** Nearly all decommissioning expenditure is capital in nature and is relieved under the capital allowances legislation. Since FA 2008, virtually all capital expenditure on decommissioning plant and machinery, whenever incurred, now attracts 100 per cent FYAs. Prior to FA 2008 mid-life decommissioning received 25 per cent WDAs.
- **corporation tax loss relief for decommissioning expenditure:** Prior to FA 2008 decommissioning losses could only be carried forward against ring fence profits, set off sideways or back against total profits for three years. Since FA 2008, losses arising as a result of decommissioning expenditure are allowable against a company's ring fence and other profits in the year in which the loss was incurred. They can be carried forward against ring fence profits and/or carried back against total profits for three years. In addition, where there are sufficient losses, they can then be carried back against a company's ring fence profits to 17 April 2002.
- **corporation tax post-cessation period:** Prior to FA 2008 the fiscal regime allowed decommissioning expenditure incurred in the 3 years after the cessation of the ring fence trade to be treated as if it were incurred in the last period of trading. FA 2008 extended this 'post cessation period' so it now runs to the point where DECC publish their 'close-out' report, which confirms that decommissioning has been completed. In this way companies are assured of obtaining relief for all their allowable decommissioning costs.

2.16 Whilst profits from oil extraction activities are ring fenced, trading losses arising from such activities are relievable for corporation tax in the same way as losses from other trading activities. Ring fence losses can be set off sideways against other profits, group relieved, carried forward into future accounting periods or carried back against the previous year's profits.

2.17 In 2004 the Government introduced an Exploration Expenditure Supplement (EES), targeted particularly at those smaller companies entering the North Sea and incurring losses in that they were unable to offset against other profits. The supplement helped to retain the value of losses incurred in exploration and appraisal activity by allowing an uplift of six per cent per annum for such losses, up to a maximum of six accounting periods. In 2006 EES was replaced by the Ring Fence Expenditure Supplement (RFES), which widened the scope to include all North Sea expenditure which cannot be relieved against North Sea profits.

Supplementary charge (SC)

2.18 Finance Act 2002 introduced a supplementary charge of ten per cent on adjusted ring fence profits. Adjusted ring fence profits are the amount of profit or loss arising from any ring fenced activities, excluding any financing costs. The rate of SC was increased in Finance Act 2006 to twenty per cent with effect from 1st January 2006. Fields not paying PRT will thus be liable to a marginal tax rate of fifty per cent.

Chargeable gains

2.19 Broadly, a chargeable gain arises when the consideration from the disposal of an asset exceeds its purchase cost plus any other costs and indexation relief allowed in computing the gain. In general the standard UK capital gains taxation rules are applied within the North Sea ring fence.

2.20 When an oil or gas interest is sold, typically the purchase price will include an estimate of both the value of the hydrocarbons in the ground and the associated physical infrastructure. Most of the infrastructure is plant and machinery, which depreciates, and is therefore unlikely to give rise to a gain on disposal. Any gain that does arise is likely to relate to the increase in the value of the unexploited hydrocarbons during the period of ownership, and possibly other

factors such as geography. For example a hub might have more value if other fields have been discovered in its vicinity and conversely a newly built hub or pipeline nearby might also increase the value of the hydrocarbons in a nearby field.

2.21 Where a company disposes of a field interest for a non-cash sum, before development consent is granted, then no gain is brought into charge. In all other cases where a gain arises, it is payable in the accounting period in which the gain is realised. However, if the proceeds of the sale of the asset are reinvested in other fields, then the gain is held over for a maximum of 10 years before coming into charge.

2.22 Where a company disposes of a field interest by selling the company that holds the licence interest, rather than selling the actual licence interest itself, there is the possibility of the substantial shareholdings exemption (SSE) applying. This exemption applies only where certain conditions are met, including minimum share ownership, period of ownership and the status of the investing company. If SSE does apply then any gain is exempt from tax.

3

The 2008 discussions - views from industry

This chapter summarises the views expressed by the participants in the 2008 discussions. These views are not those of HM Treasury or wider Government. The Government's conclusions and views on the issues raised are set out in the following chapters.

The consultation process

3.1 The consultation document, '*Securing a sustainable future*', launched two consultative processes. The first, which ran until the end of January 2008, was to invite views and comments on the proposals for reforms to the fiscal regime contained within that document. The second was to continue discussions on all outstanding issues pertaining to the fiscal regime.

3.2 The outcome of the first consultative process was the package of reforms to the fiscal regime announced at Budget 2008. A summary of the views raised by industry, and the impact these had on the final shape of the package is contained in Annex D.

3.3 The second consultative process was formally completed at the end of June 2008, although in practice discussions continued until November 2008.

3.4 A wide range of UKCS stakeholders, including individual oil and gas companies, representative bodies, academics, supply chain representatives and other stakeholders contributed to this process.¹ As a result of this broad cross section of stakeholders, representing many different interests, positions and strategies, there was, on various issues, no consensus from industry.

Headline messages

3.5 However, as expected the headline messages received from across industry remained consistent with those stated in the previous rounds of consultation. As summarised by Oil & Gas UK, a common belief was expressed that the fiscal framework should:

- promote the recovery of the UK's oil and gas reserves;
- be applied consistently across exploration, development, operation and decommissioning;
- provide certainty for the lifespan of the asset, including ongoing investment and the treatment of future decommissioning liabilities;
- sustain competitiveness of the UKCS, both globally and regionally;
- provide an appropriate balance between risk and reward;
- recognise the long term nature of investments and refrain from increasing tax rates in response to short term increases in commodity prices;

¹ A list of all those bodies which have fed into this latest round of discussions since December 2007 can be found at Annex E. This list shows both those with whom Government had face-to-face discussions and those who have submitted written submissions.

- not increase the tax burden on individual fields or assets as a result of future changes in the overall fiscal regime;
- avoid fiscal anomalies, which can lead to inappropriate behaviour; and
- ultimately see the UKCS taxed on the same basis as other industries.

Development incentives

Industry proposals

3.6 Overall, this latest round of discussions has built on issues discussed over the preceding consultations. However, following the package of reforms introduced in Budget 2008, recent discussions were much more focused on whether there was anything the fiscal regime could do to support production. A particular emphasis was on new fields and incremental projects in existing fields that were economically viable, but commercially marginal in materiality terms, when competing for scarce resources with other projects, both within the UKCS and globally. This approach could be seen in Oil & Gas UK's proposals which set out the following three specific areas where they believed Government assistance would have an impact:

- a 25 per cent uplift on capital investment in the UKCS;
- assistance in accelerating the development of new infrastructure West of Shetland; and
- additional support for enhanced oil recovery (EOR) projects to promote the required leading edge technologies.

3.7 An adoption of these proposals would, they believe, help meet the investment challenge and overall raise the ultimate recovery from the UKCS. Industry argued that such investment was needed now, as in their view:

- the UKCS is currently attracting insufficient investment to maximise its potential;
- there is a limited window of opportunity to exploit certain parts of the UKCS due to ageing infrastructure – yet this infrastructure will be vital if smaller hydrocarbon accumulations are to be accessed; and
- the UK currently has very strong supply chain advantages, and needs to take full advantage of that.

3.8 If such a package of measures were adopted then industry believe there could be a substantial increase in the number of barrels ultimately recoverable from the UKCS – for example they argue that if the UK's EOR potential was maximised the prize could be over 1 billion extra barrels of oil equivalent.

Options for targeting

3.9 In the course of discussions with individual companies some also raised the possibility of more targeted incentives focused on particular types of oil/gas fields that were currently felt to be marginal. However, some companies expressed a concern that either it would not be possible to target projects effectively, reducing the potential benefits, or that the Government should not be seeking to 'pick winners'. In such a case they argued it would be better not to have any incentives at all.

3.10 Where companies engaged in a debate on targeting then the following areas were seen as those most likely to be currently facing development challenges and therefore those that would benefit most from a targeted incentive.

- **Small fields:** The falling size of discoveries within the UKCS and the increasing costs of development have resulted in potentially a large number of economically viable, but commercially marginal, fields. Whilst acknowledging that there was no specific point at which a field's size made it commercially challenging, and indeed acknowledging that in the correct circumstances very small fields could be highly profitable, there was a general feeling that fields below 10 – 15 million barrels of oil equivalent were currently likely to be uncommercial;
- **High pressure high temperature:** (HPHT) fields. Due to the extremes of pressures and temperature such developments are often expensive, technically challenging and carry a high degree of risk. Yet such fields have been estimated to form a substantial element of the UK's remaining reserves;
- **Heavy oil:** As with HPHT, the nature of the hydrocarbon provides a challenge above and beyond those faced with conventional reserves, resulting in greater technical challenges and increased costs. In addition, due to the nature of the hydrocarbon heavy oil, fields tend to suffer from both lower recovery rates and lower market prices, – again increasing the development challenges; and
- **Geographical areas:** Areas that due to the difficulties faced by deep water, challenging conditions and inadequate pre-existing infrastructure require extra assistance to be developed. The most commonly cited example was West of Shetland.

Proposals for incentive delivery

3.11 Stakeholders also came up with a number of different proposals as to how such fields could be best incentivised – with differing proposals over the method for applying an incentive and not surprisingly over the levels at which such an incentive would need to be set.

3.12 On methods for delivering incentives, the alternatives were seen as the following:

- **uplift of capital expenditure:** Capital investment expenditure currently receives 100 per cent capital allowances – hence it is all available to be offset against profits in the year within which it is expended. Under these proposals the value of that offset would effectively be increased – for example, for every £100 invested under the 25 per cent uplift proposals £125 could be offset against profits;
- **a reduction in supplementary charge:** Under this proposal all new developments would be subject to either a lower rate of, or no SC;
- **a volume allowance:** Here proposals were for new developments to face a lower rate of taxation on the first “x” million barrels of oil equivalent of production, as currently occurs by way of oil allowance within the PRT system; and
- **a value allowance:** As per the volume allowance, but instead with the first ‘y’ million pounds of income from a development being taxed at a lower rate.

Change of use

3.13 Following the publication of ‘*Platform for Change*’ in November 2007, the Government and the industry have continued to engage closely in discussions over potential issues within the North Sea fiscal regime that could stand in the way of the reuse of North Sea infrastructure for alternative purposes: particularly carbon capture and storage (CCS), gas storage and offshore wind farms.

3.14 Three key areas were raised by industry where they believed changes might need to be made:

- tax treatment of the transfer of assets from ring fence trade to non-ring fence trade and the use of PRT qualifying assets other than in connection with a taxable field;
- tax treatment of income and expenditure arising from change of use activities – the correct allocation of items either side of the North Sea/non-North Sea fiscal divide; and
- access to tax relief for decommissioning costs where ex-oil and gas assets were subsequently used for a change of use purpose.

