



HM Treasury

# Tax issues for late-life oil and gas assets:

discussion paper

---

March 2017





HM Treasury

# Tax issues for late-life oil and gas assets:

discussion paper

---

March 2017



© Crown copyright 2017

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit [nationalarchives.gov.uk/doc/open-government-licence/version/3](http://nationalarchives.gov.uk/doc/open-government-licence/version/3) or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: [psi@nationalarchives.gsi.gov.uk](mailto:psi@nationalarchives.gsi.gov.uk).

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at [www.gov.uk/government/publications](http://www.gov.uk/government/publications)

Any enquiries regarding this publication should be sent to us at [public.enquiries@hmtreasury.gsi.gov.uk](mailto:public.enquiries@hmtreasury.gsi.gov.uk)

ISBN 978-1-911375-93-7  
PU2058

# Contents

---

		Page
Chapter 1	Introduction	3
Chapter 2	The future of the UK Continental Shelf	5
Chapter 3	The oil and gas tax system and decommissioning	11
Chapter 4	How UKCS assets can be bought and sold	13
Chapter 5	Tax issues for late-life assets	17
Chapter 6	Next steps	23



# 1 Introduction

---

**1.1** For over 40 years, the oil and gas reserves of the UK Continental Shelf (UKCS) have made a significant contribution to the economy, providing jobs and encouraging technological innovation. While the basin is now mature compared to other prospects around the world, significant opportunities remain. Estimates suggest that between 10 and 20 billion barrels of oil equivalent (boe) remain recoverable, while the offshore oil and gas industry continues to support around 330,000 jobs.<sup>1</sup>

**1.2** In recent years, the government has worked to provide one of the most competitive oil and gas fiscal regimes in the world and recognises that a stable regime is key to attracting investment.

**1.3** At Budget 2017, the government announced it would publish a discussion paper on the tax treatment of late-life oil and gas assets. These assets could continue to produce oil and gas for years to come, but, without further investment, could reach the end of their productive lives and be decommissioned sooner. Encouraging investment in strategically important assets is in line with the government's objective of Maximising Economic Recovery (MER) from the UK's oil and gas reserves. Part of this investment could include new, innovative investors taking over older, late-life assets.

**1.4** In the past few months, HM Treasury has had numerous discussions with stakeholders on the interaction between tax and late-life asset transactions. This paper covers the issues that were most frequently raised. The purpose of this paper is to ask for additional evidence to support the government in considering these issues in greater detail, highlighting particular areas of interest where the government would welcome further input. It is intended to facilitate discussion, and should not be viewed as indicative of government policy.

**1.5** This paper covers the following topics:

- the current state of the UKCS, including recent changes to the oil and gas tax rules, why some believe further changes could facilitate asset transactions, and the government's objectives in considering any change
- background on the current tax regime for the UKCS
- a summary of the various ways that late-life assets can be bought and sold and the corresponding tax treatment
- a detailed consideration of the tax issues for late-life assets, including specific areas where views would be useful.

**1.6** The government has not yet made a decision to change any of the tax rules for late-life assets. HM Treasury is seeking to improve its understanding of the issues and identify areas where a change to tax legislation or guidance could help put late-life assets into the hands of those willing to invest in them. Any change must be balanced against its potential to increase exposure to the taxpayer or create additional complexity in the tax system.

**1.7** The government requests that submissions on the points discussed in this paper are submitted by 30 June 2017. The government will then consider the responses.

---

<sup>1</sup> Oil and Gas UK Economic Report 2016





# The future of the UK

## 2 Continental Shelf

---

**2.1** The UK has a long and successful history of oil and gas production. Since activity started in earnest in the 1970s, the industry has made billions of pounds of investments in the UK economy and is estimated to have paid the equivalent of £330 billion in direct upstream taxes in 2017 prices.<sup>1</sup> Today, the oil and gas industry continues to contribute towards the UK's primary energy needs, supports hundreds of thousands of jobs and maintains a world-class domestic supply chain.

**2.2** While the UKCS is a mature oil and gas basin, it still has significant potential; production has increased from 1.4 million boe per day in 2014 to 1.6 million boe per day in 2015 and 2016.<sup>2</sup> Estimates suggest there could be between 10 and 20 billion barrels of oil equivalent (boe) remaining to extract.<sup>3</sup> The challenge for the UK is to make as many of these reserves as possible economically recoverable, in line with the MER strategy, supporting employment in the sector and boosting revenues. The Oil & Gas Authority believe that there is an opportunity to increase gross revenues from oil and gas production in the UKCS by £137 billion between now and 2035.<sup>4</sup>

**2.3** Having been a major producer of oil and gas since the 1970s, the UKCS has many old, 'late-life' assets. These are usually held by companies (also referred to as licensees) who were early prospectors of the UK's oil and gas reserves in the 1970s and '80s. In many cases, production from these assets can be extended by investment in the surrounding infrastructure to prolong productive life and also make newer, adjoining fields economic. Attracting the investment to extend the operational life of these late-life assets is an important part of the MER UK strategy.

**2.4** Companies operating on the UKCS need to compete for investment capital at a global level. Projects are typically approved by board members or central offices following a comparison of opportunities across global portfolios. Oil and gas companies are still investing in the UKCS, with a number of new developments coming on stream in recent years. However, the basin is competing with other provinces across the globe, and there is an ongoing challenge to attract the funding needed to prolong the productive life of late-life UKCS fields and assets.

**2.5** Anecdotal evidence suggests licensees are focussing on strategic hubs (both in the UK and outside it) and seeking to reduce their ownership of older, outlier fields in the UKCS. The hubs in the UKCS will contribute to a large part of future production, but late-life assets outside these hubs could also contribute, providing a return for the taxpayer, if they can secure further investment.

**2.6** The characteristics of investors have also shifted considerably. The UKCS is increasingly seeing investment from companies who concentrate on the UK alone (rather than a global portfolio) or who specialise in maximising value from a smaller portfolio of assets. Non-traditional participants, such as private equity, are also playing an increasingly important role.

