



HM Revenue  
& Customs

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**UK oil and gas: offshore bareboat chartering - Draft  
Legislation, Explanatory Note and  
Tax Information and Impact Note (TIIN)**

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Technical Note  
1 April 2014

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## Introduction

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At Autumn Statement 2013 the government announced a measure to ensure that more of the profits made by offshore contractors in the UK are subject to UK tax. Offshore contractors have used intra-group payments to move up to 90% of operating profit made in connection with activity on the UK Continental Shelf (UKCS) overseas. This measure was part of a £9bn package of measures addressing unfair tax outcomes.

The government consulted informally with affected businesses, representative bodies and advisers on the measure during February 2014 and, based on the evidence received during consultation, made a number of changes:

- i. the measure will now only apply to drilling rigs and accommodation vessels;
- ii. the cap on the bareboat deduction is increased from 6.5% to 7.5%; and
- iii. the pro-rata calculation is based on worldwide use of the vessel.

The legislation will operate by capping the tax deduction available for a bareboat (or similar) leasing payment in the UKCS to an associated person, where this arises as part of a composite service. The legislation will also ensure that the profits arising from that service are not reduced by unrelated tax relief. Any amounts arising in excess of the cap can be set against non-UKCS activity.

The draft legislation is now published for a short period of technical consultation, which will close on 9 May 2014.

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## Chapter 1 - Draft Legislation

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The draft legislation appears on pages 5 to 16 inclusive.

**1 Oil contractor activities: ring-fence trade etc**

Schedule 1 contains provision about the corporation tax treatment of oil contractor activities.

## SCHEDULES

### SCHEDULE 1

Section 1

#### OIL CONTRACTORS: RING-FENCE TRADE ETC

##### CTA 2010

- 1 CTA 2010 is amended as follows.
- 2 In section 1 (overview of Act), in subsection (3), after paragraph (a) insert –  
“(aa) oil contractor activities (see Part 8ZA),”
- 3 In Chapter 4 of Part 8 (oil activities: calculation of profits), after section 285 insert –

##### *“Hire of relevant assets*

#### **285A Restriction on hire etc of relevant assets to be brought into account**

- (1) This section applies if –
  - (a) oil contractor activities are, or are to be, carried out, and
  - (b) a company that carries on a ring fence trade makes, or is to make, one or more payments under a lease of a relevant asset, or part of a relevant asset, which is, or is to be, provided, operated or used in the relevant offshore service in question.
- (2) The total amount that may be brought into account in respect of the payments for the purposes of calculating the company’s ring fence profits in an accounting period is limited to the hire cap.
- (3) The “hire cap” is an amount equal to the relevant percentage of TC at the beginning of the accounting period, subject to subsection (4).
- (4) If payments in relation to which subsection (2) or section 356N(2) (restriction on hire for oil contractors under Part 8ZA) applies are also made, or to be made, by one or more other companies in respect of the relevant asset or part, the “hire cap” is to be such proportion of the amount mentioned in subsection (3) as is just and reasonable, having regard (in particular) to the amounts of the payments made, or to be made, by each company.
- (5) The “relevant percentage” and TC are to be determined in accordance with section 356N(5) to (16).
- (6) To the extent that, by virtue of this section, payments within subsection (1)(b) cannot be brought into account for the purposes of calculating the company’s ring fence profits in an accounting period, the payments may be –

- (a) allowed as a deduction from the company’s total profits for the accounting period, or
  - (b) treated as a surrenderable amount of the company for the accounting period for the purposes of Part 5 (group relief) (see section 99(7)) as if they were a trading loss, but this is subject to subsection (7).
- (7) No deduction may be made by virtue of subsection (6) from total profits so far as they are ring fence profits or contractor’s ring fence profits.
- (8) If the company or an associated person enters into arrangements the main purpose or one of the main purposes of which is to secure that subsection (2) does not apply in relation to one or more payments to any extent, that subsection applies in relation to the payments to the extent that it would not otherwise do so.
- (9) In subsection (8) “arrangements” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).
- (10) In this section –  
“associated person” has the meaning given by section 356LB;  
“contractor’s ring fence profits” has the meaning given by section 356LD;  
“oil contractor activities” and “relevant offshore service” have the meanings given by section 356L;  
“relevant asset” has the meaning given by section 356LA;  
“lease” has the meaning given by section 868.”

4 After Part 8 (oil activities) insert –

**“PART 8ZA**

OIL CONTRACTORS

**CHAPTER 1**

INTRODUCTION

**356K Overview of Part**

- (1) This Part is about the corporation tax treatment of oil contractor activities.
- (2) Chapter 2 contains basic definitions used in this Part.
- (3) Chapter 3 treats oil contractor activities as a separate trade.
- (4) Chapter 4 makes provision about the calculation of profits from oil contractor activities.
- (5) For the meaning of oil contractor activities, see section 356L.

