

Oil and Gas Industry Direct Tax Forum

Minutes of meeting held on 20 March 2018

London:

Marie Baird (HMRC – Sector Lead), Claire Angell (KPMG), Ray Daly (HMRC), Padrig Davies (HMRC), Jenny Doak (V&E), Hugh Dorey (HMRC), Nick Gardner (Ashurst), Hugh Grainger (HMRC), Phil Greatrex (CWE), Carsten Hansen (INEOS E&P), Paul Haworth (Marathon Oil), Craig Hill (ExxonMobil), Anne Hurdman (HMRC), Simon Lee (Deloitte), Zoe Leung-Hubbard (HMRC), Donald MacAskill (HMT), James Marshall (HMRC), Romina Mele-Cornish (OGUK), Thomas Thornton-Kemsley (HMT) Tanzana Uddin (HMRC), Andrew Willis (HMT), Mike Earp (OGA)

Aberdeen:

Simon Kelsey (CNR – UKOITC Chair), Alastair Blain (ConocoPhillips), Paul Bostock (Enquest) Bob Cardno (EY), Gordon Cormack (Shell), Alistair Dunbar (PwC), Sunny Ghatauray (Dana Petroleum), Professor Alex Kemp (University of Aberdeen), Martin Kirkham (Chevron), Derek Leith (EY), Catriona Manzi (Premier Oil), Thomas McKnight (Repsol Sinopec), Christine Mitchell (CNR), Derek Reid (TAQA), Linda Ritchie (Total), Philip Wood (CNR), Claire Yeats (Apache)

1. Introduction and minutes of last meeting

- MB and SK welcomed the group.
- MB apologised that there was no HMRC attendee in Aberdeen, and in general they would aim to be represented on both sites in future.
- MB explained that this should be a forum for open discussions to clarify what HMRC and industry agree and disagree on and why, without final decisions being made which attendees would later be held to.
- She noted that formal written communications may be appropriate in due course, but initial discussions would ensure both parties understood the areas of contention more quickly.
- SK noted the importance of avoiding surprises and encouraged the sharing of information before meetings.
- The minutes for the previous meeting in October were agreed.

2. Policy update

2.1 HMT Policy Update

- AW echoed the desire for an open forum for discussions.
- He introduced Thomas Thornton-Kemsley who has joined the policy team in HMT, and Donald MacAskill who has also newly joined on secondment to assist with technical issues, in particular around late life assets.
- AW also noted that there was a new Exchequer Secretary to the Treasury, Robert Jenrick.

2.2 Transferable Tax History

- DM gave an update on Transferable Tax History (TTH), announced by the Chancellor in the Autumn Budget. Draft legislation will be published in the spring, and it will take effect from 1 November 2018. Some engagement has already taken place with industry.
- MB updated on the operational and administrative issues with implementation, which will entail a number of IT updates to ensure HMRC's systems capture and retain the appropriate information. Although without final legislation it can be difficult to fully design systems, the process has begun.

- Much of this work will be internal to HMRC rather than customer facing, but some areas, such as changes to the CT600i will require industry input once designs have reached the appropriate stage. It will also be necessary for industry to consider their own systems and ensure they would have appropriate methods of obtaining, retaining and assuring the information submitted.
- PD noted in particular that operational difficulties arise from the lengths of time involved, and systems would need to be robust enough to support this.
- ZLH noted that the once draft legislation is published, there will be a consultation on this, but the gap between the consultation closing and the legislation taking effect will be reasonably short, so HMRC will welcome early engagement and responses to the consultation.
- ZLH clarified that when the legislation is published would partly depend on the Office of Parliamentary Counsel (OPC), and they had mostly been instructed. L-Day would shortly be announced, and the legislation would be published no later than this.
- MB welcomed any initial questions or concerns at this stage from industry.
- AD noted that the informal questions to industry so far had been helpful, and requested that any further questions come sooner rather than later.
- Industry asked whether the interaction between Decommissioning Relief Deeds (DRDs) and TTH had been considered, and ZLH said that this would be addressed in draft guidance due to be published at the same time as the draft legislation.