---

<sup>1</sup> Oil and Gas UK Economic Report 2016

<sup>2</sup> Oil & Gas Authority Overview 2016

<sup>3</sup> Summary of UK Estimated Remaining Recoverable Hydrocarbon Resources as at end 2015

[https://www.ogauthority.co.uk/media/2446/summary\\_of\\_uk\\_estimated\\_remaining\\_recoverable\\_hydrocarbon\\_resources\\_july\\_2016.pdf](https://www.ogauthority.co.uk/media/2446/summary_of_uk_estimated_remaining_recoverable_hydrocarbon_resources_july_2016.pdf)

<sup>4</sup> Oil & Gas Authority Overview 2016

These trends could contribute towards securing the future of the basin, bringing new focus and investment to late-life assets.

**2.7** Capital expenditure (investment) in the UKCS peaked at £14.8 billion in 2014, but only around £7 billion is expected during 2017.<sup>5</sup> This is in line with trends seen in the global industry: following the sharp fall in oil price over 2014-2016, long-term oil and gas price expectations have re-adjusted and many incumbent oil and gas operators have been reducing their investment in new opportunities.<sup>6</sup>

**2.8** A number of sales of late-life assets have been announced in recent months, demonstrating that there is appetite for new investment in this market. However, some argue that the UKCS needs more deals of this kind in order to maximise economic recovery, through investment in late-life assets by new entrants.

## Recent changes to the UK oil & gas fiscal regime

**2.9** The government undertook a wide-ranging review of the UKCS fiscal regime in 2014, in recognition of the changing economics of the basin. The aim was to ensure the fiscal regime supported the government's twin objectives of maximising economic recovery while ensuring a fair return for the nation on its oil and gas resources.

**2.10** The outcome of this review was 'Driving Investment: A plan to reform the oil and gas fiscal regime'.<sup>7</sup> This recognised that fiscal change was needed to ensure the UKCS could compete for global capital. Driving Investment also established three important principles for tax policy:

- to be consistent with the objective of maximising economic recovery as new projects become ever more marginal, the overall tax burden will need to fall as the basin matures
- when making judgements about fiscal policy, the government will consider the wider economic benefits of oil & gas production, in addition to revenues
- the government's judgement of what constitutes a 'fair return' will account for the competitiveness of commercial opportunities in the UK and UKCS and take account of both commodity prices and costs.

**2.11** At Autumn Statement 2016, the government recommitted to the long-term plan set out in 'Driving Investment'. The government recognises the importance of certainty and stability in the UK fiscal regime, given the long lead-in time for investments in the oil and gas industry.

**2.12** The government has made a number of substantial changes to the UK oil and gas fiscal regime, consistent with the principles set out in 'Driving Investment'. These have helped to improve the competitiveness of the UKCS and create the right conditions for ongoing investment. The government has:

- **reduced the supplementary charge from 32% to 10%:** Since Autumn Statement 2014, the supplementary charge has been reduced twice, from 32% to 20% from 1 January 2015 and from 20% to 10% from 1 January 2016. This has recognised the challenging conditions facing the industry and has sent a strong signal that the UK is open for business

---

<sup>5</sup> Oil & Gas UK Activity Survey 2016

<sup>6</sup> E.g. Wood Mackenzie - Cautiously optimistic: global upstream outlook for 2017 at <https://www.woodmac.com/analysis/cautiously-optimistic-global-upstream-outlook-2017>

<sup>7</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/382785/PU1721\\_Driving\\_investment\\_-\\_a\\_plan\\_to\\_reform\\_the\\_oil\\_and\\_gas\\_fiscal\\_regime.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382785/PU1721_Driving_investment_-_a_plan_to_reform_the_oil_and_gas_fiscal_regime.pdf)

- **permanently reduced Petroleum Revenue Tax (PRT) from 50% to 0%:** With effect from 1 January 2016, no companies will ever pay PRT again. PRT was brought down to 0% from 50% at Budget 2016 on a permanent basis. This has simplified the regime for investors, levelling the playing field between older and newer developments. The tax was not formally abolished, so that companies could continue to carry back decommissioning losses against previous PRT profits. HMRC has simplified the reporting regime and made it easier for fields to opt out altogether
- **introduced new Investment and Cluster Area Allowances:** Budget 2015 introduced a basin-wide investment allowance to replace the previous system of field allowances, to encourage investment and reduce complexity for investors. The allowance was initially based on capital expenditure; it is now being extended to other investment expenditure, including leasing costs and operating costs that add value to a field, as well as tariff income. A cluster area allowance has also been introduced to encourage the development of near field exploration
- **extended the Ring Fence Expenditure Supplement (RFES):** At Autumn Statement 2014, RFES was extended from 6 to 10 accounting periods, to further support oil and gas companies during the exploration and appraisal stages
- **funded two programmes of seismic surveys in the UKCS:** The government provided £20 million of funding for seismic surveys in 2015-16 and a further £20 million for 2016-17. This will provide industry and academia with better data on prospects in the UKCS, helping to boost offshore exploration and encourage investment in under-explored areas

**2.13** As a result of these changes, the UK now has one of the most competitive regimes for oil and gas in the world. This fiscal reform has been in line with the principles of 'Driving Investment', recognising the changing economics of the UKCS as well as the challenges faced by the UK industry, following the steep fall in oil price.

**2.14** The government has also made significant changes to provide certainty on decommissioning tax relief. The government has:

- **introduced Decommissioning Relief Deeds (DRDs):** The government introduced a new, contractual approach to provide oil and gas companies with certainty on the tax relief they will receive when decommissioning assets. The industry estimates that, to date, this has unlocked £5.9 billion of capital which can now be invested elsewhere in the UK and UKCS<sup>8</sup>
- **provided certainty on tax relief where a seller retains decommissioning liability:** At Budget 2016, HMRC published a Technical Note confirming that companies who retained the decommissioning liability for an asset after a sale would still be able to claim ring fence corporation tax and supplementary charge relief for the decommissioning costs they incur

**2.15** The government has made significant progress in making the UKCS fiscal environment one where transfers of late-life assets are more attractive for both long-term incumbents and new entrants. The government believes that a stable, competitive regime is fundamentally the best way to encourage investment and will continue to consider any further changes against the principles of 'Driving Investment' and its objectives for the UKCS fiscal regime.