**CHAPTER 2**

## BASIC DEFINITIONS

**356L “Oil contractor activities” etc**

- (1) The definitions in this section have effect for the purposes of this Part.
- (2) “Oil contractor activities” means activities carried on by a company (“the contractor”), which are not oil-related activities (within the meaning of section 274), but are –
  - (a) exploration or exploitation activities in, or in connection with, which the contractor provides, operates or uses a relevant asset (see section 356LA) in a relevant offshore service, or
  - (b) otherwise carried on in, or in connection with, the provision by the contractor of a relevant offshore service.
- (3) The contractor provides a “relevant offshore service” if the contractor provides, operates or uses a relevant asset in, or in connection with, the carrying on of exploration or exploitation activities in a relevant offshore area by the contractor or any other associated person.
- (4) “Exploration or exploitation activities” means activities carried on in connection with the exploration or exploitation of the seabed and subsoil and their natural resources.
- (5) “Relevant offshore area” means –
  - (a) the territorial sea of the United Kingdom;
  - (b) the areas designated by Order in Council under section 1(7) of the Continental Shelf Act 1964.

**356LA “Relevant asset”**

- (1) In this Part “relevant asset” means an asset within subsection (2) in respect of which conditions A and B are met.
- (2) An asset is within this subsection if it is a structure that –
  - (a) can be moved from place to place (whether or not under its own power) without major dismantling or modification, and
  - (b) can be used to –
    - (i) drill for the purposes of searching for, or extracting, oil, or
    - (ii) provide accommodation for individuals who work on or from a structure used in a relevant offshore area for, or in connection with, exploration or exploitation activities.
- (3) In subsection (2) –
 

“oil” means any substance capable of being won under the authority of a licence granted under Part 1 of the Petroleum Act 1998 or the Petroleum (Production) Act (Northern Ireland) 1964;

“structure” includes a ship or other vessel.



- (4) Condition A is that the asset, or any part of the asset, is leased (whether by the contractor or not) from an associated person other than the contractor.
- (5) Condition B is that the asset is of the requisite value.
- (6) The asset is of the “requisite value” if its market value is £2,000,000 or more.
- (7) The Treasury may by regulations modify the meaning of “requisite value”.
- (8) Regulations under subsection (7) may –
  - (a) amend this section,
  - (b) make different provision for different cases or different purposes, and
  - (c) make incidental, consequential, supplementary or transitional provision or savings.

#### **356LB “Associated person”**

- (1) For the purposes of this Part each of the following is an “associated person” –
  - (a) the contractor,
  - (b) any person who is, or has been, connected with the contractor,
  - (c) any person who has acted, acts, or is to act, together with the contractor to provide a service, and
  - (d) any person who is connected with a person falling within paragraph (b) or (c).
- (2) A person does not act together with the contractor to provide a service by reason only of leasing an asset, to any person, which is provided, operated or used in the service.

#### **356LC “Lease”**

In this Part “lease” has the meaning given by section 868 and “leased” and “leasing” are to be construed accordingly.

#### **356LD “Contractor’s ring fence profits”**

In this Part the “contractor’s ring fence profits”, in relation to an accounting period, means the contractor’s income arising from oil contractor activities for that period.

### **CHAPTER 3**

#### **DEEMED SEPARATE TRADE**

#### **356M Oil contractor activities treated as separate trade**

If the contractor carries on oil contractor activities as part of a trade, those activities are treated for the purposes of the charge to corporation tax on income as a separate trade, distinct from all other activities carried on by the contractor as part of the trade.

## CHAPTER 4

## CALCULATION OF PROFITS

*Hire of relevant assets***356N Restriction on hire etc of relevant assets to be brought into account**

- (1) This section applies if the contractor makes, or is to make, one or more payments under a lease of –
  - (a) a relevant asset, or
  - (b) part of a relevant asset.
- (2) The total amount that may be brought into account in respect of the payments for the purposes of calculating the contractor’s ring fence profits in an accounting period is limited to the hire cap.
- (3) The “hire cap” is an amount equal to the relevant percentage of TC at the beginning of the accounting period, subject to subsection (4).
- (4) If payments in relation to which subsection (2) or section 285A(2) (restriction on hire for company carrying on a ring fence trade under Part 8) applies are also made, or to be made, by one or more other companies in respect of the relevant asset or part, the “hire cap” is to be such proportion of the amount mentioned in subsection (3) as is just and reasonable, having regard (in particular) to the amounts of the payments made, or to be made, by the contractor and each other company.
- (5) Subject to subsection (7), the “relevant percentage” is to be –

$$7.5\% \times \frac{\text{UROS}}{\text{TU}}$$

where –

UROS is the number of days in the accounting period that the relevant asset is provided, operated or used in a relevant offshore service, and

TU is the number of days in the accounting period that the relevant asset is provided, operated or used (whether or not in a relevant offshore service).

- (6) Accordingly, the relevant percentage is zero if the relevant asset is not provided, operated or used in the accounting period.
- (7) If the accounting period is less than 12 months, the relevant percentage is to be proportionally reduced.
- (8) The Treasury may by regulations modify the “relevant percentage”.
- (9) Regulations under subsection (8) may –
  - (a) amend this section or section 285A,
  - (b) make different provision for different cases or different purposes, and

- (c) make incidental, consequential, supplementary or transitional provision or savings.