2.3 HMRC Policy Update

- ZLH introduced Hugh Dorey, who will be taking over as the new O&G Policy Lead for the next year.
- HD explained he had most recently been in the Exchange of Information Team working on Country-by-Country Reporting, and prior to that had been a Large Business case worker. So he explained that while he has a Policy and CT background, this has not been in Oil & Gas.
- ZLH noted that Finance Act 2018 had recently passed, including the clarification of the treatment of Tariff Receipts. A technical note on this was published on 1 December 2017, and draft guidance will shortly be circulated. Comments on these are welcome.
- The SI for Investment Allowance is currently being drafted, and it is hoped this will be published in June.
- ZLH also updated on the new digital system for PRT. Funding has been received for this, and work has begun on development. It is hoped a prototype will be ready by the end of the year, and when this is ready it will be shared for testing. It is hoped this will entail a reduced burden on customers.
- RD clarified that this was at an early stage, but the aim is for both electronic input and output, with the merging of some forms to minimise the number which have to be completed and make the process easier to operate going forward.
- MB noted that this interacted with the move of work from London to Scotland & Northern Ireland. The PRT work will move to Edinburgh, but it is remaining in London until the new system is developed. There will be a long run-in time to the Edinburgh team taking over, to ensure continuity.
- MB also noted that the aim is to focus on what is needed, and HMRC will need industry's help to ensure it is right, so ideas are welcome.
- AD noted the previous recommendations on PRT which had been put to the side as they relied on IT updates, and asked whether these have been considered.
- ZLH confirmed they were aware of the recommendations and considering them, but that was not to say all would be taken up.

- MB raised the concern with digitising previous paper documents as part of HMRC’s move to paperless offices, and confirmed that care was being taken to ensure that everything important was being kept in some form.

3. Decommissioning

3.1 Introduction to Decommissioning

- Bob Cardno had shared a draft paper in advance with a preliminary history and analysis of the decommissioning relief legislation at s163 Capital Allowances Act 2001.
- He noted that there were two related questions –
 - Is expenditure decommissioning?
 - Does the expenditure meet the conditions in s163(3A)?
- MB thanked BC for preparing the paper, and welcomed discussion to clarify how both HMRC and industry interpreted costs incurred of various types and at various stages in light of the decommissioning rules.
- BC agreed to lead the discussion by walking the attendees through the paper, and noted that as it was not shared until shortly before the meeting he did not expect that attendees would have had time to consider it in depth.
- In respect of the first question above, BC noted that decommissioning is defined in the legislation at s163(4A). These words were introduced in 2001, and prior to that the legislation has referred to “demolition”. “Decommissioning” was intended to be read wider, and this was confirmed by a contemporaneous letter from HMRC to UKOITC.
- BC introduced some examples of activities industry would consider as decommissioning, although this was not intended to be exhaustive.
- JM noted that there was lots of common ground as a starting point.
- BC moved on to the conditions in s163(3A), which were introduced in Finance Act 2009 to replace wording from the Capital Allowances Act 1990. Hansard records from the time show that this wording was not intended to restrict availability for relief for “mid-life” decommissioning, and the Explanatory Notes for FA09 confirm that the intention was to allow decommissioning to take place at the most economic point, rather than allow tax rules dictate the timing.
- JM thanked BC for setting out this background, and confirmed HMRC did not consider that s163(3A) necessarily restricted relief for mid-life decommissioning, as the conditions or agreements referred to could be mid-life.
- BC clarified that the paper was not intended to imply that HMRC did not agree this position.

3.2 Examples of Decommissioning

- BC led the discussion on the specific examples, and why industry consider these to be decommissioning and to meet the conditions in s163(3A).
- Decommissioning studies are considered a necessary pre-cursor to the decommissioning programme, and are required for the approval of a programme, so they meet the condition at s163(3A)(b). HMRC had in the past questioned whether these could be considered “demolition” costs under the previous wording of the legislation, but had confirmed they were allowable.
- JM confirmed that this was now reflected in HMRC’s guidance.
- JM asked whether Plugging & Abandonment (P&A) for wells might be treating as qualifying for MEAs, and BC confirmed that this isn’t considered to matter now, as either treatment

would obtain equivalent relief. DL stated this had previously been more of a concern before the rules on loss carry back were changed.