---

<sup>8</sup> Decommissioning Relief Deeds: Written Ministerial Statement to Parliament, 20 December 2016

## Role of decommissioning and the tax system in asset transfers

**2.16** When companies are negotiating the sale of an oil or gas asset, the buyer and seller will often have very different viewpoints about its value. This can be driven by differing views about the future production profile of the asset, different oil and gas price expectations or uncertainty over the eventual decommissioning liability of the asset.

**2.17** The government understands that, among those other factors, decommissioning obligations can add significant complexity to asset transactions. Licensees are legally obliged to decommission oil and gas fields at the end of a field's life. This is expensive, challenging work and imposes significant costs on oil and gas companies once production ceases. The fiscal regime recognises this by allowing licensees to claim tax relief on decommissioning expenditure. This is calculated in reference to the tax that has previously been paid by the company carrying out the decommissioning, also known as tax history (more detail is included in Chapter 3).

**2.18** Some industry participants have asserted that particular aspects of the tax relief system could be impeding transactions for late-life assets, particularly where the nearness of decommissioning costs will have a substantial impact. The suggestion is that, in some circumstances, an uneven playing field exists between current UKCS licensees and smaller, non-traditional companies who are new entrants to the UKCS:

- current UKCS licensees who are selling their assets often have decades of tax history to rely upon and can be confident of claiming relief when they come to decommission
- new entrants to the UKCS have to be confident that the acquired asset will generate enough tax history over its remaining life to equal the decommissioning costs at the end of the field's life

**2.19** Buyers are unlikely to purchase an asset where they expect the costs of the asset (including decommissioning) to exceed its profits. However, costs from a buyer's other fields could affect this position. Additionally, while a field may be expected to return a net profit in a buyer's central economic modelling case, the downside modelling may show an exposure from an unexpected change in oil prices.

**2.20** The need to take into account this downside can possibly introduce friction between the buyer and seller in agreeing a fair price for the asset (the 'value gap'), potentially leading to protracted negotiations. At the extreme – if incumbent owners cannot obtain what they regard as a fair price – it could present an obstacle to deals, preventing late-life assets from attracting the investment needed to extend their lives.

## Representations to date on tax and late-life assets

**2.21** The government believes that the tax system should adopt as neutral an approach as possible, while recognising that sellers and buyers may adopt different structures for asset deals. HM Treasury has begun to consider in more depth whether tax issues could be preventing some late-life assets from being transferred into the right hands, in line with the stated aim of maximising economic recovery.

**2.22** To inform its work, HM Treasury has recently had discussions with over 40 stakeholders to identify the tax issues most relevant for late-life assets. This has included representations from current licensees, potential buyers, private equity investors, banks, lawyers and tax advisers.

**2.23** The government recognises that the tax history value gap is not the only concern in attracting investment for late-life assets. Other factors can create a similar or greater level of equal or greater difficulties.

**2.24** For many buyers, obtaining financial security to cover future decommissioning costs is a far bigger challenge. Particularly in light of the recent steep fall in oil price, obtaining finance and convincing lenders of the viability of late-life UKCS assets is a significant hurdle. Uncertainty over the extent of decommissioning costs only adds to the difficulties.

**2.25** While financing is the biggest challenge for buyers, some stakeholders feel there are aspects of the tax regime that add to the complexity of late-life asset transactions between incumbent owners and new entrants in the UKCS. HM Treasury has received differing views on how the tax system might be changed in this respect. As noted above, the difference in tax history between seller and buyer has been cited as an issue, although, as noted in Chapter 4, this does not affect all deals.

**2.26** While there is a consensus that tax is not the main reason for deals failing in most cases, HM Treasury has been presented with a small number of recent, potential deals where the buyer's lack of tax history created a value gap that either prevented the deal from completing or contributed to the deal failing. As noted above, in some deals, the buyer may see access to tax history as an insurance against the downside case – it may not be needed in the base case. The issues associated with the possibility of transferring tax history are complex and are discussed below in Chapter 5.

**2.27** There are still deals being completed in the UKCS, often bringing in new investors. These deals are rarely simple asset acquisitions; they tend to be either corporate acquisitions (see paragraph 4.22 onwards) or asset deals where the seller has retained liability for some or all of the decommissioning cost, meaning the tax history issue was neutralised (see paragraph 4.17 onwards).

**2.28** Deals where decommissioning responsibility is retained by the seller are often complex and sometimes might not be feasible, such as when the seller wants a “clean break” or for tax issues. In particular, while HMRC has issued guidance on the ring fence corporation tax treatment for the seller retaining decommissioning liability, there remain issues on the PRT treatment of retained decommissioning, which are discussed below in Chapter 5.

**2.29** Some stakeholders have also requested further guidance on the tax rules for decommissioning. HM Treasury and HMRC are currently considering whether, and in what format, such guidance could be made available.

**2.30** Infrastructure, such as pipelines and oil and gas terminals, plays a vital role in the UKCS and will be important in continuing the development of the basin. However, much of this infrastructure is ageing and may require new investment. HM Treasury is aware of a recent trend for ownership of infrastructure to move from oil companies to independent infrastructure specialists. These specialists are outside the oil and gas ring fence for tax purposes.

**2.31** The government acknowledges that there are a number of tax issues on oil and gas infrastructure, including the treatment of tariff income and disposal of infrastructure. It is still considering these points at present.

## **Discussion paper objectives**

**2.32** The government wants to ensure the tax treatment of the UKCS, particularly in relation to late-life assets, continues to support maximising economic recovery as the basin becomes more mature, while ensuring a fair return for the taxpayer.

**2.33** The government will consider any issues that are raised in response to this discussion paper in a manner consistent with its long-term strategy set out in 'Driving Investment'. Any case for change will also be evaluated against the following objectives:

- any change to the tax regime should only be made if it will deliver a sufficient and proportionate benefit for the UK taxpayer, as well as encouraging innovation and maximising economic recovery
- mitigate, as far as practical and achievable, tax-based obstacles to late-life assets transferring to new owners
- prevent gaming or commodification of tax history or other tax attributes that could result in greater exposure to the taxpayer
- not impose disproportionate administrative complexity for either industry or government
- not affect decommissioning obligations under existing legislation and treaties

**2.34** Through this discussion paper, HM Treasury is seeking to improve its understanding of the issues that stakeholders have brought to our attention. The aim is to identify the areas of the tax system that could be preventing assets being transferred to new owners who could maintain the assets in line with MER principles.