(10) TC is –

OC + CE

- (11) Unless subsection (13) applies, OC is the sum of –
  - (a) subject to subsection (14), any consideration given for the acquisition of the relevant asset or part when it was first acquired by an associated person, and
  - (b) any expenses incurred by an associated person in connection with that acquisition (other than the costs of financing the acquisition).
- (12) Subsection (13) applies if the relevant asset or part –
  - (a) is leased by an associated person from a person who is not an associated person, and
  - (b) has never been owned by an associated person.
- (13) OC is the sum of –
  - (a) subject to subsection (14), the consideration that it is reasonable to suppose would have been given for the acquisition of the relevant asset or part, if it had been acquired by an associated person by way of a bargain at arm's length at the time it was first leased as mentioned in subsection (12)(a), and
  - (b) the expenses (other than the costs of financing the acquisition) that it is reasonable to suppose would have been incurred by an associated person in connection with such an acquisition.
- (14) OC does not include any part of the consideration mentioned in subsection (11)(a) or (as the case may be) (13)(a) that it is reasonable to attribute to anything that –
  - (a) formed part of the relevant asset or part, and
  - (b) at the beginning of the accounting period –
    - (i) does not form part of the relevant asset or part, or
    - (ii) if it forms part of the relevant asset or part, does not affect, or reduces, the amount that a person would agree by way of a bargain at arm's length to pay under a lease of the relevant asset or part.
- (15) CE is, subject to subsection (16), capital expenditure on the relevant asset or part incurred by an associated person after it was first acquired by an associated person or (as the case may be) was first leased as mentioned in subsection (12)(a).
- (16) CE does not include any part of the capital expenditure mentioned in subsection (15) that has not resulted in the amount that a person would, at the beginning of the accounting period, agree by way of a

bargain at arm's length to pay under a lease of the relevant asset or part being greater than it would otherwise have been.

- (17) To the extent that, by virtue of this section, payments within subsection (1) cannot be brought into account for the purposes of calculating the contractor's ring fence profits in an accounting period, the payments may be –
- (a) allowed as a deduction from the contractor's total profits for the accounting period, or
  - (b) treated as a surrenderable amount of the contractor for the accounting period for the purposes of Part 5 (group relief) (see section 99(7)) as if they were a trading loss, subject to subsection (18).
- (18) No deduction may be made by virtue of subsection (17) from total profits so far as they are contractor's ring fence profits or ring fence profits for the purposes of Part 8.
- (19) If an associated person enters into arrangements the main purpose or one of the main purposes of which is to secure that subsection (2) does not apply in relation to one or more payments to any extent, that subsection applies in relation to the payments to the extent it would not otherwise do so.
- (20) In subsection (19) "arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).

*Loan relationships*

**356NA Restriction on debits to be brought into account**

- (1) Debits may not be brought into account for the purposes of Part 5 of CTA 2009 (loan relationships) in respect of the contractor's loan relationships in any way that results in a reduction of what would otherwise be the contractor's ring fence profits, but this is subject to subsections (2) to (4).
- (2) Subsection (1) does not apply so far as a loan relationship is in respect of money borrowed by the contractor which has been –
  - (a) used to meet expenditure incurred by the contractor in carrying on oil contractor activities, or
  - (b) appropriated to meeting expenditure to be so incurred by the contractor.
- (3) Subsection (1) does not apply, in the case of debits falling to be brought into account as a result of section 329 of CTA 2009 in respect of a loan relationship that has not been entered into, so far as the relationship would have been one entered into for the purpose of borrowing money to be used or appropriated as mentioned in subsection (2).
- (4) Subsection (1) does not apply, in the case of debits in respect of a loan relationship to which Chapter 2 of Part 6 of CTA 2009 (relevant non-lending relationships) applies, so far as –
  - (a) the payment of interest under the relationship is expenditure incurred as mentioned in subsection (2)(a), or

- (b) the exchange loss arising from the relationship is in respect of a money debt on which the interest payable (if any) is, or would be, such expenditure.
- (5) If a debit—
  - (a) falls to be brought into account for the purposes of Part 5 of CTA 2009 in respect of a loan relationship of the contractor, but
  - (b) as a result of this section cannot be brought into account in a way that results in any reduction of what would otherwise be the contractor's ring fence profits,the debit is to be brought into account for those purposes as a non-trading debit despite anything in section 297 of that Act.
- (6) References in this section to a loan relationship, in relation to the borrowing of money, do not include a relationship to which Chapter 2 of Part 6 of CTA 2009 (relevant non-lending relationships) applies.