3.15 Within these three areas industry had 5 proposals and these are summarised below.²

Capital allowances and deemed disposals

3.16 Where an asset that qualifies for capital allowances within the North Sea ring fence is used for a purpose outside of the ring fence then under existing legislation that asset is subject to a deemed disposal. Under a change of use scenario, such an occurrence would happen for example if a platform was converted from being used for oil extraction to CCS. Industry representatives argue that this imposes a further cost upon a change of use project, and does so in advance of any revenues being earned.

3.17 They therefore propose that a ring fence trade and a change of use activity should be treated as the same trade – resulting in there being no deemed disposal. Alternatively, if a disposal value has to be brought in, then the tax written down value should be used rather than the market value, so that neither a balancing charge, nor a balancing allowance would arise.

Capital allowances clawback

3.18 Under the North Sea fiscal regime, if a capital asset that has received 100 per cent FYAs is not used within the North Sea ring fence, or is used for an alternative purpose within five years of the allowance being given, then those capital allowances can be clawed back.

3.19 Industry argue that there could potentially be circumstances where expenditure has been incurred for the purposes of a ring fence trade but, within the five year time period under which claw back could occur, was instead used for a change of use activity. Under such circumstances they propose that the 5-year rule legislation should not be invoked.

PRT – disposal of qualifying asset rule

3.20 Under existing PRT rules, where an asset is transferred for use other than in a PRT liable field then part of the original cost of the asset is clawed back for PRT relief purposes. The amount is based on a time apportionment system that seeks to calculate the total expected life of the asset and the proportion of that lifespan that the asset was used in connection with a PRT liable field.

3.21 Industry argue that this legislation is likely to create a disincentive for companies considering change of use activities; particularly where the change of use could run for a considerable period of time, as the longer the post oil activity, the greater the amount that would be clawed back. Industry therefore proposes that the PRT claw back should not apply where the assets are used for change of use purposes.

² These proposals are set out in greater detail in Appendix 1 of “Platform for Change” – available from: <http://www.hmrc.gov.uk/oto/change-of-use.htm>

Treatment of income and expenditure

3.22 Industry are concerned that, under the existing fiscal regime, it would be possible for income or expenditure to fall the wrong side of the ring fence/non-ring fence divide. Industry therefore proposes that legislation should be introduced to ensure that in all circumstances change of use revenues and expenditure is exempt from PRT, RFCT and SC.

Decommissioning relief

3.23 Whether or not oil and gas infrastructure is used for some other purpose after production ceases, there will at some point be a statutory obligation requiring the infrastructure to be decommissioned. Under existing legislation, special rules exist that recognise the significant decommissioning costs – allowing such costs to receive 100 per cent capital allowances and, if the realisation of those allowances leads to a loss, allowing that loss to be carried back against previous profits as far as April 2002. However, once such assets have left the ring fence, they become assets of an ordinary trade and are treated as such under the general corporation tax rules. Under these circumstances, the extent to which decommissioning costs are allowable for tax purposes is much more restricted and if losses arise those losses can only be relieved through a one year carry back or against other profits in the company.

3.24 Under PRT the rules are slightly different, in that access to PRT profits following decommissioning is still possible even if the asset has been used for a non-PRT purpose. However only the ‘relevant portion’ of the expenditure is allowable against PRT profits – with the amount being decided on a just and reasonable basis.

3.25 Industry argue that effective access to decommissioning relief is a critical issue when considering the economics of a change of use project, and that the current treatment is extremely likely to result in a change of use activity not going ahead where it utilised existing infrastructure that was expected to have a substantial decommissioning costs.

3.26 Industry therefore propose that losses arising from the decommissioning of North Sea infrastructure, if subsequently used for a change of use activity, should be treated as having been incurred within the ring fence trade (if the ring fence trade was still ongoing) or on the last day of the ring fence trade (where it had already ceased). Where the asset is a PRT asset then they argue that the decommissioning costs should likewise be allowed in full for PRT purposes and not be subject to apportionment.

Asset transfer and chargeable gains

3.27 Over the course of the discussions, a number of companies raised the issue that chargeable gains arising on the disposal of field licence interests could potentially act as an impediment to asset trades and stop fields getting into the hands of those companies most likely to successfully exploit them. They argue this is inconsistent with the wider best interests of the UKCS and the Government’s objective to maximise the economic recovery of the UK’s oil and gas resources.

3.28 Industry’s view is that the current rules for taxing chargeable gains create a ‘double taxation’ burden, in that an increase in the value of a field that is then sold potentially gives rise to a chargeable gain in the hands of the vendor. As the reserves are then extracted by the purchaser, they would be subject to RFCT, SC and (if appropriate) PRT. Companies argue that, as vendors, they are being taxed on the increase in the value of oil they had not produced and, as purchasers, they are then caught because they cannot offset the capital cost of acquiring the licence interest against the income charge on production.

3.29 Industry recognise that the substantial shareholdings exemption (SSE) does provide a vehicle for disposing of a field interest without giving rise to a chargeable gain, by way of a disposal at the corporate tier rather than the asset tier. However use of SSE requires a particular

structure in which the company holding the field interest can be disposed of, unencumbered by other rights and responsibilities, which is not always easily managed. In addition, where a field interest is transferred into a group company, using the no-gain/no-loss rules, there remains an exit charge if the field then leaves the company within five years, so there is no 'quick and easy' way out of the group for a field interest at the corporate level to get the benefit of the SSE exemption.

3.30 Industry came up with a number of proposals for fiscal changes – these include:

- bringing field interests within the Intangible Property regime;
- exempting all licence swaps from the chargeable gains legislation (as is, effectively, the case for pre-development asset swaps);
- allowing oil licences to qualify for rollover relief (thereby creating the opportunity for greater or indeed permanent tax deferral); and
- providing a complete exemption from tax for all disposals of licence interests.

Petroleum Revenue Taxation

3.31 The future of the PRT regime was extensively discussed within the previous round of consultation. The focus was on whether the Government could give any greater certainty surrounding its intentions to honour the existing PRT rules for giving tax relief on decommissioning costs. Discussions also looked at whether steps could be taken to abolish PRT or reduce the rate at which it was charged to help encourage investment in PRT liable fields. Finally reform of the existing system, if a complete removal was not possible, was also discussed.

3.32 In Budget 2008, the Government announced a number of reforms to the PRT regime to remove anomalies and increase certainty. Following the previous discussions, the Government had also reiterated once again that whilst it recognised the potential benefits that could come with PRT abolition, the retention of PRT is tenable and, if there were no mutually acceptable options for the removal or major reform of PRT, then such a retention could well be desirable and in the interests of the overall UKCS policy perspective.

3.33 Following these statements, PRT represented much less of a topic of discussion in this latest round of discussions. The conversations that did occur focused on two areas. Firstly, whether any further progress could be made on the question of abolishing PRT altogether – in particular on the 'PRT Buy-Out' option and secondly, whether there were further adjustments that could be made to the regime to remove potential anomalies and make it simpler and with a reduced administrative burden.

Abolition of PRT

3.34 As set out above, the further discussions on this area focused on the concept of a 'Buy-Out' – whereby companies currently liable for PRT would buy themselves out of the regime through an upfront payment to cover their remaining estimated PRT liabilities minus the relief on decommissioning, with PRT then being abolished.

3.35 Those companies who had previously opposed the concept of a Buy-Out did not participate any further in these conversations, apart from to register their continued opposition to the concept. However, a small group of companies continued to engage with the Government on this issue to explore it in greater depth. The focus of these discussions was around how the computation of the outstanding PRT position could be calculated – with the companies putting forward a number of proposed metrics that could be employed and undertaking an initial estimate of how such a position would be calculated on an actual field.

3.36 As previously, there were also differing views on how a PRT Buy-Out should be applied if a common position on the calculation could be reached. Some companies suggested that an optional process should be undertaken. Under this companies would elect their fields into a Buy-Out, with the PRT regime remaining for those who did not opt in. Others argued that, despite the Government's clear statement in the December 2007 consultation document that they would not impose a Buy-Out across the board, this was what they continued to believe the Government should do.

Further changes to the PRT regime

3.37 The discussions on this area effectively came down to two issues – anomalies and the potential for further simplification. On the question of outstanding anomalies industry reiterated its concerns over the potential for the expiry of a petroleum production licence for a field to lead to the loss of PRT relief for costs incurred after licence expiry. Industry expressed no desire to look any further at the question of more radical reforms to the PRT regime.

3.38 On simplification, following the Government's encouragement, industry engaged in a discussion on potential options for simplification of the PRT regime. Whilst supportive of any measures that might reduce the administrative burden and complexity of the regime industry were keen to ensure that any changes did not have any unforeseen consequences in relation to the effective operation of the legislation. They were also keen that any changes should not require significant upheaval – arguing that, whilst the PRT regime was complex, it was generally well understood by those who had to operate within it.

Other issues

3.39 In addition to the main issues raised above certain elements of industry also brought other issues to the Government's attention. These were:

- **inheritance tax (IHT) and decommissioning funds:** – Under current IHT rules, monies put into a decommissioning fund become liable to an IHT charge on withdrawal from the fund and on each 10 year anniversary of monies having been contributed to the fund. Industry propose that where a fund is for the use of the decommissioning of a ring fenced asset then the fund should not fall within the scope of the IHT rules.
- **Coal Bed Methane:** (CBM) – Some interested parties raised the view that CBM developments should be taken outwith the North Sea fiscal regime. Alternatively, it was proposed that, although remaining within the fiscal regime, certain elements of the regime should not apply.

4

Conclusions from the discussions - incentives

This chapter outlines the Government's views pertaining to the need for additional incentives within the North Sea fiscal regime to provide a further stimulus to investment, activity and hence production.

The case for incentives

4.1 The UKCS is facing increasing challenges due to its nature as a maturing basin. The easy to recover hydrocarbons have been exploited and the remaining opportunities are, increasingly, either smaller in size or require the use of cutting edge technologies to enable extraction. One result of this is that many potential projects have become commercially marginal and unable to compete with other projects around the globe. These challenges are exacerbated by the current uncertainty over future oil prices and the high cost levels faced within the North Sea.

4.2 The UKCS still has great potential, with a significant amount of oil and gas still to be recovered. As set out in chapter 1, the oil price, underlying geology and technological progress will play a major role in deciding the future of the UKCS. However, the fiscal and regulatory regimes also have an important role to play and this chapter sets out the Government's position on the role of the fiscal regime in incentivising production.

West of Shetland and Enhanced Oil Recovery (EOR)

4.3 As set out in Chapter 3, the three areas industry believed Government should focus on were West of Shetland, assistance for EOR and potential fiscal incentives.