**2.35** As noted in Chapter 1, the government has not yet made any decision on whether any change to the tax system should be made and would not be willing to do so where this would present additional exposure to the taxpayer or add further complexity to the deals landscape.

# The oil and gas tax system

## 3 and decommissioning

---

**3.1** Oil and gas exploration and production in the UK and UKCS is taxed under a “ring fence” corporation tax regime differing from regular corporation tax.

**3.2** This regime acknowledges the troughs and peaks of an oil and gas company’s investment lifecycle. Broadly, it supports the significant investment needed in the exploration and development of oil and gas fields, taxes the profits from production and provides relief for decommissioning at the end of a field’s life. This supports the government’s twin objectives of maximising economic recovery of the UK’s remaining hydrocarbon reserves while ensuring the nation achieves a fair return on its resources.

**3.3** The fiscal regime applying to oil and gas production is comprised of three taxes:

**3.4 Ring Fence Corporation Tax (RFCT)** at 30% – Profits chargeable to RFCT are computed on the same basis as the normal corporation tax rules, with a few notable exceptions:

- the “ring fence” prevents losses from non-UK/UKCS oil and gas activities or excess interest payments being used to offset profits made from the production of oil and gas
- oil and gas production is highly capital intensive. Support for investment is provided by 100% first year capital allowances. This is available for virtually all capital expenditure
- the main rate of RFCT is set separately from the rate of mainstream corporation tax. Further, profits within the charge to RFCT are exempt from wider reforms to corporate tax such as interest deductibility and loss reform
- the rules for the use of decommissioning losses will not be materially affected by the proposed reforms outlined in Finance Bill 2017. In addition, ring fence expenditure supplement (RFES) allows carried forward losses to be increased by 10% for up to 10 accounting periods
- costs of decommissioning are subject to special rules, as outlined in section 3.7 below

**3.5 Supplementary Charge (SC)** currently at 10% – The SC is an additional charge levied on top of RFCT on adjusted ring fence profits (calculated in the same way as RFCT, except finance costs are excluded)

- the investment and cluster area allowances were introduced at Budget 2015 to stimulate investment in projects that are economic, but commercially marginal. This reduces the amount of adjusted ring fence profits subject to the supplementary charge. The portion of profits reduced by the allowance is dependent on a company’s investment expenditure and is generated at 62.5% of that spend
- the onshore allowance was introduced at Autumn Statement 2014 to encourage investment in onshore oil and gas projects. It works in a similar way to investment allowance, but with a 75% allowance

**3.6 Petroleum Revenue Tax (PRT) at 0%** – This is a field-based tax charged on profits arising from oil and gas production in individual oil fields that were given development consent before 16 March 1993. PRT is deductible as an expense in computing profits chargeable to RFCT and SC. At Budget 2016, the government permanently zero-rated PRT to simplify the regime for investors and level the playing field between older and newer fields. PRT has not been abolished, which allows losses from decommissioning to be carried back against previously paid PRT.

## Decommissioning

**3.7** The fiscal regime provides tax relief in relation to decommissioning costs incurred by oil and gas operators. The relief is only available once decommissioning costs are incurred, ensuring companies pay the full amount of tax from all profits generated in a field during its productive life. Relief is limited to the tax that the company has paid.

**3.8** If a tax loss arises on decommissioning, that loss can be carried back and offset against the profits chargeable to RFCT, SC and PRT. If tax was paid on profits in previous years, the company will then be entitled to reclaim some of the previously paid tax. Different rules are used to calculate how much relief can be claimed on decommissioning costs, depending on whether the relief is claimed for RFCT/SC or PRT.

**3.9** As noted above, the current tax rules recognise the different stages of an oil field's life and the requirements of each stage. In particular, the flexibility to relieve losses available at the end of a field's life is far more generous than is available in other industries, as the losses can be carried back considerably further.

**3.10** In the case of RFCT and SC, any loss from decommissioning can be relieved in the following ways:

- carried forward against future taxable ring fence profits
- surrendered to other group companies in the same year (group relief)
- carried back against previous years' ring fence taxable profits on a last in, first out (LIFO) basis, back to April 2002

**3.11** Even if a company was previously in a taxpaying position, a loss is likely to arise upon decommissioning due to the significant costs involved. Any losses created by decommissioning costs are likely to be carried back against the previous taxable profits of the company.

**3.12** If the losses from decommissioning are greater than the company's previous taxable profits, the remaining losses must be carried forward to set off against future ring fence profits, or, if the ring fence trade has ceased, the losses are extinguished.

**3.13** In the case of PRT (which is a field-based tax), any loss from decommissioning can be carried forward against future taxable profits of the same field or carried back against taxable profits of the same field in previous years on a last in, first out basis without limit. Any previously paid PRT is refunded with interest and is subject to RFCT and SC.

**3.14** If the decommissioning loss from the field exceeds its total taxable profits, the remaining loss can be surrendered to another field that the seller has an interest in.

**3.15** As noted in Chapter 2, HM Treasury and HMRC are also considering the possibility of issuing additional guidance on the tax rules for decommissioning.



# How UKCS assets can be bought and sold

## 4

---

**4.1** UKCS assets (including late-life assets) can broadly be disposed of using one of two approaches – an asset or corporate disposal. There are variants within each approach, and each results in a different tax treatment.

**4.2** Whichever approach is used to dispose of an asset will generally depend on the characteristics of the buyer and seller. The buyer and the seller may be willing to make either an asset deal or a corporate deal, with the final outcome a matter of commercial negotiation. The main consideration is whether the buyer wants all of the assets (i.e. oil fields) in a company, or only certain assets.

### Asset disposals

#### Simple asset disposal

**4.3** An asset disposal is where the licence for the oil field, together with the associated plant and infrastructure, is sold by the current licensee. In the most straightforward case, the licence is purchased for cash, but other forms of remuneration are also possible.