### **356NB Restriction on credits to be brought into account**

- (1) Credits in respect of exchange gains from the contractor's loan relationships may not be brought into account for the purposes of Part 5 of CTA 2009 (loan relationships) in any way that results in an increase of what would otherwise be the contractor's ring fence profits, but this is subject to subsections (2) to (4).
- (2) Subsection (1) does not apply so far as a loan relationship is in respect of money borrowed by the contractor which has been—
  - (a) used to meet expenditure incurred by the contractor in carrying on oil contractor activities, or
  - (b) appropriated to meeting expenditure to be so incurred by the contractor.
- (3) Subsection (1) does not apply, in the case of credits falling to be brought into account as a result of section 329 of CTA 2009 in respect of a loan relationship that has not been entered into, so far as the relationship would have been one entered into for the purpose of borrowing money to be used or appropriated as mentioned in subsection (2).
- (4) Subsection (1) does not apply, in the case of credits in respect of a loan relationship to which Chapter 2 of Part 6 of CTA 2009 (relevant non-lending relationships) applies, so far as—
  - (a) the payment of interest under the relationship is expenditure incurred as mentioned in subsection (2)(a), or
  - (b) the exchange gain arising from the relationship is in respect of a money debt on which the interest payable (if any) is, or would be, such expenditure.
- (5) If a credit—
  - (a) falls to be brought into account for the purposes of Part 5 of CTA 2009 in respect of a loan relationship of the contractor, but
  - (b) as a result of this section cannot be brought into account in a way that results in any increase of what would otherwise be the contractor's ring fence profits,

the credit is to be brought into account for those purposes as a non-trading credit despite anything in section 297 of that Act.

- (6) Section 356NA(6) applies for the purposes of this section.

### *Relief*

#### **356NC Management expenses**

No deduction under section 1219 of CTA 2009 (expenses of management of a company's investment business) is to be allowed from the contractor's ring fence profits.

#### **356ND Losses**

Relief in respect of a loss incurred by the contractor may not be given under section 37 (relief for trade losses against total profits) against that contractor's ring fence profits except so far as the loss arises from oil contractor activities.

#### **356NE Group relief**

- (1) On a claim for group relief made by a claimant company in relation to a surrendering company, group relief may not be allowed against the claimant company's contractor's ring fence profits except so far as the claim relates to losses incurred by the surrendering company that arose from oil contractor activities.
- (2) In section 105 (restriction on surrender of losses etc within section 99(1)(d) to (g)) the references to the surrendering company's gross profits of the surrender period do not include the company's relevant contractor's ring fence profits for that period.
- (3) The company's "relevant contractor's ring fence profits" for that period are –
  - (a) if for that period there are no qualifying charitable donations made by the company that are allowable under Part 6 (charitable donations relief), the company's contractor's ring fence profits for that period, or
  - (b) otherwise, so much of the company's contractor's ring fence profits for that period as exceeds the amount of the qualifying charitable donations made by the company that are allowable under section 189 for that period.
- (4) In this section "claimant company" and "surrendering company" are to be read in accordance with Part 5 (group relief) (see section 188).

#### **356NF Capital allowances**

A capital allowance may not to any extent be given effect under section 259 or 260 of CAA 2001 (special leasing) by deduction from the contractor's ring fence profits."

- 5 In Schedule 4 (index of defined expressions), insert the following entries at the appropriate places –

“associated person (in Part 8ZA)	section 356LB”
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“contractor (in Part 8ZA)	section 356L(2)”
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“contractor’s ring fence profits (in Part 8ZA)	section 356LD”
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“exploration or exploitation activities (in Part 8ZA)	section 356L(4)”
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“lease (in Part 8ZA)	section 356LC”
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“oil contractor activities (in Part 8ZA)	section 356L(2)”
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“relevant asset (in Part 8ZA)	section 356LA”
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“relevant offshore area (in Part 8ZA)	section 356L(5)”
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“relevant offshore service (in Part 8ZA)	section 356L(3)”
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*Commencement etc*

- 6 This Schedule is to be treated as having come into force on 1 April 2014 (“the commencement date”).
- 7 Section 356L of CTA 2010 has effect in relation to activities carried out on or after the commencement date.
- 8 If, on the commencement date, a company was carrying on a trade that consisted of, or included, carrying out oil contractor activities, an accounting period ends (if it would not otherwise do so) with 31 March 2014.
- 9 (1) A company may be given relief under section 45 of CTA 2010 (carry forward of trade loss against subsequent trade profits) for a loss made in an accounting period ending before the commencement date against profits of a ring fence trade so far as (and only so far as) the loss would have been a loss of the ring fence trade had section 356L of that Act had effect in relation to activities carried out before the commencement date.
- (2) In sub-paragraph (1) “ring fence trade” means oil contractor activities that constitute a separate trade (whether by virtue of section 356M of that Act or otherwise).



## Chapter 2 - Explanatory Note

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### OIL CONTRACTOR ACTIVITIES

#### SUMMARY

Clause 1 and Schedule 1 introduce provisions to restrict the use of deductions for leasing payments relating to assets used as part of a composite offshore oil and gas service.