4.4 On the first of these, the joint Government and industry West of Shetland Taskforce is looking closely at proposals that could unlock West of Shetland and the Government remains fully supportive of that process. On the second, it has become clear through the discussions to date that both the Government and industry need to gain a much better understanding of the issues associated with EOR before any potential incentives can be properly looked at. Therefore, as announced by the Prime Minister on 4 September 2008, the Government will be launching a joint working group to examine these issues. This chapter does not therefore focus any further on these issues, but concentrates on the third – the case for wider incentives.

Summary of the Government's conclusions on the case for incentives

4.5 Having engaged in extensive discussions with stakeholders on the question of fiscal incentives the Government has come to the following conclusions:

- a correctly targeted and designed incentive could, over the life of the UKCS, lead to both an increase in investment and a subsequent increase in production. However, such an incentive will need to be carefully calibrated to ensure a mutually beneficial outcome where both taxpayers and producers benefit.
- having examined a number of possible mechanisms to deliver such an incentive the Government believes that the method which seems to have the greatest potential for achieving this is a 'value allowance'.

- for such an allowance to be effective it will need to be carefully targeted on those fields at the margin that are most in need of assistance.

4.6 Further detail on these conclusions is set out below. Subject to consultation with the industry confirming that a value allowance can be delivered which meets the Government's criteria, the Government would aim to introduce the necessary legislation in Finance Bill 2009.

Options considered

4.7 The Government has examined the following possible mechanisms for delivering an incentive: a flat reduction in the rate of SC; an across the board capital expenditure uplift; a volume allowance; a value allowance.

Criteria

4.8 The Government is committed to the twin principles of encouraging investment in economic activity whilst ensuring a fair return for the UK taxpayer. Therefore the different options have been assessed against the following criteria, to:

- promote investment and production – targeting support on those fields facing the greatest challenges within the UKCS;
- ensure a fair return for the UK taxpayer from the North Sea to maintain the UK's long term fiscal position;
- minimise any deadweight cost;
- be simple and sustainable and give as much up front clarity and certainty as possible; and
- support only commercially marginal projects and not act to bring forward projects which are otherwise uneconomic.

A reduction in supplementary charge

4.9 The Government does not believe that an across the board reduction in the rate of SC would be desirable. This would act to give the greatest incentive to those projects with the greatest profitability, which by definition are those that least require support, and therefore would result in significant deadweight costs. Moreover, whilst the Government recognises that some new fields may require additional support, as stated in Chapter 1 the Government believes that overall the fiscal regime is appropriately balanced and set at the correct level to ensure a fair return to both producers and consumers.

Uplift on capital expenditure

4.10 Industry proposed that Government should introduce an across the board 25 per cent uplift on capital expenditure. However, the Government does not believe this would represent a solution that was in line with the criteria set out above.

- an across the board uplift would represent a blunt instrument as it would apply to all capital expenditure, including already sanctioned expenditure. It would not therefore effectively target support on those fields facing the greatest challenges within the UKCS.
- it would involve significant deadweight cost. Whilst it was argued in the course of the discussions that this deadweight cost could be offset by the resulting increased production, more detailed analysis has suggested that this is unlikely to be the case.

This proposal would therefore also undermine the principle of maintaining a fair return to the UK taxpayer.

- implementation of such an incentive would be neither simple to design or operate. Giving relief for 125 per cent of capital costs would require either a fundamental rewriting of large parts of the capital allowances rules (to take account of relieving more than 100 per cent of cost) or the introduction of a whole new relieving mechanism for the additional 25 per cent uplift. Either would require large amounts of additional legislation, and additional ongoing compliance obligations for both HMRC and companies.

4.11 Government also has concerns that, in addition to not meeting the criteria set out above, the proposal has the potential to reward failure – by reducing the risk in taking forward marginal projects and transferring it onto the Government instead. Given that the Government already effectively takes a substantial share of the risk in any project, greater if undertaken in a PRT field, a further transfer of risk to the Government is not desirable.

A Volume or value allowance

4.12 Two broader options for delivering an incentive were therefore examined and discussed with stakeholders: a volume allowance, where a certain number of barrels of oil would be subject to a reduced, or zero rate of supplementary charge, or alternatively a value allowance, where a certain amount of adjusted ring fence profits would be similarly taxed at a lower or zero rate of supplementary charge.

4.13 These two options are similar – the major difference being whether the volume of hydrocarbon or its value is the object of the targeting. The Government does not believe that a volume allowance would be effective, for, as the oil price increases, the amount of income free of supplementary charge similarly increases. This is clearly not a desirable result, as it leads to the Government giving an increased incentive to production just as such an incentive becomes less necessary. Equally an oil price fall is accompanied by a fall in the value of a volume allowance, this time when it would seem to be most needed.

4.14 The Government has therefore looked closely at the possibilities that a value allowance might present and believes that:

- a value allowance would, if effectively designed and implemented, allow support to be targeted on those commercially marginal, but economic, fields facing the greatest challenges within the UKCS.
- if set at the correct level, and correct targeted, has the potential to both benefit producers and UK taxpayers, and minimise deadweight cost.
- should be designed to be both simple and give up front clarity and certainty to industry when investment plans are being drawn up.

4.15 In addition the Government is attracted towards such an option as it would reward success, only applying once new production is brought on line, and should minimise the impact of the fiscal regime on how companies choose to develop particular projects.

4.16 The Government believes therefore that this option has the greatest potential out of those options examined to meet the criteria set out above and contribute to the Government's overall objective to maximise the recovery of the UK's oil and gas reserves. However clearly much will rest on the final design as to whether it could meet the Government's criteria and hence be of benefit to the UKCS.

A targeted incentive

4.17 Having drawn the above conclusions Government therefore examined potential options for targeting such an incentive, and discussed these with stakeholders.

A case-by-case approach

4.18 The most targeted approach would be a case-by-case clearance system, with successful cases then being given one of the other incentives discussed here. This would seem to have the potential to minimise deadweight costs and target an incentive on those projects displaying the greatest need. However given the potential number of fields that would need to be looked at, and the administrative and compliance burdens for both industry and the Government, the Government does not believe this would be an effective delivery method, nor would it give industry the certainty they have stated they would need for an incentive to have a full effect.

4.19 Moreover, any incentive that is introduced is not intended to merely assist in bringing forward existing projects into production. Rather the Government believes that, if clearly set out, one of the overall benefits of an incentives system would be the knock-on effect on exploration and appraisal activity, both of which are vital if the potential of the UKCS is to be maximised. A case-by-case approach would not seem to have this effect, as certainty would only be given once a field development plan had been fully worked up.

A criteria based approach

4.20 The Government therefore believes that a criteria based approach is the best way of balancing the requirement to target support on those fields facing the greatest challenges within the UKCS, whilst also giving industry the wider certainty necessary to work up project plans.

4.21 Following the discussions to date with industry the Government believes that such an approach should be practicable and achievable and that it should be possible to draw up criteria that would effectively target those fields most in need of support. As a starting point Government has notes the three main categories proposed to date by industry and wishes to discuss further the case that can be made by all of these and how they could be defined.

Consultation questions

4.22 Therefore the Government believes that any incentive will need to be delivered through a simple and sustainable method, give as much up front clarity and certainty as possible, and promote investment and production from those fields facing the greatest challenges. It will also need to be carefully set at such a level that it is firmly in line with our commitment to ensure a fair return to the UK taxpayer and maintain the UK's long-term fiscal position. As set out above the Government believes a value allowance would seem to have the greatest potential to meet these criteria.

4.23 Over the consultation period the Government therefore wishes to build on the discussions already had to date and discuss the following with stakeholders:

- **the method for delivering any allowance:** The Government would like to explore how a value allowance would work in practice and the legislative solutions to deliver it.
- **the types of field upon which such an allowance should be targeted:** The Government has noted the three main categories set out by industry of HPHT, heavy oil and small fields and wishes to discuss further the case that can be made by all of these.

- the levels at which the allowance would need to be set in order to make a material difference to the economics of economically viable but commercially marginal fields.

5

Conclusions from the discussions - change of use

This chapter outlines the Government's proposals relating to the interaction of the fiscal regime with potential change of use activities undertaken within the UKCS. It sets out the changes that Government proposes to make to a number of areas to facilitate the re-use of North Sea ring fence assets for certain alternative uses.

5.1 On 3 October 2008, a new Government department was created, the Department of Energy and Climate Change (DECC), aimed at tackling the twin challenges of energy security and climate change. In the same month, the Government committed the UK to cutting greenhouse gas emissions by 80 per cent (on 1990 levels) by 2050¹ and announced that the UK had become the world leader in wind farms built offshore².

5.2 These key themes – security of supply, renewable energy and reduction in greenhouse gas emissions – have all featured in the work of the joint Industry/Government Working Group on fiscal issues arising from the change of use of North Sea infrastructure. In the North Sea, there are already offshore wind turbines helping to power oil and gas platforms; a number of companies have expressed an interest in ventures that could utilise spent or partially-spent fields for gas storage; and others are considering the feasibility of using North Sea fields for carbon sequestration.

5.3 Some of these proposed reuses of existing oil and gas pipelines, platforms and other assets will require significant re-engineering of the equipment and there will be technological and economic challenges. But they do provide the opportunity to extend the working life of some of the nearly 14,000km of existing pipelines and nearly 300 oil and gas facilities on the UKCS.

5.4 Over the last two years, a number of oil and gas companies have approached HMRC, HMT and DECC, seeking clarification of the tax treatment when assets used for the purposes of oil and gas extraction or transportation are put to some other use. There are tax consequences when assets move out of the ring fence corporation tax and petroleum revenue tax regimes into mainstream corporation tax - in terms of the tax allowances that have already been given, the treatment of future income and expenditure, and the availability of relief for decommissioning costs.

5.5 The Government recognises the importance of clarity for industry when considering and costing change of use projects and in the 2006 Pre-Budget Report announced the setting up a joint Industry/Government Working Group to explore and clarify how the existing tax law would apply to change of use projects. The Group, containing representatives from HMRC, DECC and the oil and gas sector, met several times and in November 2007, the report 'Platform for Change' was published³.

¹ <http://nds.coi.gov.uk/environment/fullDetail.asp?ReleaseID=381477&NewsAreaID=2>

² <http://nds.coi.gov.uk/environment/fullDetail.asp?ReleaseID=381930&NewsAreaID=2>

³ <http://www.hmrc.gov.uk/oto/change-of-use.pdf>

5.6 Following the publication of this document, the Government stated in the December 2007 consultation documents that it, ‘considers that some of these areas (those outlined in chapter 3 above) merit legislative change but wishes to explore them more fully with industry to ensure that any measures are properly targeted and proportionate.’

5.7 In July 2008, HMRC published a technical paper entitled ‘The North Sea fiscal regime and the reuse of oil and gas infrastructure’ which sought to take forward discussions on a number of industry’s proposals. A number of further meetings were subsequently held to discuss the issues raised by industry and the potential solutions. Following those conversations, the Government has reached the conclusions set out below. Where the Government proposes to make changes to the relevant legislation, the Government intends those changes to be made in Finance Act 2009. On all of the conclusions the Government would welcome the further comments and views of stakeholders. If at all possible, the Government will also seek to publish draft legislation to give effect to these proposals prior to the publication of Finance Bill 2009, to allow comments to be made on the wording of the legislation as well.