**4.4** Licence transfers need the consent of the Oil and Gas Authority (OGA). In addition, some joint operating agreements (JOAs) give other licensees in the field the power to block the transfer, or even pre-empt the sale with the option of buying the asset themselves. In some circumstances, this could make both parties prefer a corporate deal.

**4.5** For tax purposes, the purchase price is split between two elements – consideration for the licence (sometimes described as consideration for reserves), and consideration for prior drilling costs.

**4.6** The tax treatment of the consideration for the licence portion is governed by the chargeable gains legislation. The seller will (potentially) have a chargeable gain, with proceeds being the licence consideration and the base cost that can be set against the proceeds being the licence consideration the seller paid when they acquired the asset. However, if the seller is planning capital expenditure on other UK oil assets, they should be able to partly or wholly offset the gain through reinvestment relief.

**4.7** The purchaser will not receive any immediate tax deduction for the licence portion of the consideration, but can use it as base cost if they sell the asset (although this may be moot if they qualify for reinvestment relief). (10% mineral extraction allowances are available on licence acquisition, but as this is limited to the original amount paid to the government, it is likely to be minimal.)

**4.8** The prior drilling costs portion will be a clawback of capital allowances claimed on the asset for the seller, which, due to the 100% capital allowance levels, can lead to a taxable profit. In contrast, the buyer is able to claim 100% capital allowances on the prior drilling costs portion, generating an immediate tax deduction for the buyer. (It is limited to the qualifying expenditure incurred by the seller, though this historic expenditure is likely to be significant in the case of late-life assets.) While this can act as a de facto transfer of tax losses, it does not transfer any tax history.

**4.9** The differing treatments can create a tension between the buyer and the seller – a greater portion going to the licence can benefit the seller (if they are entitled to reinvestment relief), while more going to prior drilling costs benefits the buyer. The allocation should reflect the market value of the two elements. HMRC has the power to revise the allocation between the two elements if it has reason to believe there has been an unjust allocation.

**4.10** For PRT purposes, an asset transfer itself has no effect, and the PRT losses and unclaimed expenditure transfer with the field. Any PRT refund from losses that are generated by the new owner and carried back to the time of the seller's ownership will be repaid to the seller. (The seller will be subject to RFCT and SC on any such refund.) Sale and purchase agreements will normally provide that the seller must pay forward the refund (after RFCT and SC) to the buyer. This has the effect that the tax history is effectively transferred for PRT purposes.

## **Variations on asset disposals**

**4.11** There are a number of possible variations in the manner that deals can be structured using an asset disposal. These are often to facilitate a deal that would not happen under a conventional sale model because of a lack of capability in either the seller (e.g. a farm-in) or the buyer (e.g. the retention of decommissioning liability).

**4.12** A number of variations of asset sales have been seen in the UKCS. The more common ones are outlined below.

### **Farm-ins and earn-ins**

**4.13** Farm-ins are disposals where the buyer undertakes to carry out an exploration or development programme in exchange for an interest in the licence. (The work programme will cover a greater portion of the field's costs than the licence share being acquired.)

**4.14** Legislation provides that farm-ins for exploration programmes are treated for tax purposes as a disposal for nil consideration – the purchasers/farmers-in are able to claim capital allowances on all the qualifying expenditure that they incur on the development.

**4.15** However, exploration programmes are unlikely to occur for late-life assets. In the case of development farm-ins (which are more likely for late-life assets), the treatment is different – the consideration is instead valued as the increase in value of the field following the development programme. This involves a significant degree of uncertainty as the increase in value will not be known until the development programme is completed (which can take several years). This means that an estimate will have to be used in the tax return for the year when the disposal is made, and the return amended when the work programme is completed. Furthermore, there is significant potential for the chosen valuation methodology to lead to disputes between HMRC and the taxpayer.

**4.16** In addition, farmers-in often reimburse previous costs incurred by the previous licence holder (an earn-in) – this is treated as cash consideration.

### **Retention of decommissioning responsibility**

**4.17** In some successful late-life asset transactions, the seller, who has built up a long tax history in the UKCS, has transferred the licence to the buyer, but remains responsible for decommissioning once cessation of production in the asset is reached.

**4.18** In some cases, sellers opt to have the licences transferred back to them when decommissioning begins, so they can claim tax deductions. HM Treasury is also aware of cases where the licence stays with the buyer.

**4.19** There have been a number of transactions where the seller only takes over part of the liability for decommissioning. This includes the seller agreeing to assume the liability for a fixed percentage of decommissioning cost, an absolute spending cap, or a combination, where the seller pays a fixed percentage, up to a capped amount. This means that the risk is split between buyer and seller and would be a matter of commercial negotiation.

**4.20** The retention of decommissioning liability is favoured in some deals because the buyer may not want or be able to fund all of the decommissioning costs, on the basis that they should not pay for all of the decommissioning costs when they will only receive part of the overall production of the field. However, this approach may not suit all entrants; buyers who are late-life/decommissioning specialists may wish to retain responsibility for decommissioning, sellers may not always be comfortable being liable for decommissioning that they do not have control over, or sellers may want to make a clean exit from the UKCS.

**4.21** While tax relief for former licensees paying decommissioning costs has been confirmed as available for RFCT and SC in the HMRC Technical Note issued at the time of Budget 2016, it does not apply to PRT. For decommissioning expenditure to be relievably, section 12 of the Oil Taxation Act 1975 requires the payment to be made by a participator in the licence; the relief does not generally extend to former participators (see Chapter 5 below).

## **Corporate disposals**

### **Normal corporate disposal**

**4.22** If the assets to be sold are all in one company, the assets could be sold through a corporate disposal, rather than the assets themselves being sold. The entirety of the company, including all of its oil and gas assets, would be transferred from the seller to the buyer.

**4.23** Such a disposal would attract the substantial shareholdings exemption (SSE), provided that the SSE criteria are met. Broadly, both the company being sold and the seller must be trading before and after the sale. If SSE applies, it means that the seller would have neither a taxable gain nor loss from the sale.