#### DETAILS OF THE SCHEDULE

##### *Schedule 1*

1. Paragraph 1 provides that CTA2010 is to be amended.
2. Paragraph 2 inserts a reference to the new Part 8ZA into the overview section of the existing overview of the CTA. New Part 8ZA contains new rules applicable to contractors operating in the offshore oil and gas industry (who are not also within the Part 8 oil and gas ring fence) who lease assets from their associates.
3. Paragraph 3 inserts a new section into the existing rules for the calculation of profits from oil and gas exploration and exploitation activities. This section mirrors the effect of the new Part 8ZA in circumstances where separate contracts have been used and is required to prevent new Part 8ZA being sidestepped.
4. New subsection 285A(1) defines the two conditions that must both be satisfied for payments to be within scope of the new section. New subsection 285A (1)(a) requires that oil contractor activities are carried out, which is defined in new subsection 285A(10) so as to have the same meaning as in new Part 8ZA. New subsection 285A (1)(b) requires that the ring fence company (that is to say one whose activities are within Chapter 4 Part 8) is making payments under a lease as part of obtaining a composite service from a contractor. New subsection 285A(10) provides the definitions for the terms used.
5. New subsection 285A(2) limits the amount that can be deducted in computing the company's ring fence profits. Any amount paid in excess of that limit will be allowed as a deduction from a company's non ring fence profit under new subsection 285A(6).
6. New subsection 285A(3) provides the size of that limitation, referred to as a "hire cap", by reference to the relevant percentage which is further defined in new subsection 285A(5).
7. New subsection 285A(4) provides for the case where more than one contractor or ring fence company are subject to the hire cap in respect of the same asset. The subsection ensures that the total hire cap available is equal to that which would apply if there had been a single entity. The hire cap itself is then allocated to each payer on the basis of their relative contribution as is just and reasonable.

8. New subsection 285A(5) defines “relative percentage” and TC (the cost on which the relevant percentage operates to determine the hire cap) by using the same definitions as in the new Part 8ZA which are to be found in new 356N subsections (5) to (15).
9. New subsection 285A(6) provides that any amount paid in excess of the hire cap will be allowed as a deduction from the company’s total profits; or may be surrendered as a trading loss for use against profits by other members of the paying company’s group. New subsection (7) prevents any deduction under new subsection 285A(6) from profits within either the existing ring fence for producers (under Chapter 4 of Part 8 of CTA2010) or the new contractor’s ring fence brought in by new Part 8ZA.
10. New subsection 285A(8) provides a targeted anti avoidance rule to prevent arrangements with a tax avoidance main purpose from frustrating the intended application of new subsection 285A.
11. New subsection 285A(9) defines ‘arrangements’ for the purposes of new subsection 285A(8).
12. New subsection 285(10) provides definitions for terms used in new section 285A by reference to definitions provided in new Part 8ZA. The definition of lease uses that provided by the existing section 868 CTA 2010 which is:  
  
“Section 868 CTA2010 Lease  
  
(1) This section applies for the purposes of this Chapter.  
  
(2) A lease is (in relation to an asset) an agreement or arrangement under which payments are made for the use of or otherwise in respect of the asset.  
  
(3) In particular it includes an agreement or arrangement under which the payments (or any of them) represent instalments of a purchase price or payments towards it.”
13. Paragraph 4 inserts new Part 8ZA into the CTA2010.
14. New section 356K provides an overview of new Part 8ZA.
15. New subsection 356L(1) gives effect to the definitions for the purposes of new Part 8ZA. New subsection 356L(2) defines what are ‘oil contractor activities’ for the purposes of new Part 8ZA and new section 285A . This excludes activities which are already within the existing ring fence for oil exploration and exploitation. There are two possible legs: new subsection 356L(2)(a) requires that the activities are exploration or exploitation activities which take place as part of the provision of a relevant offshore service, which is defined in new subsection 356L(3). New subsection 356L(2)(b) covers the situation where the activities are carried on alongside the provision of a relevant offshore service.
16. New subsection 356L(3) defines a relevant offshore service.
17. New subsection 356L(4) defines exploration and exploitation activities and requires that those services are in connection with the exploration or exploitation of the natural

resources under the sea. (“In connection” takes its natural wide meaning so as to encompass all stages of exploitation and exploration from initial searching for oil to the final decommissioning of extraction plant).

18. New subsection 356L(5) defines “relevant offshore area” for the purposes of new subsection 356L. “Territorial sea” is defined by section 1170 of CTA2010.
19. New section 356LA provides the definition of a “relevant asset” for the purposes of the hire cap. New subsection 356LA(1) identifies three conditions which must all be met for an asset to qualify.
20. New subsection 356LA(2) provides the first of these conditions. New subsection 356LA(2)(a) requires that the asset is a mobile asset. New subsection 356LA(2)(b) further restricts the type of vessels capable of being a relevant asset by reference to the use to which they can be put. Note that this does not require that they are being so used. New subparagraph (b)(i) identifies vessels used to drill for oil, whilst new subparagraph (b)(ii) identifies any vessel used to provide accommodation in connection with exploration and exploitation activities carried on by anyone whether connected with the accommodation provider or not.
21. New subsection 356LA(3) provides further definitions for the purposes of identifying the vessel classes in new subsection 356LA(2).
22. New subsection 356LA(4) provides the second condition (Condition A), which is that the asset or any part of the asset, is leased from an associated person. (“Associated person” is defined in new subsection 356LB). It does not matter to whom the asset is leased.
23. New subsection 356LA(5) provides the third condition (Condition B), which is that the asset is above the requisite value as defined in new subsection 356LA(6).
24. New subsection 356LA(6) provides that the requisite value for Condition B of new section 356LA is that the market value of the asset is £2m or more.
25. New subsections 356LA(7) and (8) provide a power for HM Treasury to amend the operation of condition C in future.
26. New section 356LB provides the definition of “associated person” for the purposes of new Part 8ZA.
27. New subsection 356LB(1) provides four classes of “associated persons”. Those classes include the contractor or contractors carrying out the oil contractor activities (new subsection 356LB(1)(a)) and anyone connected with them or who has been connected with them (new subsection 356LB(1)(b)). Connected has the same meaning here as for the rest of CTA 2010, which is provided by section 1122 of CTA2010. The final two classes of associated person are those who act together with the contractor (new subsection 356LB(1)(c)) as well as those who are connected with the classes in (b) and (c) (new subsection 356LB(1)(d)).