- BC confirmed that the best practice was that P&A not be left until Cessation of Production (CoP), but rather rigs should be used while active and in place, so costs could be spread throughout life of the field.
- ZLH noted that there could be substantial costs in planning decommissioning and setting-up the project team, and MB asked how staff costs would be treated – whether the cost-code for staff would move wholesale to be booked as decommissioning?
- BC clarified this would normally be based on the time staff spend on the project, and other industry representatives suggested it was more typical to have dedicated specialist decommissioning engineers rather than staff who dealt with this and production, so the main use of time-writing would be in the allocation of costs to fields.
- Industry noted that the discipline and assurance already existed because of the possibility of partner audits to confirm costs are booked to the appropriate place.
- BC clarified that P&A would require a well consent process, Well Operations Notification Scheme (WONS), which constitutes an agreement with or condition imposed by the Secretary of State, so this would meet the condition in s163(3A)(c). While WONS is operated by OGA now, rather than the Secretary of State, this isn't considered to be a concern as there is still a clear regulatory process and a clear link between OGA and the Secretary of State.
- JM stated that there was no desire from HMRC to say that the condition was not met purely because of OGA taking over the Secretary of State's role in this regard.
- OGA said that it might be useful to have clear guidance on this which HMRC has shown to the OGA, as OGA is not the Secretary of State, and this distinction can matter in different contexts.
- JM said that consideration could be given to whether the legislation needed to be updated, but the bar to legislating was high and if the legislation was working there isn't much desire to change it.
- Industry added that even if WONS was not issued by the Secretary of State, all except the most recent licenses were and these contained the model clauses such as obligations to decommission, including an obligation to P&A. Even the most recent licensees were obliged by s5 of the Petroleum Act to abide by the model clauses, which were issued by the Secretary of State.
- BC raised the requirements of flushing, cleaning and disconnecting lines. These were subject to Pipeline Works Authorisation (PWA) variations, which are also within the OGA's responsibility, so some of the same issues as with respect to WONS apply.
- AH raised that this would be very fact-based, as would the removal of redundant modules and equipment before cessation of production. It would depend on what happened and what specifically was required under the conditions or agreements with the Secretary of State. This would especially be true where there was no BEIS agreement. It was noted that there were policy questions here, in regard to what "conditions" or "agreements" meant in the context of s163(3A), and also operational questions of obtaining assurance in respect of the facts and agreements.
- DL considered that this would be the removal of redundant equipment, not a replacement, and it may be the most sensible thing to do this as and when equipment becomes redundant rather than wait until CoP and an agreed decommissioning programme. He considered that this was a clear example of mid-life decommissioning as envisaged.
- AD noted that s163(4A) also includes "preparing plant and machinery for reuse", so even where equipment was later reused it could still qualify as decommissioning.