Capital allowances and deemed disposals

5.8 The Government questions whether it is likely that fields with significant value still remaining in their production assets would be subject to a change of use project. Rather, it is considered that where the field and the associated assets (plant and machinery etc) had a low or close to zero value (particularly taking account of asset integrity and end of life decommissioning obligations), change of use activities might be seen as a viable option. As such the market value to be brought in for any deemed disposal is likely to be low and the economic impact as a result of using market value would similarly be low. However, the Government accepts that there may be some situations where the balancing charges arising from the deemed disposal rules will not be insignificant.

5.9 The computation of some form of value for asset disposals, whilst not free from difficulty, is the sort of process that industry continually goes through, when selling field interests. Companies will compare the value to them of either retaining the field interest or selling it to another producer. But in circumstances where there is the possibility of the field moving from a production to a change of use activity, it would be likely that the company would then assess whether it was more profitable (or efficient) to carry on the change of use activity ‘in-house’ or dispose of the field interest to a third party. This process would inevitably involve attaching some sort of market value to the assets, in order to make a proper assessment of the options.

5.10 At least in the medium term, it is likely that most of the assets that will be considered for change of use activity are those that were acquired before 2002, and so will not have qualified for 100 per cent first-year plant and machinery allowances. These assets will have been entitled to a writing-down allowance of 25 per cent (now 20 per cent) on a reducing balance basis. As this is intended as a proxy for commercial depreciation, it is likely that there will now not be a significant discrepancy between the written-down value and the market value of the assets.

5.11 Consequently, it is the Government’s view that there is no case to treat ring fence and change of use activities as the same qualifying activities for capital allowances purposes. In addition, the Government considers that, as a matter of principle, the application of the market value rule for deemed disposals provides the correct result. The use of market value ensures that the right amount of plant and machinery allowances have been given against the profits of the ring fence trade – reflecting the amount the assets have genuinely depreciated in value in the period in which they were ring fence assets. The rules that give rise to a balancing adjustment are not creating an additional new tax charge, rather they are ensuring that the correct amount of allowances have been given within the ring fence and no more. **The Government therefore proposes no change to this legislation.**

5.12 However, on the valuation point, given the cutting-edge nature of a number of change of use projects, where change of use is genuinely being contemplated, HMRC will endeavour to give advance clearance of a company's valuation of the plant and machinery, which should provide industry with certainty. Further guidance on the procedure for making non-statutory clearance applications can be found on the HMRC website.⁴

Capital allowances claw back

5.13 HMRC's view, expressed in the working group, was that there was not a compelling argument for legislative change here, inasmuch as the chance of expenditure on plant and machinery being incurred wholly for the purposes of a ring fence trade, yet within five years that same plant and machinery being used for some other purpose, appears to be very remote. This was particularly the case given that the 100 per cent first-year allowances legislation requires the expenditure to have been incurred for use 'wholly for the purposes of a ring fence trade'. It was not at all clear that the operation of this anti-avoidance rule would provide a significant barrier to change of use activities.

5.14 At a recent meeting of the Change of Use Working Group, industry agreed that they would not seek to press for further changes to the clawback provision. **The Government therefore proposes no change to this legislation.**

PRT – disposal of qualifying asset rules

5.15 The Government accepts that the particular way the claw back mechanism operates could give rise to situations where it would impact on the willingness of companies to re-use infrastructure in PRT fields, notwithstanding the general corporation tax treatment of deemed disposals of assets outside the ring fence considered above.

5.16 At the time of the introduction of the key elements of the PRT legislation in 1975, 1983 and in subsequent finance acts, it was not envisaged that there would be the potential for the assets to remain in situ for a number of years, yet be used for some other non-oil and gas production purpose, for a number of years.

5.17 **The Government therefore proposes** that where a qualifying asset:

- ceases to be used in connection with a taxable field;
- is used for a 'change of use' purpose (see comments on definitions below); and
- no disposal receipts arise within two years following last use in connection with a taxable field;

then the 'change of use' activity shall be deemed not to have been used 'otherwise than in connection with a chargeable field'.

5.18 **This will remove any PRT charge where a qualifying asset is no longer used for a PRT purpose but is used instead for a change of use purpose.**

Treatment of income and expenditure

5.19 In relation to RFCT and SC, HMRC believes that it should be possible to properly ascribe income and expenditure either to the ring fence trade or the change of use trade, using existing legislation and case law. This process of identifying and allocating income and expenditure is undertaken all the time for tax computational purposes by those groups that have both

⁴ At <http://www.hmrc.gov.uk/cap/links-dec07.htm>

upstream and downstream activities within the same company. There is no clear evidence that legislating or otherwise stating the general principle, that income arising from a non-ring fence trade should not be taxed within the ring fence, adds significantly to the existing statutory position. But if companies nevertheless have specific concerns about particular items of income and expenditure, then HMRC will be happy to consider them, and if further clarification is required, provide this by way of guidance or legislation, as appropriate.

5.20 For PRT, there is no equivalent ring fence trade vs. non-ring fence trade divide. The principles of what is income from the production of oil and gas and what is the expenditure incurred in winning, transporting etc. that oil and gas, are well established and participants are used to identifying income and expenditure in drawing up their PRT computations.

5.21 The rules on tariff receipts are, however, quite broad in their scope. They state that any income, no matter what its nature, which is derived from a qualifying asset, is subject to PRT. A 'qualifying asset' is essentially an asset the cost of which has previously been allowed for PRT purposes.

5.22 The Government recognises the strength of the argument that a PRT income charge should not arise in relation to assets used for a change of use purpose, even where those assets have previously benefited from PRT relief when acquired. **The Government therefore proposes to ensure that PRT is not levied on income relating to change of use activities.**

Decommissioning relief

5.23 The Government recognises the impact that access to decommissioning relief might have on change of use projects, particularly given the statutory obligation to decommission and the greater access and higher rate of relief available for those companies decommissioning infrastructure whilst it is still within the ring fence corporation tax regime.

5.24 **The Government proposes to provide for the relief of decommissioning costs of ex-ring fence assets which are used for a change of use activity on the same basis that would have been available had the assets remained within the ring fence trade.** Decommissioning costs of any assets on which expenditure was incurred outside the ring fence would fall to be relieved, where appropriate, within the existing general CT rules.

5.25 The PRT legislation apportions abandonment expenditure, where the qualifying asset has at some time been used other than in connection with the field, and that apportionment is to be made on a just and reasonable basis. This is unlike the disposal rule for PRT discussed above which operates on a time-apportionment basis.

5.26 It is the view of HMRC that, the 'relevant portion' for the purposes of giving relief for abandonment costs, would be the whole of the abandonment expenditure that related to qualifying assets, which by definition are assets that are PRT assets and therefore relate to the PRT-able period. In that respect it should be possible, using the wording of the current legislation, **to ensure that abandonment costs of qualifying assets are relievable for PRT purposes.**

5.27 However, for the avoidance of further doubt on the potential interpretation of 'just and reasonable', one solution would be to deem the change of use activity not to be a use 'other than in connection with a field'. This would take the assets out of the apportionment rules and leave all the abandonment costs fully within the PRT legislation. **The Government would welcome the views of industry on whether this additional step is necessary or not.**

The need for a definition of 'change of use'

5.28 From a ring fence perspective, there is probably no need at present to define change of use activities – the proposals set out above provide a general treatment for ex-ring fence assets, in relation to access to decommissioning costs and relating them back to the ring fence trade.

5.29 The situation is different for PRT. For the PRT legislation, elements of it that require an apportionment between PRT and non-PRT use (including decommissioning relief) will be deemed not to apply where that other use is a 'change of use' activity. Government will therefore undertake to define "change of use" activity for these purposes.

5.30 However, the Government believes that the definitional issues should not be problematic. The number of activities that are currently being considered are limited – wind power, carbon capture and storage and gas storage – and it should be possible to define such activities by reference to the DECC licensing regime or some other criteria. **Views from industry on the best method for defining 'change of use' activities would be welcomed.**

5.31 It would not be the case that the list would be exhaustive, but would sensibly encompass likely change of use activities. If new uses were found for North Sea infrastructure and the Government was convinced of the case to add them to the change of use list, then that would be possible.

6

Conclusions from the discussions - chargeable gains and PRT

This chapter outlines a number of changes to the North Sea fiscal regime that the Government is proposing to announce at Budget 2009 in relation to PRT and the taxation of chargeable gains within the ring fence. It also covers the Government's views on the 'other' issues flagged at the end of Chapter 3.

The North Sea fiscal regime and chargeable gains taxation

6.1 In relation to issues pertaining to chargeable gains, the Government is proposing to make two changes to the existing legislation:

- build on the existing provision under which pre-development licence interests can be swapped for nil consideration, by providing that where UKCS licences are swapped, no gain will arise to the extent that the value of the licence acquired equals the value of the licence disposed of; and
- enhance relief for gains on arm's length disposals of ring fence licence interests by exempting, not simply deferring, gains where the sale proceeds are reinvested in other ring fence licence interests.

6.2 The Government believes these two proposals will:

- assist in reducing any distortionary impact of the fiscal regime on licence trades;
- encourage licence trades, and hence the migration of oil and gas fields into the hands of those best able to maximise their potential; and
- encourage the reinvestment of the proceeds of a licence sale within the UKCS.

Further details on these changes and the rationale behind them are set out below:

6.3 As was acknowledged in the December 2007 Consultation Document 'Securing a sustainable future', the Government recognises the importance of reducing any distortionary impact of the fiscal regime on investment decisions and helping facilitate asset trades. However, the Government does not consider it appropriate that all disposals of licence interests should fall outside the scope of the chargeable gains regime. If a company has benefited from the increase in value of a licence interest during its ownership (and the most common reason will be an increase in the price of oil or gas) then, if the proceeds of the sale are not reinvested within the UKCS, it is right that any chargeable gain should be subject to tax.

6.4 It was also suggested during the consultation that oil licences could be brought within the Intangible Property regime. Government is of the view that there are no compelling accounting or policy reasons for taking this step. It has previously been suggested that under the most common accounting methods, oil licences would potentially have a dual (intangible, then tangible) character, giving rise to complexity and uncertainty were they to be within the scope of IP. In addition whilst those acquiring licenses would get some relief for purchase costs, any profits to the seller would be charged as income. Industry has previously expressed the view that this might well discourage licence transactions and therefore hinder the efficient exploitation of the North Sea.