**4.24** In addition, the company being sold would retain its tax history, which could be used to claim relief for decommissioning costs. This would be subject to the various anti-avoidance measures on loss buying.

**4.25** However, it may not always be possible for a company to be sold with all of the buyer's desired assets, particularly if all of the assets are in one company and the seller wishes to retain some assets. Pre-disposal reorganisations could be used, but could possibly fall foul of anti-avoidance measures and may not transfer all of the tax history.

### **Hive downs**

**4.26** One notable variation of a corporate disposal is a hive down, where a trade can be transferred to new subsidiary and the subsidiary is then sold. This results in the new company taking on the tax losses associated with the trade. This new company is then sold, along with its losses. The availability of these losses would still rely on there being no major change in the conduct or management of the business.

**4.27** The disposal of the company qualifies for SSE if the underlying trade meets the SSE criteria.

**4.28** This can be more helpful for assets that have just finished development and have tax losses since the losses are transferred with the company.

**4.29** Anecdotally, the use of hive downs has been fairly popular for disposals in the UKCS, as it allows sellers to obtain SSE on the disposal of the new company, without having to sell the entire company. Upon completion of the transaction, buyers obtain access to losses in a company without a long history that could require extensive due diligence.

**4.30** However, hive downs may not be attractive for late-life assets, as there may not be any tax losses to transfer and, unlike tax losses, tax payment history is not transferred into the new company.

**4.31** This demonstrates that there are several ways of disposing of assets and that tax considerations for each vary. In particular, it should be noted that transferring tax history is not needed for all forms of transactions. For some other transactions, the government recognises that there are some tax issues, such as the PRT rules for retained decommissioning, while for others, the issues have been resolved by previous reforms.

# Tax issues for late-life assets

## 5

---

**5.1** HM Treasury has held several discussions to date with stakeholders to understand the tax issues affecting late-life assets. This section summarises the issues that have been frequently raised in discussion and where the government would like to further explore these concerns.

**5.2** There are a number of questions included in this chapter in relation to the identified issues. These questions are intended to improve the government's understanding of these issues and facilitate debate. They should not be seen as indicative of any future government policy.

### Treatment of tax history

**5.3** In the discussions HM Treasury has had to date, it has been stated on numerous occasions by industry stakeholders that some form of transferable tax history (TTH) could assist some deals. This would permit a seller to transfer a portion of their ring fence corporation tax payment history to the buyer, alongside the asset as part of the deal. Currently, this is not possible as tax history is attached to the company who originally paid the tax and cannot be transferred. (This is not an issue for PRT, which is a field-based tax.)

**5.4** If a TTH existed, in its simplest form, when a UK oil or gas asset is sold, it would allow the seller to pass some of its tax payment history to the buyer. The buyer could then carry back the losses it subsequently incurs on decommissioning against this TTH, allowing the buyer to receive a tax refund that it would not have received without TTH. The seller would accordingly not be able to claim a refund against the tax history that was transferred.

**5.5** Advocates for TTH argue that, without it, the asset would not be sold, and would instead be decommissioned earlier than it would be if the asset was not sold. The incumbent would set off the decommissioning costs against its own tax history, which could otherwise have been transferred.

**5.6** A transferable tax history would represent a significant departure from the current system of tax relief. The government would need to be convinced of a compelling case for change before committing to any further consideration and any changes would need to meet the objectives outlined in Chapter 2.

**5.7** In considering how a hypothetical TTH would operate, there are a number of issues that would need to be considered. Some of these are complex and the government will need to decide whether the objectives stated in Chapter 2 can be adequately met.

### Issue 1: Determining transferred tax history

**5.8** Determining the tax history for an asset could be very difficult; details of individual fields' income and expenses are generally not kept in a format that could be used to determine tax history. An exception to this is PRT fields; the PRT returns will show income and expenses, but even these have differences from a corporation tax history – allowable costs can be different and PRT profits do not take into account the effect of offsetting losses from other fields.

**5.9** One possibility could be to pro-rate the taxable profits of each field based on its production, but this would not take into account the possibility that some fields will have higher costs per unit of production (and hence lower profits) than others.

**5.10** An approximate profit could possibly be determined by using the income from the field and the costs of major projects, with the remaining costs being pro-rated. However this would be resource intensive and there would still be the need for HMRC to be able to review the allocation, which could be difficult, as they would not have any records to review the allocated TTH.

**5.11** Another alternative could be allowing the buyer and seller to agree the amount of TTH to be transferred through commercial negotiation. If the use of the TTH is limited to decommissioning the transferred asset, as considered in paragraph 5.12 below, this could mean the buyer would only acquire the TTH they estimate they need. If TTH was limited in use, there may be no need to limit the quantity of TTH transferred. Allowing buyer and seller to self-determine the amount of TTH to be transferred could allow an element of commodification: if the seller has 'excess' TTH that it does not expect to use in respect of its own decommissioning liabilities, it could transfer an element of TTH equal to the excess, which could allow it to immediately access tax payment history at higher rates for its own decommissioning if there were no restrictions.

**Question 1:** If TTH was introduced, in your view, what methodology could be used to determine the appropriate amount of tax history to transfer to a buyer with an asset? Which factors could be given consideration when calculating the amount?

### Issue 2: Possible restrictions on TTH

**5.12** The government has significant concerns that any TTH could lead to tax history being treated as a tradable commodity. One possible means of preventing this could be through imposing restrictions on how the TTH could be used. Such restrictions could include limiting the use of TTH to decommissioning and/or restricting the use of TTH to the asset it is transferred with. In such cases, the transferred TTH would need to be allocated on a field by field basis.

**5.13** Undertaking both restrictions could go some way to combatting the risk of commodification. However, the buyer would need to be satisfied that the TTH was sufficient to cover the relevant decommissioning costs for the transferred field.

**5.14** Conversely, if an excessive amount of TTH is transferred, without restrictions, it could allow the buyer to get tax repayments on decommissioning the transferred asset and also assets that they already own, thereby monetising the decommissioning losses, resulting in a loss to the taxpayer.

**Question 2:** If TTH was introduced, in your view, what restrictions, if any, could be imposed on the expenditure against which tax relief from TTH could be claimed against?