- Industry considered that if redundant equipment was removed at the end-of-life, it would be considered decommissioning, so if it is removed at the more cost-effective point before cessation of production, this should also be considered decommissioning.
- MB commented that there was a need to distinguish between removal as part of an overall plan to decommission the wider asset, and simply the moving of plant & machinery from one place to another where it can be used better operationally. This could be the sort of questions HMRC would require evidence of.
- JM noted that OPRED regulate decommissioning, and no decommissioning can be carried out without their approval. So if it is not approved, then in one sense it cannot be decommissioning, but how did this fit with the definition in s163(4A).
- DL understood this position, but noted that previous statements from OPRED or BEIS that not all removal of modules would necessarily be considered decommissioning did not necessarily represent OPRED's final view of the matter. DL does not agree with this approach, noting that for tax purposes the definition in the tax legislation is paramount. He considered that the pre-2008 legislation would have allowed this, and Parliament was clear that the FA09 changes were not intended to restrict mid-life decommissioning.
- DL considered the drivers of decommissioning work should be MER, not tax considerations, and from this perspective there was no reason to restrict relief purely because activity takes place before the asset has reached the end of life. The desire is to reduce operating costs on the platform and this can sometimes be achieved by removing equipment at an early stage, but where full relief was previously not available this was difficult to justify. Where the concerns are on the reuse of assets, this can be considered separately, as typical cases will involve the removal and scrapping of the equipment.
- There was some discussion of whether industry had any freedom with regard to how costs were treated – whether as operating expenditure, capital expenditure on plant and machinery or as decommissioning.
- DL stated there is significant case law on whether expenditure is revenue or capital in nature. Industry stated that as they have an obligation to decommission, a provision would be accounted for to reflect this. There was no desire to book decommissioning costs as operating expenditure as this would increase cost-per-barrel and leave the decommissioning provision in place. Additionally, the accounts are subject to audit, so it would not be possible or desirable to book decommissioning expenditure as productive fixed capital assets instead.
- MB said that HMRC's approach was to look at all the facts and come to an objective conclusion. It is not HMRC's view that everything is tax driven, but the conversation will be different if there appears to be a significant tax motivation to particular transactions, compared with situations where ample evidence of the reasons behind an approach can be provided.
- BC addressed the significant preparatory work which can be incurred prior to the approval of a decommissioning programme. Where this was directly linked to the decommissioning, BC considered it too should be accounted for as decommissioning expenditure.
- JM asked for clarification on maintenance expenditure incurred in maintaining the asset, and when this would be considered capital decommissioning expenditure rather than ongoing revenue costs.
- AD said that the question was why the asset is being maintained. If the maintenance was during the decommissioning and after the cessation of production, then it has ceased to be operating expenditure and becomes incidental to the capital costs of the project as a whole. These costs would be set against the decommissioning provision in the accounts.
- BC also noted that s163(4A)(b) specifically includes preserving plant and machinery for reuse and demolition as part of decommissioning costs.
- JM asked whether any ongoing costs would be included for mid-life decommissioning.

- Industry said that this was not typical, although it could probably be done. It would be a question of materiality of the operating costs attributable to the mid-life decommissioning as opposed to the ongoing production.
- Industry asked whether sometimes expenditure could become a 'tax nothing' if it failed to meet the conditions for relief under s163 CAA01 et seq.
- JM stated that if expenditure was revenue in nature rather than capital it may be deductible as a revenue expense. Where expenditure was capital in nature but failed the conditions in s163, it may qualify under s26 CAA01 as demolition costs, but the relief would be writing down allowance, so there would be a timing difference in when relief was obtained, as well as restrictions on the carry-back of losses arising. If companies were aware of situations where expenditure could become a 'tax nothing' JM was happy to discuss this with them further.

3.3 Summary and next steps

- RMC asked whether the paper covered the issues HMRC are seeing in practice with decommissioning.
- AH said it covered some, but there were also others although they were quite customer specific.
- MB suggested that next time HMRC could bring particular issues to discuss. She noted that there was an Action Point for JM to take away to consider some of the policy issues. Additionally, it was very useful to have a paper to provide a starting point for the discussions, so she suggested this could happen more often, perhaps from either HMRC or industry.
- MB thanked BC for preparing the paper and leading the discussion.
- Industry asked that discussions not purely be limited to these quarterly meetings, as this is a current live issue for some groups. MB assured industry that HMRC would aim to respond as soon as possible and not wait for the next meeting. AH also noted that clarification could be piecemeal, with no need to wait until every issue was settled to confirm the view on any one issue.

4. Other Technical Issues

4.1 Customs Information Paper 33 – End Use

- MB noted that this was not a direct tax issue, but thought it would be worthwhile to raise in any case given the impact on industry, both financial and operational.
- MB also meets with UKOITC Indirect, and she is working with them and the policy stakeholders on this issue.
- MB confirmed that all authorisations have been extended to 31 July and HMRC are in the process of communicating this through Customer Compliance Managers and UKOITC Indirect.
- Additionally, Brexit will have an impact, and although MB cannot give any certainty on what this will entail, she welcomes the views of industry on any area they are concerned with.

5. Close

- MB thanked all for attending, and for the useful discussions.