6.5 The Government is prepared, however, to substantially increase the scope of disposals which will not, or are unlikely to, give rise to a chargeable gain and proposes two changes. This should encourage the sort of disposals that will allow North Sea assets to get into the hands of those companies most willing and able to develop them to their full potential.

6.6 The existing provision under which pre-development licence swaps do not give rise to chargeable gains will be extended to all UK and UKCS licence swaps, albeit by a slightly different route. Where licence interests are swapped, to the extent that the consideration for the disposal is another licence, the consideration will be deemed to be allowable costs plus indexation – giving rise to a no gain/no loss transfer. This amount will also be the acquisition cost for the new licence interest. Where licence interests are swapped and there is an additional amount of consideration paid, that consideration will fall within the gains regime, subject to offset of allowable costs and indexation.

6.7 The second change is in relation to the application of the held-over gains rules within the ring fence. The current rules provide that where the roll-over relief rules apply to any gains that are being reinvested, the new assets are treated in all cases as depreciating assets. The result is that the basic roll-over rules are displaced, and the gain on disposal of the old asset does not reduce the acquisition cost of the new asset. Instead the gain is ‘held over’ until the earliest of three events: the new asset is disposed of, the new asset ceases to be used for the ring fence trade, or ten years elapse from the time the new asset is acquired.

6.8 What is proposed is that the ‘hold-over’ treatment outlined above will not apply where the ring fence assets are licence interests. Instead, where the old asset on which the gain arises is a ring fence licence interest, the old asset was disposed of by way of an arm’s length bargain, and the proceeds from disposing of the interest are reinvested in acquiring one or more new ring fence licence interests, the gain on the old asset will be exempted from charge.

6.9 The overall effect of these two proposals is that ring fence licence swaps will not give rise to chargeable gains, in relation to the shared value of the licence swapped; and where proceeds of a sale of a ring fence licence are wholly reinvested in other ring fence licences, the gain will be eliminated. Where ring fence licences are sold (rather than swapped) and the proceeds are not reinvested, gains will be taxed as normal.

Petroleum Revenue Taxation regime

6.10 In relation to the issues pertaining to the PRT regime, the Government is proposing:

- a change to existing legislation to ensure that companies have the potential for full PRT relief for decommissioning costs, where licences are terminated prior to the completion of decommissioning; and
- a package of measures to simplify further the PRT regime.

6.11 More detail on these proposals is set out below. The Government believes they will act to give industry added certainty over the longer term viability of the PRT regime – improving stability and simplifying the fiscal regime and through this reduce the administrative burden imposed upon companies.

The future of PRT

6.12 The Government reiterates its belief that the removal of the PRT system could have benefits for the UKCS. Its removal would be expected to result in increased investment in PRT paying fields and could, as a result, potentially increase the recovery of the remaining oil and gas reserves contained within those fields and from other fields utilising the same infrastructure. The Government also accepts that such a removal would simplify the overall fiscal regime and could

be argued to reduce the uncertainty that some companies currently continue to believe exists over the Government's future intentions towards PRT.

6.13 For these reasons, the Government has continued to explore with industry potential options for the abolition of the PRT Regime – in particular the potential surrounding the 'PRT Buy-Out' model. Throughout this process the Government has reiterated that any progress made in this area would have to take into account the wider interests of the UKCS as a whole and continue to ensure that the UKCS provides a fair return for UK taxpayers.

6.14 Following this process, the Government has concluded that a buy-out should not be considered further at the current time. The list of potential issues set out in the December 2007 Consultation document – whilst given considerable extra attention by both the Government and industry over the past months – has not been met with solutions. In addition, the current instabilities surrounding oil prices, decommissioning (and other) costs and future production would make it extremely hard to arrive at a figure for a buy-out that satisfied both industry and the Government. What has also become apparent over the course of the discussions is that the risk premium that both parties would, quite reasonably, wish to apply to any such computation would further reduce the chances of agreed figures being arrived at.

6.15 However, the Government continues to hold the views stated above in paragraph 6.12. The Government is therefore willing to continue to engage with industry on the wider question of PRT abolition if there is a belief that genuine progress can be made.

Licence expiry

6.16 On 27 November 2007 DECC wrote to industry to invite input on how the expiry of first round licences – to take place in 2010 – would be managed. The issue was explored further at the PILOT Exploration Forum on 18 June 2008 and the broad thrust of the proposal to manage the licence expiry is for a Deed of Variation ('DoV') to be made which will take back all acreage from non-producing fields. The DoV also allows for short-term extensions for potential producing fields and a final extension for producing fields.

6.17 This arrangement poses problems for companies in that the decommissioning of infrastructure will still need to take place following the cessation of production. In the context of a licence that is due to expire, a company may well find itself in the position of having to carry out decommissioning activities in respect of a field that is no longer subject to a petroleum production licence.

6.18 As explained in the December 2007 consultation paper¹, for PRT purposes a company is, broadly, a participator in a field while they hold a relevant licence interest in a field and for two chargeable periods after that licence has been held. As a result of the licence expiry, the company would be in the situation where it had an obligation to meet decommissioning expenditure in respect of a PRT liable field but, having ceased to have a licence interest at the point where it ceased producing oil or gas from the field, was unable to claim PRT relief for some or all of that expenditure.

6.19 HMRC has been in consultation with DECC in order to arrive at the most appropriate method for ensuring that companies are able to claim full PRT relief for decommissioning costs under the circumstances described above. The approach will be, for the purposes of the PRT legislation, to deem companies to be participators in the field where they have previously been licence holders but still have decommissioning obligations subsequent to the expiry of the licence.

¹ "Securing a sustainable future" – Chapter 4, paragraphs 4.22 to 4.25

6.20 The Government intends to shortly make available to industry draft legislation on the above and will then be happy to listen to any concerns or suggestions that industry might have.

PRT simplification

6.21 The Government is committed to reducing the administrative burden for industry in general and this includes the simplification of the tax codes. Under this banner HMRC has taken the opportunity to look at areas where the PRT legislation can be improved or simplified and, together with industry, have identified a number of potential areas where the legislation can be improved or removed altogether. **The Government would welcome industry's comments on these proposals.**

6.22 Provisional expenditure allowance – HMRC intends to repeal this piece of legislation with a transition period to ensure that any relief given prior to repeal is recovered through the claw back mechanism.

6.23 Commingling agreements – The Government's proposal is to remove the requirement for companies to provide information whenever a new field comes on stream and is blended with other production or where there is a change in the allocation methodology. Instead, production would be allocated on a "just and reasonable basis" in the same way as joint expenditure is allocated between fields.

Other items of legislation for repeal

6.24 HMRC has identified a number of elements of the PRT legislation for which there appears to be no reason for retaining – these are outlined below. HMRC welcomes any comments industry has on these proposals; for example there may be other areas of legislation which could be simplified or there may be as yet unidentified issues with the following items for repeal.

6.25 Spreading of supplement – Legislation at paragraph 9 of Schedule 3 to Oil Taxation Act (OTA) 1975 allows companies to elect to spread relief for qualifying "supplemented" expenditure for up to 20 chargeable periods. The legislation does not currently appear to serve any useful purpose.

6.26 Pre-PRT expenditure – Legislation at paragraph 3 of Schedule 4 to OTA 1975 applies to certain expenditure incurred prior to 13 November 1974. The normal time limit for claiming expenditure for PRT is six years and in any event HMRC is not aware of any outstanding claims under this legislation.

6.27 Tariff Receipts Allowance – alternative calculation – Legislation at section 9 of OTA 1983 provides a volume based allowance against tariff receipts similar to that of Oil Allowance being relieved against sales of oil. Section 9(3) of OTA 1983 provides an alternative calculation for chargeable periods ending on or before 30 June 1987. The legislation is relatively complicated and clearly is now no longer applicable.

6.28 Transitional provisions for certain rules within OTA 1983 – Section 13 of and Schedule 5 to this Act provide transitional rules for periods ending before or straddling 1 July 1982 in respect of the application of these new rules. These transitional rules are no longer applicable.

Other issues

- **IHT and decommissioning trusts** – The Government once again reiterates its willingness to engage further with industry on this issue. The Government continues to await further communications from industry setting out the potential impact that it is believed such a change would occasion and the issues that the current treatment is causing.

- **Coal Bed Methane** – The Government believes that this issue needs to be discussed further before any views can be reached with regard to any potentially different fiscal treatment. The Government therefore invites further views from stakeholders on these issues.

7

Next steps

7.1 As stated in the introduction this paper is intended to give stakeholders the chance to comment on the Government's proposals to make changes to the North Sea fiscal regime, and to engage further on the question of potential fiscal incentives, with the intention being to bring forward a package of reforms at Budget 2009.

7.2 The Government therefore invites industry to comment by 13 February 2009 on these proposals. Whilst the Government will attempt to take on board any comments received after this date this may not prove possible.

7.3 Following Budget 2009 the Government will continue to engage with stakeholders on the future of the North Sea fiscal regime – looking to build upon the proactive and positive relationship that has been established since discussions were initially launched at Pre-Budget Report 2005. For whilst significant progress has been made, with the Government believing that the fiscal regime is now more sustainable and effective and will act more effectively in supporting the Government's over-arching objectives for the UKCS, it is apparent that in areas such as EOR there are still further debates to be had.

7.4 The Government once again extends its thanks to all those stakeholders who have engaged in the debate on the future of the North Sea fiscal regime since Pre-Budget Report 2005.

7.5 Any views or comments on the proposals and conclusions set out in this document should be directed to:

Rob Douglas
Head of North Sea Taxation
HM Treasury
1 Horse Guards Road
London SW1A 2HQ
Email: Robert.Douglas@hm-treasury.gsi.gov.uk
Telephone (Treasury switchboard): 020 7270 5000

or

Mike Crabtree
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22 Kingsway
London WC2B 6NR
Email: mike.crabtree@hmrc.gsi.gov.uk
Telephone: 020 7438 6576

A Impact Assessments

Impact assessments on the PRT and chargeable gains proposals are contained within this Annex and are set out on the following pages.

Summary: Intervention & Options

Department /Agency: HM Treasury and HM Revenue and Customs	Title: Impact Assessment of changes to the application of chargeable gains legislation to the North Sea ringfence.	
Stage: Consultation	Version: 1	Date: 24 November 2008
Related Publications: Supporting Investment: A consultation on the North Sea Fiscal Regime; Securing a Sustainable Future: A consultation on the North Sea Fiscal Regime.		

Available to view or download at:

<http://www.hm-treasury.gov.uk>

Contact for enquiries: Mike Crabtree

Telephone: 0207 438 6576

What is the problem under consideration? Why is government intervention necessary?

Government has an overall aim to maximise the economic recovery of the UK's oil and gas reserves. Government believes that one important way of achieving this is to reduce the impact of the fiscal regime on investment decisions. One aspect of this pertains to asset trades - with Government holding the belief that assets' potential will inevitably be maximised if they are placed in the hands of those most willing to invest. Industry has argued that the current structure of the fiscal regime's treatment of gains arising from asset trades is inconsistent and detrimental to asset trade occurring.