### Issue 3: Order of TTH utilisation

**5.15** As outlined in Chapter 3, decommissioning losses (like other losses) are carried back against previous tax history on a last in/first out (LIFO) basis. If TTH was introduced, it would need to be decided if the tax history generated by the asset following the acquisition could be utilised before the TTH, or the TTH could be set against the decommissioning costs without regard to the profits earned by the asset. Alternatively, the decommissioning cost could be set against the buyer's total post-acquisition tax history, which would include profits from the buyer's other oil assets.

**5.16** Allowing the buyer to use the TTH before post acquisition profits would be simple to model and would give certainty to the buyer that they would be able to utilise the TTH. However, it would be a significant departure from how decommissioning losses are used against normal tax history (on a LIFO basis against total tax history) and could create additional costs for the taxpayer. In particular, prioritising TTH use would “lock in” the value of the tax history at the tax rate for the years that the TTH was transferred from. This would mean the tax repayment could be at a higher tax rate than the tax rate a normal carry back of losses would receive.

**5.17** Carrying the loss back against all of the buyer’s post acquisition profits before TTH would mirror the normal loss carry back treatment. This would generally be in line with the normal decommissioning rules, could be more straightforward to operate and support tax neutrality between different types of transaction.

**5.18** However, there would be uncertainty for the buyer on how much TTH would be used. It could be the case that post acquisition profits are at such a level that the transferred tax history is never used. If the restrictions considered in paragraph 5.12 were in place, this could mean that the buyer acquires TTH that it never uses, although the advantage of the TTH safety net would remain.

**5.19** Additionally, if the transferred asset is decommissioned before assets the buyer already owns, it could use up the general post acquisition tax history while not accessing the TTH. When the existing assets are later decommissioned, the general tax history the buyer could access would be reduced. If there were restrictions as outlined in paragraph 5.12, they could not access the TTH, meaning that the buyer could be in a worse position than if they did not acquire the asset. (However, this risk also occurs under the current rules, and therefore may not be a significant issue.)

**Question 3:** If TTH was introduced, and profits are generated by a new owner from a transferred asset, in your view, how could the ring-fence decommissioning loss carry-back rules interact with a transferable tax history?

#### Issue 4: Administration of TTH

**5.20** Any TTH would be a significant change from the current treatment of tax history. It would require new administrative structures to be created, which could introduce additional costs for both industry and government. Any such structures would need to address the following points:

- how HMRC would be informed of the transfer of TTH
- whether HMRC should provide certification that the seller has enough tax history to transfer the TTH and that the amount of TTH is correct. (This could be covered by the buyer’s due diligence)
- how the transferred TTH is tracked following transfer and during its use
- how the removal of the TTH is shown by the seller
- how the transferred TTH is allocated between accounting periods. (It could be on a LIFO basis, or the buyer and seller could decide which accounting periods to be transferred)
- how TTH for periods under enquiry with HMRC would be treated
- whether HMRC should have the ability to challenge the amount of TTH transferred if HMRC judges it to not be “just and reasonable”

**5.21** This should not be viewed as a definitive list; the government would be grateful if any other possible issues are brought to its attention.

**5.22** As noted above, transferring tax history is not a concept that currently exists in corporation tax, and any TTH would have to be able to operate within HMRC's systems. Tracking a separate tax history could also be potentially onerous for seller and buyer. As noted in the objectives in Chapter 2, the government will need to be comfortable that any benefit to the taxpayer is proportionate to the administrative cost.

**Question 4:** If a TTH was introduced, in your view, how could such a scheme be administered? What systems would industry have to put in place in order to verify and track any transfer of tax history?

### Issue 5: Attribution of TTH

**5.23** A fundamental point for any TTH would be whether a transferred TTH would be attributed to the company or the asset. If TTH was attributed to the asset, the TTH would be transferred with the asset on subsequent sales. If attributed to the company, it would stay with the company on disposal of the field.

**5.24** Which option would be more appropriate would be dependent on the other characteristics of the TTH. If there were restrictions, such as in paragraph 5.12, that meant TTH could only be used against decommissioning costs from the transferred field, there would appear to be no point in the TTH being attributed to the company – if the field was subsequently sold, the TTH remaining with the company could not be used.

**5.25** A complexity could be added if only part of the asset (i.e. part of a field) is subsequently sold. In such cases, it would need to be decided if the amount of TTH transferred with the asset is in proportion to the proportion sold.

**5.26** An associated point is whether intra-group transfers of TTH would be allowed. If the intent of TTH would be to incentivise the transfer of fields from incumbents to newer, nimble companies, allowing intra-group TTH transfers does not appear to meet this goal, instead simply incentivising transfers around a group that has the same capital constraints on investment.

**5.27** HM Treasury notes that there are some groups where the decommissioning costs could be in one company, and the tax history in another company. This could be mitigated by intra-group transfers, although this is affected by the change in nature of trade rules discussed in below.

**Question 5:** If a TTH was introduced, in your view, would buyers be restricted in subsequent transfers of acquired tax history, if the associated field is sold again?

### Issue 6: Tax treatment of sellers and TTH

**5.28** It is possible that buyers would pay a premium to sellers for acquiring TTH, reflecting the inherent value of the certainty provided by the tax history. However, the level of any premium would be dependent on how likely the TTH is to be used and how restricted its use would be.

**5.29** If there was a premium, the government would need to ensure that it was taxed, to ensure a fair return for the taxpayer. The premium could be treated as outlined in paragraph 4.6 above, as a licence element subject to chargeable gains. (Treating the premium as prior drilling costs



would not work, as it is not expenditure that qualifies for capital allowances.) Alternatively, the premium could be taxed as income.

**Question 6:** If a TTH was introduced, in your view, what could be the tax treatment of the sale of tax history in the hands of the vendor?

### Issue 7: Mandatory or optional system

**5.30** Making use of TTH mandatory would give certainty; both buyer and seller would know that TTH would apply. However, even putting aside the difficulties of quantifying each asset's tax history (as discussed above), mandatory TTH transfer would remove flexibility in negotiating deals. Sellers may not want to transfer tax history in all deals and not all buyers may need tax history to be transferred to them. This would be especially the case with transfers of early-life assets.