28. New subsection 356LB(2) clarifies that simple leasing of an asset to others, who carry out relevant services themselves, is insufficient for those persons to be acting together.
29. New section 356LC provides the definition of the term “lease” for the purposes of new Part 8ZA and new section 285A. This uses the existing wide definition in section 868 as noted in paragraph 12 above.
30. New section 356LD provides the definition of contractor’s ring fence profits for the purposes of new Part 8ZA and new section 285A. This means income arising from oil contractor activities which are themselves defined in new section 356L.
31. New section 356M provides the new contractor’s ring fence. It splits a contractor’s actual trade into two parts by defining the activities carried on which are to be treated as a separate trade for corporation tax purposes. This applies to oil contractor activities which are defined in new section 356L. Additional restrictions on how the profits of that separate trade are computed for corporation tax purposes are provided by new sections 356NA to 356NE. These provisions mirror those in place for the existing ring fence in Part 8 of the CTA2010.
32. New section 356N makes provision for a hire cap. New subsection 356N(1) identifies the circumstances in which the hire cap is to apply.
33. New subsection 356N(2) limits the amount that can be deducted when computing the contractor’s ring fence profits. Any amount otherwise allowable as a deduction is dealt with under new subsections 356N(14) and (15).
34. New subsection 356N(3) provides the size of that limitation (the hire cap), by reference to the relevant percentage (further defined in new subsection 356N(5)), which applied to qualifying total costs (as further defined in new subsections (9) to (13)).
35. New subsection 356N(4) applies in the case where more than one lessor would be entitled to a deduction and therefore subject to the hire cap in respect of the same asset. The subsection ensures that the total hire cap does not exceed that which would have been available had there been a single lessor. The hire cap is to be allocated amongst the lessors as a whole in such a way as is just and reasonable.
36. New subsection 356N(5) provides that the relevant percentage is a proportion, calculated according to the formula provided, of 7.5%. The effect of the formula is to reduce the relevant percentage in cases where a relevant vessel is in fact in use somewhere other than the UKCS or territorial waters during an accounting period (the greater the number of days it is used elsewhere, the lower the relevant percentage, and so the lower the hire cap).
37. New subsection 356N(6) confirms that, if the vessel is not used at all anywhere in the world - including UK waters - for the whole of an accounting period, then the hire cap is reduced to nil.

38. New subsection 356N(7) provides that, where the accounting period is less than 12 months, the amount of the hire cap provided by new subsection 356N(2) is reduced proportionately.
39. The amount of the percentage provided by new subsection 356N(5) can be amended by Treasury regulations made under new subsections 356N(8) and (9).
40. New subsection 356N(10) provides the formula for computing total qualifying costs (to which the relevant percentage is to applied, under new subsection 285A(3) and new subsection 356N(3)) to determine the hire cap. It is made up of two components, the original cost (OC) which is defined in new subsections 356N(11) to (13) and certain subsequent capital expenditure (CE) which is defined in new subsection 356N(14).
41. New subsection 356N(11) provides the base rule for determining OC. The amount has two components. The first (new subsection 356N(11)(a)) is the original acquisition cost by an associated person (as defined in new section 356LB). This effectively provides for the cost to the contractor's group as a whole. It does not recognise intra group transfers since the asset was first acquired. The second component (new subsection 356N(11)(b)) is any acquisition expenses incurred at the time of first acquisition, but does not include any finance costs.
42. New subsections 356N(12) and (13) provide for an alternative computation in certain circumstances. New subsection (12) sets out those circumstances as being when the relevant asset has never been acquired by an associated person, but instead has been leased from a third party. (It follows that a relevant asset which was once owned by an associated person cannot qualify under this section, even if it subsequently leased from a third party).
43. New subsection 356N(13) provides the alternative calculation of OC when making the computation in new subsection 356N(10). OC will be based on the cost that would have arisen at the time the relevant asset was first leased, if the associated person had acquired the asset at that point rather than leased it (new subsection 356N(13)(a)). That cost is increased by the expected incidental costs of acquisition that would have arisen, other than financing (new subsection 356N(13)(b)).
44. New subsection 356N(14) excludes from the computation of OC (under either computation) any expense related to items which are effectively no longer part of the asset. This includes items which have subsequently been removed (new subsection 356N(13)(a)) or items which, whilst still present, are otiose and so no longer give rise to hire income (new subsection 356N(13)(b)).
45. New subsection 356N(15) provides the definition of the CE used in the computation of total cost by new subsection 356N(9). CE includes any subsequent capital expenditure on the asset (such as subsequent modifications).
46. New subsection 356N(16) excludes from the computation of CE any expense related to items which are effectively no longer part of the asset. This includes items which have subsequently been removed or items which, whilst still present, are otiose and so no longer give rise to hire income.