What are the policy objectives and the intended effects?

To prevent the fiscal treatment of chargeable gains from standing in the way of asset trades, whilst not removing the ability to tax such gains when the proceeds are being taken out of the UKCS.

What policy options have been considered? Please justify any preferred option.

1. Do nothing - and risk current treatment inhibiting asset swaps and reinvestment of gains, or
2. Remove chargeable gains taxation from asset swaps (and partially achieve desired objectives), or
3. Do 2, and where proceeds from disposal of a UK licence are reinvested in another UK licence, convert the holdover gain to a rollover gain - therefore chargeable gains taxation will only arise at the point where the benefit is taken outwith the UKCS, or
4. Preferred Option: Do 2, and where proceeds from the disposal of a UK licence are reinvested in another UK licence then exempt the gain from chargeable gains taxation.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The evaluation of savings will be included in any review of the measures implemented following the November 2008 Consultation on the North Sea

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



.....Date: 20 November 2008

Summary: Analysis & Evidence

Policy Option: North Sea Fiscal Regime CG reform

Description: Option 1: Do nothing

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' No change compared to the current position	
	One-off (Transition)	Yrs		
	£ 0			
	Average Annual Cost (excluding one-off)			
	£ 0		Total Cost (PV)	£ 0
Other key non-monetised costs by 'main affected groups' No change compared to the current position				

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' No change compared to the current position	
	One-off	Yrs		
	£ 0			
	Average Annual Benefit (excluding one-off)			
	£ 0		Total Benefit (PV)	£ 0
Other key non-monetised benefits by 'main affected groups' No change compared to the current position				

Key Assumptions/Sensitivities/Risks As now, asset trades will continue to be inhibited as a result of their tax treatment, thereby continuing to inhibit the reinvestment of gains and providing a barrier to the rationalisation of asset holdings.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate)		
What is the geographic coverage of the policy/option?		UKCS			
On what date will the policy be implemented?		Tbc			
Which organisation(s) will enforce the policy?		HMRC			
What is the total annual cost of enforcement for these organisations?		£ 0			
Does enforcement comply with Hampton principles?		Yes			
Will implementation go beyond minimum EU requirements?		N/A			
What is the value of the proposed offsetting measure per year?		£ N/A			
What is the value of changes in greenhouse gas emissions?		£ N/A			
Will the proposal have a significant impact on competition?		No			
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of	£ 0	Decrease of £ 0
Net Impact		£ 0

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence

Policy Option: North Sea Fiscal Regime CG reform

Description: Option 2: Remove chargeable gains taxation from asset swaps

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups'
	One-off (Transition)	Yrs	
	£ Negligible – tbc		Negligible overall change to business admin burdens, wider business compliance costs and to HMRC operating costs.
	Average Annual Cost (excluding one-off)		
	£ Negligible – tbc		
Total Cost (PV)			£ Negligible – tbc
Other key non-monetised costs by 'main affected groups'.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups'
	One-off	Yrs	
	£ Negligible – tbc		Negligible overall change to business admin burdens, wider business compliance costs and to HMRC operating costs.
	Average Annual Benefit (excluding one-off)		
	£ Negligible – tbc		
Total Benefit (PV)			£ Negligible - tbc
Other key non-monetised benefits by 'main affected groups' Wider unquantified economic benefits should arise from increased investment and activity occurring from assets ending up in the hands of those most willing to invest in them. This stems from the removal of barriers to asset trades.			

Key Assumptions/Sensitivities/Risks Enabling companies to rationalise their North Sea asset holdings will encourage an increase in production and consequently tax revenues that will outweigh any potential future loss of revenue from applying chargeable gains in a narrower range of circumstances.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate)
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What is the geographic coverage of the policy/option?		UKCS			
On what date will the policy be implemented?		Tbc			
Which organisation(s) will enforce the policy?		HMRC			
What is the total annual cost of enforcement for these organisations?		£ tbc			
Does enforcement comply with Hampton principles?		Yes			
Will implementation go beyond minimum EU requirements?		N/A			
What is the value of the proposed offsetting measure per year?		£ N/A			
What is the value of changes in greenhouse gas emissions?		£ N/A			
Will the proposal have a significant impact on competition?		No			
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)		
Increase of	£ neg	Decrease of	£ neg	Net Impact £ neg

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence

Policy Option: North Sea Fiscal Regime CG reform

Description: Option 3: Roll-over gains into reduced acquisition cost where proceeds are reinvested in a UKCS licence

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' As option 2, negligible overall change to business admin burdens, wider business compliance costs and to HMRC operating costs.
	One-off (Transition)	Yrs	
	£ Negligible – tbc		
	Average Annual Cost (excluding one-off)		
	£ Negligible – tbc		
Total Cost (PV)			£
Other key non-monetised costs by 'main affected groups'			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' As option 2, negligible overall change to business admin burdens, wider business compliance costs and to HMRC operating costs.
	One-off	Yrs	
	£ Negligible – tbc		
	Average Annual Benefit (excluding one-off)		
	£ Negligible – tbc		
Total Benefit (PV)			£
Other key non-monetised benefits by 'main affected groups' As option 2, but in addition providing greater incentives for increased investment and activity and also providing an incentive not to remove gains from the North Sea.			

Key Assumptions/Sensitivities/Risks As Option 2, though Option 3 will magnify both potential future loss of yield from disapplying chargeable gains taxation and potential gains from the taxation of higher production.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate)
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What is the geographic coverage of the policy/option?		UKCS		
On what date will the policy be implemented?		Tbc		
Which organisation(s) will enforce the policy?		HMRC		
What is the total annual cost of enforcement for these organisations?		£ tbc		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		N/A		
What is the value of the proposed offsetting measure per year?		£ N/A		
What is the value of changes in greenhouse gas emissions?		£ N/A		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)		
Increase of	£ tbc	Decrease of	£ tbc	Net Impact £ tbc

Key:

Annual costs and benefits: Constant Prices

(Net) Present Value

Summary: Analysis & Evidence

Policy Option: North Sea Fiscal Regime CG reform	Description: Option 4: Remove chargeable gains taxation from asset swaps and exempt gains where proceeds reinvested in a UKCS licence.
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' As Option 3, negligible overall change to business admin burdens, wider business compliance costs
	One-off (Transition)	Yrs	
	£ Negligible – tbc		
	Average Annual Cost (excluding one-off)		
	£ Negligible – tbc		
Total Cost (PV)			£
Other key non-monetised costs by 'main affected groups' There will be a negligible loss in ring fence corporation tax from the transfer of assets within the UKCS that under the current regime might have attracted tax by way of a chargeable gain.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' As option 3, negligible overall change to business admin burdens, wider business compliance costs and to HMRC operating costs.
	One-off	Yrs	
	£ Negligible – tbc		
	Average Annual Benefit (excluding one-off)		
	£ Negligible – tbc		
Total Benefit (PV)			£
Other key non-monetised benefits by 'main affected groups' As option 3, but in addition providing greater simplicity and reducing legislative complexity, with positive implications at the margin for business certainty and admin burdens.			

Key Assumptions/Sensitivities/Risks As option 3.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate)
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What is the geographic coverage of the policy/option?		UKCS			
On what date will the policy be implemented?		Tbc			
Which organisation(s) will enforce the policy?		HMRC			
What is the total annual cost of enforcement for these organisations?		£ tbc			
Does enforcement comply with Hampton principles?		Yes			
Will implementation go beyond minimum EU requirements?		N/A			
What is the value of the proposed offsetting measure per year?		£ N/A			
What is the value of changes in greenhouse gas emissions?		£ N/A			
Will the proposal have a significant impact on competition?		No			
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)		
Increase of	£ tbc	Decrease of	£ tbc	Net Impact £ tbc

Key: Annual costs and benefits: (Net) Present

Rationale for Intervention

As was acknowledged in the December 2007 Consultation Document 'Securing a sustainable future', Government recognises the importance of reducing any distortionary impact of the fiscal regime on investment decisions and helping facilitate asset trades. Government believes where assets are in the hands of those most willing to fully exploit them then this will be to the benefit of the UK.

Over the course of the consultation referred to above, Industry have argued that the current treatment is inconsistent and complicates asset trades, up to and including the point of preventing otherwise viable asset deals from proceeding. They also argued that the current rules for taxing chargeable gains within the UKCS creates a unique "double taxation" burden, in that an increase in value in a field that was then sold would potentially give rise to a chargeable gain in the hands of the vendor. As the reserves were then extracted by the purchaser, they would be subject to the special North Sea fiscal regime that is expressly designed to capture a fair share of the value of the natural resource being produced. Companies argued that as vendors they were being taxed on the value of oil they had not produced, and as purchasers they were then caught because they could not offset the capital cost of acquiring the licence interest against the income charge on production.

Analysis suggested that the current legislation was standing in the way of some asset trades, and Government therefore makes the following proposals.

Policy Proposals

Government therefore proposes to undertake the following actions in relation to the treatment of chargeable gains within the North Sea ringfence. In arriving at these proposals Government did not consider it appropriate that all disposals of licence interests should fall outside the scope of the chargeable gains regime. If a company has benefited from the increase in value of a licence interest during its ownership (and the most common reason will be an increase in the price of oil or gas), then if the proceeds of the sale are not reinvested within the UKCS, it is right that any chargeable gain should be subject to tax.

Government is prepared, however, to substantially increase the scope of disposals which will not, or are unlikely to, give rise to a chargeable gain and proposes two changes. This should encourage the sort of disposals that will allow North Sea assets to get into the hands of those companies most willing and able to develop them to their full potential

- Build on the existing provision under which pre-development licence interests can be swapped for nil consideration, by providing that where UKCS development licences are swapped, no gain will arise to the extent that the value of the licence acquired franks the value of the licence disposed of
- That where the proceeds of a UK licence sale are reinvested in other UK licences then the gain on the original sale will be exempt.

Costs and Benefits

Options 2, 3 and 4 all remove barriers to asset trades. In all cases compliance cost savings should accrue to companies through the removal of a requirement to track gains through the existing rollover system. For all three options tax would be levied in fewer circumstances than at present, but the result should be to encourage more investment and activity, leading to a greater recovery of North Sea oil and gas reserves and hence to additional tax yield overall.

Compared to Option 2, this effect is likely to be magnified by Options 3 and 4, as they provide more restrictions on the current application of tax and as a result should encourage greater investment and activity compared to Option 2.

Option 4 largely achieves the same ends as Option 3 but does so in a much simpler and neater way, i.e. providing a pure exemption from chargeable gains taxation (following reinvestment in the North Sea) rather than enabling holdover gains to be converted to rollover gains. Option 4 has the additional

benefits of providing greater clarity and simplicity and, at the margin, more business certainty and reduced admin burdens. The Government proposes Option 4.