**Question 7:** If TTH was introduced, in your view, would the use of TTH be optional or could it be mandatory to transfer an asset's associated tax history when the asset is transferred?

## Retained decommissioning and PRT

**5.31** Current UKCS licence holders are looking at a number of ways to mitigate uncertainty over the decommissioning liability as part of deals for late-life assets. As noted in paragraph 4.17, one common method is that the seller retains some or all of the responsibility for decommissioning. This may not be suitable in all instances, but is becoming more common and has been seen in a number of recent deals.

**5.32** The ring fence corporation tax position on retention of decommissioning liability by the seller has been clarified by the HMRC Technical Note in Budget 2016.<sup>1</sup> However, the issue is not resolved for PRT purposes.

**5.33** If the seller is no longer on the licence when they incur decommissioning costs, they will not be able to claim a PRT deduction for these costs. This is because PRT returns can only be made by "participators" – i.e. licence holders, ex-licence holders who receive tariff receipts and ex-licence holders due to a cessation event.<sup>2</sup>

**5.34** At present, this means that if the seller retains decommissioning costs, neither the buyer nor the seller is able to claim the costs as deductible for PRT. As noted above, if the seller incurs the costs, they cannot claim a deduction, as they are not a participator. If the buyer incurs the costs, but is reimbursed for them by the seller, the buyer cannot claim a PRT deduction due to rules preventing PRT deductions for subsidised costs.<sup>3</sup>

**5.35** The government would like to understand if this issue is making asset transfers more difficult and whether there are solutions that could combat these difficulties.

**5.36** One possible solution would be for the company undertaking the decommissioning to be treated for PRT purposes as "standing in the shoes" of the participator they are doing the decommissioning for. This would be a deemed transfer of the licence to the decommissioner on commencement of decommissioning. As a deemed transfer, this could deal with concerns of a partner pre-empting any transfer of the licence back to the decommissioner. The

<sup>1</sup> See <https://www.gov.uk/government/publications/oil-and-gas-companies-tax-relief-for-decommissioning-expenditure/oil-and-gas-companies-tax-relief-for-decommissioning-expenditure>

<sup>2</sup> s.12 Oil Taxation Act 1975

<sup>3</sup> Paragraph 8, Schedule 3, Oil Taxation Act 1975

decommissioning loss would then be carried back through the current participator's PRT history before it passes to the previous participator (who is likely to be the decommissioner). If the seller only paid for part of the decommissioning costs, this cost would still be carried back – the change would be that the portion paid by the seller would attract a PRT deduction, when previously it would have been lost. In addition, it combats the possibility that the current rules could be used for tax avoidance.

**5.37** This could potentially be complex, especially when the seller's decommissioning liability is capped or limited to a percentage of the decommissioning costs.

**5.38** Alternatively, the seller could fund the decommissioning, with the costs being treated as incurred by the buyer, with resulting PRT loss being carried back. At present, the anti-subsidy rules will prevent this from occurring. If such a change is made to the rules, sellers and buyers may need to consider how it affects the arrangements currently in place under existing sale and purchase agreements.

**5.39** In addition, any change would need to consider whether there would be any knock-on effect on the anti-subsidy rules. It would need to ensure that the tax system did not prevent tax deductions that would be available if the assets had not been sold.

**Question 8:** In your view, what are the benefits of the methods outlined above of dealing with retention of decommissioning for PRT? Are there any alternative means of resolving this issue?

## Treatment of losses on transfer of trade

**5.40** One concern that has been raised is on the treatment of tax losses once a trade has been transferred.

**5.41** Under the current rules, if a company has a change of ownership and a major change in the nature or conduct of its trade in a three year period, its losses can be extinguished.

**5.42** As noted in Chapter 4, transfers of assets can be done by selling the company holding the asset, instead of the asset itself. This can be suitable for groups who are seeking a clean break from the UKCS.

**5.43** However, stakeholders have expressed concern that the losses in the transferred companies could be lost if there is a "major change in the nature or conduct of trade", or whether the trade has become "small and negligible" and is later revived. While the acquired companies will probably be continuing a trade of oil and gas extraction, there may well be changes in management and business processes. Whether these will be considered major is often unclear.

**Question 9:** In your view, what action will provide the most certainty, while meeting the government's aim of preventing tax avoidance? Are there other actions that could be taken that could meet those objectives?

## 6 Next steps

---

**6.1** Alongside this document, the government will establish an expert panel to consider the issues identified in this paper in greater detail. The panel will be composed of industry stakeholders to discuss detailed aspects of the UKCS fiscal regime in relation to late-life assets.

**6.2** All interested parties are invited to respond to the questions and points raised in this discussion paper. Responses should be provided to [ETTanswers@hmtreasury.gsi.gov.uk](mailto:ETTanswers@hmtreasury.gsi.gov.uk) or

Late-Life Oil and Gas Asset Responses  
Energy and Transport Tax Team  
Business and International Tax Group  
HM Treasury  
1 Horse Guards Road  
London SW1A 2HQ

**6.3** HM Treasury may ask for a follow-up meeting.

**6.4** HM Treasury would be grateful if all responses are received by 30 June 2017. The government will then consider the representations received in response to this discussion paper.

**6.5** Please note confidential data collected by HMT will be protected under the absolute exemption at section 41 of the Freedom of Information (FOI) Act. The statutory Code of Practice under section 45 of the FOI Act sets out, amongst other things, the obligations of confidence that public authorities must comply with. Please ensure that your response is marked clearly if you consider that your response should be kept confidential. An automatic confidentiality disclaimer generated by your IT system will not, by itself, be regarded as binding on the Departments. Responses will be shared with HMRC and HM Treasury may share extracts with the OGA in order to inform our views on these issues.



### **HM Treasury contacts**

This document can be downloaded from  
[www.gov.uk](http://www.gov.uk)

If you require this information in an alternative  
format or have general enquiries about  
HM Treasury and its work, contact:

Correspondence Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 5000

Email: [public.enquiries@hmtreasury.gsi.gov.uk](mailto:public.enquiries@hmtreasury.gsi.gov.uk)