47. New subsection 356N(17) provides that any amount paid in excess of the hire cap will be allowed as deduction from the contractor's total profits, or may be surrendered as a trading loss for use against profits by other members of the paying company's group, as a trading loss.
48. New subsection 356N(18) prevents any deduction under new subsection 356N(17), from profits of the existing ring fence for producers (under Chapter 4 of Part 8 of CTA2010) or the new contractor's ring fence .
49. New subsection 356N(19) provides a targeted anti avoidance rule to prevent arrangements with a tax avoidance main purpose from frustrating the intended application of new subsection 356N(2).
50. New subsection 356N(20) defines "arrangements" for the purposes of new subsection 356N(16).
51. New subsections 356NA to NF provide rules as to how the new contractor's ring fence operates. These are based on similar rules which operate with respect to the existing ring fence in part 8 CTA2010 (which applies to oil production and is referred to as the "production ring fence" below).
52. New section 356NA modifies the loan relationship rules in the case of a ring fence trade. It is based on section 286 of CTA2010, which applies to the Part 8 CTA2010 ring fence for oil producers. New subsection 356NA(1) ensures that non-trading debits from a company's loan relationships cannot be set against the company's contractor's ring fence profits, unless the loan relationship represents money borrowed to finance oil contractor activities under new subsection 356NA(2). The loan relationship rules are in Parts 5 and 6 of CTA 2009.
53. New subsection 356NA(5) provides that where a non-trading debit is restricted in this way, the legislation allows the company to have relief for the debit against profits other than those of the contractor's ring fence.
54. New section 356NB ensures that exchange gains in respect of loan relationships are not treated as part of the contractor's ring fence profits where the exchange gains do not arise from money borrowed to finance oil contractor activities. It is based on section 287 CTA2010, which applies to the production ring fence. The section operates in a similar way to new section 356NA. Where a credit is excluded from the computation of ring fence profits it is brought into account by new subsection 356NA(5).
55. New section 356NC prohibits a deduction for expenses of management of an investment business against a contractor's ring fence profits.
56. New section 356ND prevents losses that arise in trades outside the contractor's ring fence from being set off against a contractor's ring fence profits.
57. New section 356NE concerns claims for group relief. New subsection 356NE(1) prevents group relief arising from losses, allowances or expenditure outside the contractor's ring fence trade from being set against profits from that ring fence trade.

58. New subsections 356NE(2) and (3) provide that where a company cannot use certain amounts against its contractor's ring fence profits, those contractor's ring fence profits are disregarded in calculating how much the company can surrender as group relief.
59. New subsection 356NE(4) provides the definitions required for group relief claims.
60. New section 356NF ensures that capital allowances arising from "special leasing" cannot be deducted from a company's contractor's ring fence profits.
61. Paragraph 5 inserts the definitions provided by this measure into Schedule 4 of the CTA2010.
62. Paragraph 6 provides the commencement for the measure, which is 1 April 2014.
63. Paragraph 7 provides that activities defined by new section 356L (oil contractor activities, relevant offshore services and relevant offshore area) relate to activities carried out on or after 1 April 2014.
64. Paragraph 8 provides that an accounting period which would otherwise straddle the 1 April 2014 commencement date is split into two accounting periods, with the first treated as ending on 31 March 2014.
65. Paragraph 9 provides the rules which apply to losses which have accumulated before commencement. The only losses which can be used against subsequent profits within the new contractor's ring fence are those which would have been losses within that ring fence, had the ring fence existed when the loss arose. Other losses can continue to be carried forward, but cannot be used against profits of the new contractor's ring fence.

## **BACKGROUND NOTE**

66. As announced in Autumn Statement 2013, the government is concerned about the use of bareboat charters to move significant taxable profit outside the UK tax net. Legislation will be introduced alongside the Finance Bill 2014 to cap the amount allowed as a deduction for companies that provide drilling services or accommodation services on the UK Continental Shelf. The cap will apply in respect of lease payments made on or after 1 April 2014). The measure will also ensure that the profits arising from that service are not reduced by unrelated tax relief.
67. The measure will contain a number of avoidance provisions. In particular, if a contractor has entered into dual contracts to separately supply and operate its vessel, then the hire cap will apply to the payer of the bareboat charter (in this case the oil producer).
68. HM Revenue & Customs (HMRC) welcome comments, observations or concerns over the draft, which should be submitted on or before 9 May 2014. The legislation will be introduced during the passage of the Finance Bill.