In all cases the change in business admin burdens and compliance costs is likely to be small per business and negligible in total (in part because a maximum of only around 160 companies are likely to be affected). Widespread or significant changes to IT systems and other business systems are not anticipated. Familiarisation costs are likely to be negligible, more so for Option 4 than for Option 3 because the former is much simpler, including in terms of the legislative change required.

To the extent that additional business costs are incurred this would largely be because the removal of a tax barrier has encouraged greater activity. In general we would assume that if a business chooses to engage in greater activity and investment they would have formed the view that the costs of doing so would be outweighed sufficiently by the benefits to them.

Government is keen to hear industry's views on the compliance costs or cost savings of the proposed change. The changes to HMRC's own administrative and operational costs are also expected to be negligible.

Impacts

Results from other Specific Impact Tests can be found in the Annexes below.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	Yes
Sustainable Development	No	Yes
Carbon Assessment	No	Yes
Other Environment	No	Yes
Health Impact Assessment	No	Yes
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	Yes
Rural Proofing	No	Yes

Specific Impact Tests: Results

Competition Assessment

The proposed change will remove a fiscal barrier that could prevent North Sea companies wishing to rationalise their asset holdings from being able to agree mutually acceptable terms. As such the preferred Option 4 promotes the exchange of assets on normal commercial terms. It should also make it more likely that new investment will be attracted into the North Sea.

The change does not directly or indirectly limit the range of suppliers, or limit the ability of suppliers to compete. It also does not limit suppliers incentives to compete vigorously.

Small Firms Impact Test

There are no small businesses involved in North Sea oil and gas extraction that are affected by Chargeable Gains taxation.

Legal Aid

The proposed changes will have no implications for legal aid.

Sustainable Development

The proposed changes should improve the sustainability of the economy by helping to increase production of oil and gas from the North Sea, and consequently ensuring a secure and affordable energy supply.

Carbon Assessment

The Government remains committed to moving towards a low carbon economy, however, while low-carbon energy solutions are developed, oil and gas will continue to play a central role and the Government has a clearly stated objective to maximise the economic recovery of the UK's oil and gas resources.

The marginal impact of the proposed changes on carbon emissions is likely to be very small.

Other Environment

Waste management, air quality, habitat and wildlife will not be affected by the proposed changes. The effect of the proposed changes on the landscape and noise levels will be ameliorated by the fact that the oil and gas fields in question are some distance offshore. Climate change will not alter the impact of the proposal.

Health Impact Assessment

The proposed changes will have no health impacts.

Race Equality

The proposed changes have no implications for race equality.

Disability Equality

The proposed changes have no implications for disability equality.

Gender Equality

The proposed changes have no implications for gender equality.

Human Rights

The proposed changes have no implications for human rights.

Rural Proofing

The proposed changes have no implications for rural areas.

Summary: Intervention & Options

Department /Agency: HM Treasury and HM Revenue and Customs	Title: Changes to Petroleum Revenue Tax legislation	
Stage: Consultation	Version: 1	Date: 24 November 2008
Related Publications: Supporting Investment: A consultation on the North Sea Fiscal Regime		

Available to view or download at:

<http://www.hm-treasury.gov.uk>

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Telephone: 020 7438 7918

What is the problem under consideration? Why is government intervention necessary?

Government is committed to simplifying the tax system wherever possible, in order to reduce administrative and compliance costs to business. The proposed changes to the Petroleum Revenue Tax (PRT) legislation will reduce the administrative obligations attached to the PRT system.

Under current legislation, a company may not have access to PRT relief on decommissioning expenditure once a field licence has expired. The proposed changes will ensure companies can gain access to PRT relief after the expiry of a field licence.

What are the policy objectives and the intended effects?

To reduce unnecessary information and administrative obligations placed on companies operating fields subject to PRT, and to remove outdated legislation.

To ensure that companies can access PRT decommissioning relief following the expiry of a field licence.

What policy options have been considered? Please justify any preferred option.

- 1.) Do nothing and persist with legislation of a greater complexity than is necessary and with uncertainty within the fiscal regime as to the tax treatment of decommissioning in certain cases.
- 2.) Preferred Option: Act now to remove redundant legislation, reduce reporting obligations and bring forward a solution to the potential licencing issue.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The evaluation of savings will be included in any review of the measures implemented following the November 2008 Consultation on the North Sea.

Ministerial Sign-off For Consultation Stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



.....Date: 20 November 2008

Summary: Analysis & Evidence

Policy Option: 1	Description: Do Nothing
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' No change from current regime.	
	One-off (Transition)	Yrs		
	£ 0			
	Average Annual Cost (excluding one-off)			
	£ 0		Total Cost (PV)	£ 0
Other key non-monetised costs by 'main affected groups' No Change from current regime.				

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' No change from current regime.	
	One-off	Yrs		
	£ 0			
	Average Annual Benefit (excluding one-off)			
	£ 0		Total Benefit (PV)	£ 0
Other key non-monetised benefits by 'main affected groups' No change from current regime.				

Key Assumptions/Sensitivities/Risks

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate)
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What is the geographic coverage of the policy/option?				UKCS	
On what date will the policy be implemented?				N/A	
Which organisation(s) will enforce the policy?				N/A	
What is the total annual cost of enforcement for these organisations?				£ 0	
Does enforcement comply with Hampton principles?				Yes	
Will implementation go beyond minimum EU requirements?				N/A	
What is the value of the proposed offsetting measure per year?				£ 0	
What is the value of changes in greenhouse gas emissions?				£ 0	
Will the proposal have a significant impact on competition?				No	
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of	£ 0	Decrease of	£ 0
Net Impact			£ 0

Key Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence

Policy Option: 2	Description: Simplification of the PRT regime
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups'
	One-off (Transition)	Yrs	
	£ Neg - tbc		
	Average Annual Cost (excluding one-off)		
	£ Neg - tbc		
Total Cost (PV)			£ Neg - tbc
Other key non-monetised costs by 'main affected groups'			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' Minor savings should accrue to companies through a reduction in the administrative burden of complying with the PRT regime.
	One-off	Yrs	
	£ 0		
	Average Annual Benefit (excluding one-off)		
	£ Neg - tbc		
Total Benefit (PV)			£ Neg - tbc
Other key non-monetised benefits by 'main affected groups' The solution to the licensing issue will give companies greater certainty over their access to decommissioning relief.			

Key Assumptions/Sensitivities/Risks

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate)
-----------------	-------------------	---------------------------	---------------------------------

What is the geographic coverage of the policy/option?		UKCS			
On what date will the policy be implemented?		Tbc			
Which organisation(s) will enforce the policy?		HMRC			
What is the total annual cost of enforcement for these organisations?		£ tbc			
Does enforcement comply with Hampton principles?		Yes			
Will implementation go beyond minimum EU requirements?		N/A			
What is the value of the proposed offsetting measure per year?		£ N/A			
What is the value of changes in greenhouse gas emissions?		£ N/A			
Will the proposal have a significant impact on competition?		No			
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)		
Increase of	£ tbc	Decrease of	£ tbc	Net Impact £ tbc

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

Rationale for Intervention

Government is committed to reducing the administrative burden for industry in general and this includes the simplification of the tax codes. HMRC has taken the opportunity to look at areas where the PRT legislation can be improved or simplified and, with industry, have identified a number of potential areas where the legislation can be improved or removed altogether.

Policy Proposals

Reducing Administrative Obligations

Government therefore proposes to undertake the following actions to simplify the fiscal regime:

Provisional Expenditure Allowance:

- HMRC intends to repeal this piece of legislation with a transition period to ensure that any relief given prior to repeal is recovered through the claw back mechanism.

Commingling Agreements:

- Government's proposal is to remove the requirement for companies to provide information whenever a new field comes on stream and is blended with other production or where there is a change in the allocation methodology. Instead production would be allocated on a "just and reasonable basis" in the same way as joint expenditure is allocated between fields.

HMRC has also identified a number of other items of legislation within the PRT regime for which there appears to be no reason for keeping them. Unless the current consultation identifies any issues, then Government proposes to repeal the following items:

- Spreading of supplement - Legislation at paragraph 9 of Schedule 3 to OTA 1975 allows companies to elect to spread relief for qualifying "supplemented" expenditure for up to 20 chargeable periods. The legislation does not currently appear to serve any useful purpose.
- Pre-PRT expenditure - Legislation at paragraph 3 of Schedule 4 to OTA 1975 applies to certain expenditure incurred prior to 13 November 1974. The normal time limit for claiming expenditure for PRT is six years and HMRC is not aware of any outstanding claims under this legislation.
- Tariff Receipts Allowance – alternative calculation - Legislation at section 9 of OTA 1983 provides a volume based allowance against tariff receipts similar to that of Oil Allowance being relieved against sales of oil. Section 9(3) of OTA 1983 provides an alternative calculation for chargeable periods ending on or before 30 June 1987. The legislation is relatively complicated and clearly is now no longer applicable.
- Transitional provisions for certain rules within OTA 1983 - Section 13 and Schedule 5 of this act provide transitional rules for periods ending before or straddling 1 July 1982 in respect of the application of these new rules. These transitional rules are no longer applicable and can be repealed.

Ensuring Access to PRT Decommissioning Relief

The first round of North Sea licences will expire in 2010. As a result, companies may have to carry out decommissioning activities in a field that no longer has a licence. For PRT purposes, a company is a participator in a field while they hold the relevant licence interest, and for two chargeable periods after that licence has been held. As a result of the licence expiry, the company may have an obligation to decommission the field, but, having ceased to have a licence interest at the point where it ceased production, may be unable to claim PRT relief for some or all of that expenditure.

HMRC has been in consultation with DECC regarding the most appropriate method to ensure that companies have full access to decommissioning relief in the event of a licence expiry. The proposed change involves deeming companies to be participators in the field where they have previously been licence holders.

Costs and Benefits

Government expects there to be an ongoing annual total North Sea Industry compliance saving in respect of the simplification measures outlined above.

Impacts

The changes proposed here will cause no distinguishable increase in emissions.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	Yes
Sustainable Development	No	Yes
Carbon Assessment	Yes	Yes
Other Environment	No	Yes
Health Impact Assessment	No	Yes
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	Yes
Rural Proofing	No	Yes

Annexes

Competition Assessment

These proposed changes will reduce the compliance cost disparity between North Sea oil and gas fields subject to PRT and those fields outside its scope.

The change does not directly or indirectly limit the range of suppliers, or limit the ability of suppliers to compete. It also does not limit suppliers incentives to compete vigorously.

Small Firms Impact Test

There are no small businesses involved in North Sea oil and gas extraction that are affected by Petroleum Revenue Tax.

Legal Aid

The proposed changes will have no implications for legal aid.