### **UK oil and gas: offshore bareboat chartering**

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#### **Who is likely to be affected?**

Companies that operate in the UK Continental Shelf (UKCS) oil and gas industry and provide drilling or accommodation services.

#### **General description of the measure**

The measure will cap the tax deduction available for a bareboat (or similar) leasing payment in the UKCS to an associated person, where this arises as part of a composite service. The measure will also ensure that the profits arising from that service are not reduced by unrelated tax relief. Any amounts arising in excess of the cap can be set against non UKCS activity.

#### **Policy objective**

The measure is designed to provide a fair amount of taxation for activities carried out on the UKCS in connection with the UK's oil and gas resources.

#### **Background to the measure**

Many offshore contracting firms own their large physical assets (such as drilling rigs) outside the UK tax net. These assets are then leased to associated entities that are operating in the UKCS, giving rise to a large deductible leasing expense in the UK and reducing the overall UK taxable profit. This means that up to 90 per cent of operating profits made in the UKCS are moved overseas and the UK does not receive a fair amount of tax.

Unlike companies that produce oil and gas, the profits from contracting firms are not subject to the protection provided by the oil and gas 'ring fence', which prevents relief which is not related to activity in the UKCS from reducing profits derived from that activity.

### **Detailed proposal**

#### **Operative date**

The measure has effect in respect of leasing payments made on and after 1 April 2014.

#### **Current law**

Section 1313 CTA2009 ensures that activities carried out in the UKCS are within the scope of UK Corporation Tax. This includes activities of both UK and non UK companies. Apart from these measures there are no specific computational rules which apply to companies that make their profits from activities solely in connection with the exploration and exploitation of the UKCS.

This contrasts with the situation of oil and gas producers, for whom there is a considerable amount of specialist legislation including that at Part 8 of CTA2010 and chapter 13 of Part 4 CAA2001.



## Proposed revisions

Legislation will be introduced during the passage of Finance Bill 2014 to cap the amount of lease payment allowed as a tax deduction for companies providing drilling rigs and accommodation vessels under a bareboat charter (or similar) arrangement, where this arises as part of a composite service. The cap will be calculated by reference to the historic capital cost of the asset which is subject to the lease, and will consist of:

- a proxy for capital expenditure at a rate of 4 per cent per calendar year;
- an amount to represent the probable finance costs of newer assets which is 5 per cent on a loan of half the historic cost; and
- an additional 1 per cent to cover other costs of ownership and the potential variance of interest rates in some external project financing.

Legislation will also be introduced to provide a new form of ring fence applicable to the composite activity which is the subject of this measure. Whilst profits within this ring fence will only be taxed at standard CT rates (and not the higher rates which apply to oil and gas producers), those profits will no longer be able to be reduced by other tax reliefs derived from activity outside the UKCS.

Draft legislation has been published today. Comments and responses are invited before 9 May 2014. The legislation will then be introduced during the passage of Finance Bill 2014.

## Summary of impacts

<b>Exchequer impact (£m)</b>	2014-15	2015-16	2016-17	2017-18	2018-19
	+135	+120	+100	+90	+90
	These figures are the combined impact of the offshore chartering costings set out in Table 2.1 and Table 2.2 of Budget 2014 which have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside the Budget				
<b>Economic impact</b>	The measure could increase the day rates by up to 10% on new contracts for drilling rigs and accommodation vessels in the UKCS if contractors pass the tax charge on to producers. However, day rates are influenced by many factors including the oil price and rig availability. The potential increase in costs to oil and gas operators equates to approximately 1 per cent of their total capital expenditure in the UKCS. Therefore, the measure is not expected to have any significant economic impacts, but this assessment will be reviewed in a year.				
<b>Impact on individuals and households</b>	The measure is considered to have no differential impact on individuals and households.				
<b>Equalities impacts</b>	The measure is considered to have no differential impact on any equality groups.				
<b>Impact on business including civil society organisations</b>	The measure is expected to have negligible impact on the administrative burden of businesses.  There will be a negligible one-off cost as only a small number of UK businesses will be affected by the measure. The proposal will introduce a new approach for estimating the allowable tax deduction for bareboat leasing payments. This is expected to result in a negligible increase in administrative burden for businesses affected by the change.				

	The measure will have no impact on civil society organisations.
<b>Operational impact (£m) (HMRC or other)</b>	It is not expected that implementing these changes will incur any significant additional costs for HMRC.
<b>Other impacts</b>	Other impacts have been considered and none have been identified.

### **Monitoring and evaluation**

The impact of the measure will be reviewed 12 months after its implementation.

### **Further advice**

If you have any questions about this change, please contact Andrew Hoar on 03000 589701 (email: [andrew.hoar1@hmrc.gsi.gov.uk](mailto:andrew.hoar1@hmrc.gsi.gov.uk)) or Carolinn Booth on 03000 589696 (email: [carolinn.booth@hmrc.gsi.gov.uk](mailto:carolinn.booth@hmrc.gsi.gov.uk)).

### **Declaration**

Nicky Morgan MP, Economic Secretary to the Treasury has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.