Sustainable Development

The proposed changes will have no impact on sustainable development.

Carbon Assessment

The Government remains committed to moving towards a low carbon economy, however, while low-carbon energy solutions are developed, oil and gas will continue to play a central role and the Government has a clearly stated objective to maximise the economic recovery of the UK's oil and gas resources.

The marginal impact of the proposed changes on carbon emissions is likely to be very small.

Other Environment

Waste management, air quality, habitat and wildlife will not be affected by the proposed changes. The effect of the proposed changes on the landscape and noise levels will be ameliorated by the fact that the oil and gas fields in question are some distance offshore. Climate change will not alter the impact of the proposal.

Health Impact Assessment

The proposed changes will have no health impacts.

Race Equality

The proposed changes have no implications for race equality.

Disability Equality

The proposed changes have no implications for disability equality.

Gender Equality

The proposed changes have no implications for gender equality.

Human Rights

The proposed changes have no implications for human rights.

Rural Proofing

The proposed changes have no implications for rural areas.

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B

Criteria for reform

B.1 To contribute to the overall Government's objective of maximising the economic recovery of the UKCS' oil and gas reserves it would be desirable for any changes to the North Sea fiscal regime to meet the following criteria, whilst recognising that on certain issues there may be a tension between some of these.

- **promote investment and production** – The maximisation of the economic recovery of oil and gas reserves will only be achieved through further promotion of investment in the UKCS and maintaining the current high levels of investment. Therefore, as with recent changes to the fiscal regime, any further changes will be subject to careful analysis to ensure that they have no negative impact on existing and future investment into the UKCS.
- **ensure a fair return for the UK taxpayer** – The fiscal regime must also act to strike the correct balance between producers and consumers and ensure a fair return for the UK from our national resources. The changes to the fiscal regime announced at the 2005 PBR acted to restore this balance and any further changes would need to be consistent with this.
- **be non-distortionary** – Decisions taken by companies in relation to the North Sea should be affected as little as possible by the fiscal regime. The current tax regime, with elements such as the one hundred per cent first year allowances, goes a long way towards achieving this. Any further changes to the regime should be looking to further reduce this impact.
- **be equitable** – Any changes should not have an inequitable impact on any one type or section of companies involved in the UKCS. Instead the fiscal regime should aim to ensure the tax burden is shared fairly across the UKCS.
- **improve stability** – Due to the long lead times for investment projects into the UKCS it is important that the fiscal regime remains as stable as possible, whilst continuing to meet the Government's overall objectives for the UKCS. Therefore any changes to the fiscal regime should act to enhance stability, both now and for the future, and help ensure that fiscal considerations have a minimal impact on decisions taken in relation to the UKCS.
- **be sustainable** – Any changes to the fiscal regime should not be made for short term purposes, but be credible for the medium and long term.
- **reduce the administrative burden** – Any changes to the fiscal regime should not increase the administrative burden on companies involved in the North Sea, either by increasing the complexity of the current regime, or through adding to the reporting requirements. Government should also actively look to reduce the administrative burden where possible.



Summary of previous changes and decisions

This annex summarises the conclusions arrived at by the Government in the various major publications and announcements since Pre-Budget Report 2005, when the current round of discussions was launched.

PBR 2006

C.1 Announced the removal of fields from the charge to Petroleum Revenue Tax if they are redeveloped following decommissioning. It also announced the creation of a joint industry and Government working group to examine the tax treatment of change of use projects.

The North Sea fiscal regime: a discussion paper (March 2007)

C.2 A price linked fiscal regime: The Government ruled out a regime that links the tax rate to the oil price, as such a system would be complicated to design and run, offer opportunities for non-compliance, increase levels of uncertainty and would have a negative impact on the Government's objective to maximise production from the UKCS.

C.3 R&D tax credits: Government restated its belief that no further action was required to give the oil and gas industry greater access to R&D tax credits, as they already have sufficient access to them. Where they do not, oil and gas companies benefit from R&D tax credits via the supply chain.

C.4 Set aside funds for decommissioning: The Government said that it would not be inclined to produce a formulaic contributory amount based on future decommissioning costs. Any attempt to do so would be very difficult due to the likely changes in costs in the coming years. There are also questions about what happens if operators fail to meet their decommissioning liabilities.

C.5 Separate tax rates for oil and gas: The Government said that it did not believe that a separate rate for gas production should be established, as this would be likely to introduce considerable complexity to the regime, and would probably have only a marginal effect on production. In addition the frequent relative changes in the gas and oil prices would require frequent changes to be made to the regime.

Platform for change (November 2007)

C.6 This set out how the existing North Sea fiscal regime would treat change of use projects and highlighted a number of areas that the Government wished to explore with industry where change might be desirable in order to facilitate such activity. These areas were examined in more detail by the technical discussion paper (see below).

Securing a sustainable future (December 2007)

C.7 This consultation document set out a number of proposals for changes to the North Sea fiscal regime and invited stakeholders to comment on those. A final announcement on these proposals was made at Budget 2008, with legislation then being enacted through Finance Bill 2008.

C.8 Relief for decommissioning costs: Industry proposed allowing up front relief for payments into decommissioning funds. The Government rejected this proposal on the basis that it would alienate funds that could be better used for investment in the UKCS.

Budget 2008

C.9 Budget 2008 announced a package of reforms to: encourage investment, improve certainty, facilitate asset trade, remove anomalies and reduce the impact of the fiscal regime on investment decisions. The changes made are listed below:

- extension of the existing Corporation Tax loss carry back provisions from 3 years to a fixed point of 17th April 2002.
- extension of the post-cessation period from 3 years to the point where decommissioning is completed, in line with the requirements set out by DECC in the Petroleum Act.
- extension of one hundred percent capital allowances to long-life assets (LLAs) and mid-life decommissioning, in line with the treatment of other UKCS capital investment.
- alignment of the treatment of pre-April '08 North Sea LLAs with the treatment of non-North Sea LLAs – increasing the ongoing writing down allowance from six percent to ten percent.
- changes to the Petroleum Revenue Tax (PRT) legislation to ensure that, where a current licence holder defaults on a decommissioning obligation, and a former licence holder is required to meet that obligation, they will have access to the PRT relief they would have been entitled to had they remained party to the licence.
- creation of a power to allow, if companies so elect, HMRC to remove fields from the PRT regime that are never likely to pay PRT.

These changes were legislated in Finance Act 2008.

The North Sea fiscal regime and the reuse of oil and gas infrastructure – a technical discussion paper (August 2008)

C.10 This paper explored in more detail those tax 'pressure points' identified in the '*Platform for Change*' document and, if there was a case for legislative change, what potential options might be considered.



Summary of consultation responses to the December 2007 consultation document

D.1 The changes to the North Sea fiscal regime announced at Budget 2008 were first proposed in *'Securing a sustainable future: a consultation on the North Sea fiscal regime'* in December 2007. Where possible draft legislation was also published alongside this document to enable detailed consideration of the measures.

D.2 This annex summarises where significant changes were made to the proposals between their initial publication and their formal announcement; or where it was argued that changes should be made but the Government did not choose to take these on board. Where one of the Budget 2008 changes is not referenced in this annex no significant changes were proposed during the consultation.

Extension of CT loss carry back

- the period following cessation of the ring fence trade, during which decommissioning expenditure can be allocated to the final period of trading, be extended from three, to seven years.

D.3 Industry argued that under this proposal, whilst an improvement on the previous position, there was still the potential for the fiscal regime to artificially influence the timing of decommissioning. Given companies were required under DECC's regulations to undertake decommissioning they proposed that instead the post cessation period should be brought in line with those regulations and the post cessation period extended until the point where decommissioning is completed, in line with the requirements set out in the Petroleum Act 1998. The Government accepted this argument and the final proposal reflected this.

Package of PRT reforms

- Ensure that companies have the potential for full PRT relief for decommissioning costs, where licences are terminated prior to the completion of decommissioning.

D.4 Whilst Industry concurred with the Government's proposal to create a fix to this potential anomaly it was decided by both parties that as DECC was undertaking a review of how to approach the issue of first round licence expiry for fields that were still producing, it would be best to run the two connected workstreams concurrently. The Government did however commit to introducing the necessary legislation to fix this issue in Finance Act 2009.

Gas injection

- The Government intends to modify the fiscal regime to ensure that companies only get relief only for the economic costs of gas injected for EOR purposes, rather than the full costs. The Government wishes to discuss this issue first with industry.

D.5 A number of companies came in to discuss this issue with the Government. Whilst some conceded the point that the current legislation was anomalous they expressed the view that such a measure could potentially act to reduce the attractiveness of such EOR projects, and also to argue that it could have a significant impact on the economic viability of existing projects.

Whilst the Government continues to believe that the existing treatment is anomalous and should be remedied, the Government accepted that this particular issue would be better taken forward in the context of the wider debate on EOR. The Government therefore did not bring forward any measure on this issue at Budget 2008.

E

List of contributors

This annex sets out a list of all the stakeholders who have contributed to the discussions since December 2007. Government again extends its thanks to all of these bodies, companies and individuals for their contributions.

Apache

Association of British Independent Oil Exploration Companies (BRINDEX)

British Chambers of Commerce

BG Group

BP

Centrica Energy

Chevron

CNR International

CO₂ Deepstore

Conoco Philips

CW Energy

Encore Oil

ENI UK

Exxon Mobil

Fairfield Energy

Maersk Oil and Gas

Marathon International

Marubeni Group

Nautical Petroleum

Nippon Oil

Noble

Oil Taxation Action Committee (OTAC)

Oil and Gas Independents Association (OGIA)

Oil & Gas UK

Perenco

Scottish Council for Development and Industry

Shell

Statoil Hydro

Talisman Energy

Total E&P

United Kingdom Oil Taxation Committee (UKOITC)

Wood Mackenzie

Professor Alexander Kemp, University of Aberdeen

Dr Hafez Abdo, Nottingham Business School

Dr Carole Nakhle, University of Surrey

F

Consultation criteria

Confidentiality statement

F.1 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

F.2 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury and HM Revenue and Customs (HMRC).

F.3 HM Treasury and HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation criteria

F.4 This consultation is being conducted in accordance with the Government's Consultation Code of Practice. If you wish to access the full version of the Code, you can obtain it online at: <http://www.berr.gov.uk/files/file47158.pdf>

The consultation criteria

- when to consult – Formal consultation should take place at a stage when there is scope to influence the policy outcome.
- duration of consultation exercises – Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
- clarity of scope and impact – Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
- accessibility of consultation exercise - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
- the burden of consultation – Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
- responsiveness of consultation exercises - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

- capacity to consult – Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

F.5 If you feel that this consultation does not satisfy these criteria, or if you have any complaints about the process, please contact:

Richard Bowyer, Better Regulation Unit
020 7147 0062 or richard.bowyer@hmrc.gsi.gov.uk

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