



HM Treasury

An outline of Transferable Tax History

November 2017

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Executive summary

As announced in the Autumn Budget, the government will introduce a transferable tax history (TTH) mechanism for UK Continental Shelf oil and gas producers for deals that complete on or after 1 November 2018. This will allow companies selling North Sea oil and gas fields to transfer some of their tax payment history to the buyers of those fields. The buyers will then be able to set the costs of decommissioning the fields at the end of their lives against the TTH. This will level the playing field between buyers and sellers of oil and gas fields, providing new investors in the UK Continental Shelf with certainty on the tax relief available for the decommissioning costs. This should encourage new entrants and fresh investment for a basin that still holds up to 20 billion barrels of oil.

This paper sets out the basis for the introduction of TTH in Chapter 1, followed by an outline of the government's proposed TTH mechanism in further detail in Chapter 2, covering its design and safeguards.

Chapter 1

Background

The operating environment

- 1.1 Oil and gas has been produced on the UK Continental Shelf (UKCS) since the mid-1960s. It remains a significant industry for the UK economy, providing around half of our energy supply and supporting around 300,000 jobs¹. While the UKCS is a mature basin compared to other prospects around the world, there is still a significant amount of oil and gas remaining. (The Oil and Gas Authority estimates the remaining recoverable oil and gas to be up to 20 billion barrels.²)
- 1.2 In recent years, the government has taken significant steps to create the right environment for oil and gas producers to maximise economic recovery of the remaining hydrocarbons in the basin. We have introduced substantial reforms to the oil and gas fiscal regime, making the UK one of the most competitive fiscal regimes for oil and gas production in the world. The government has:
- permanently reduced Petroleum Revenue Tax from 50% to 0%, and cut Supplementary Charge from 32% to 10%
 - introduced new Investment and Cluster Area Allowances
 - extended the Ring-Fence Expenditure Supplement, and
 - funded two programmes of seismic surveys in the UKCS, and is providing further funding for exploration projects
- 1.3 The government has also signed Decommissioning Relief Deeds with oil and gas companies, to provide certainty on the tax relief they will receive when decommissioning assets.
- 1.4 There are currently just under 300 installations³ and thousands of kilometres of pipelines on the UKCS. When oil and gas fields come to the end of their lives, licence holders are legally obliged to decommission this infrastructure. This is expensive, challenging work, and as the basin ages the prospect of decommissioning liabilities is being factored more into commercial

¹ Oil and Gas UK Economic Report 2017

² OGA Annual Report and Accounts 2016-17

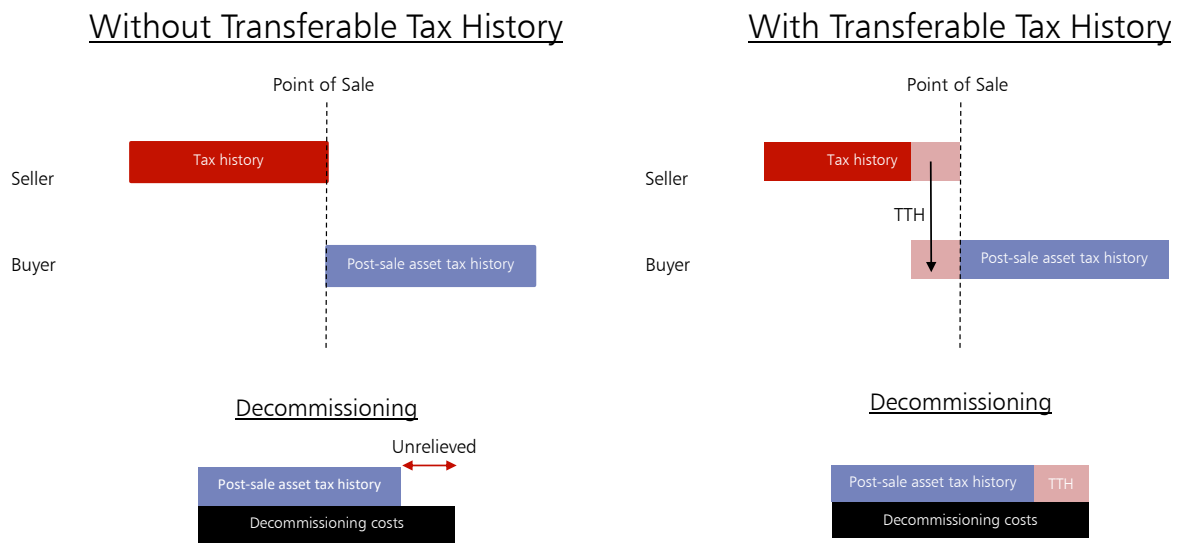
³ <https://www.ogauthority.co.uk/media/3561/appendix-13-installations-23-march-2017.xls>

negotiations and decisions. The Oil and Gas Authority estimate that the total cost of decommissioning between now and 2055-56 is £59.7 billion.⁴

The case for introducing a transferable tax history

- 1.5 The government's objective is to maximise economic recovery of its remaining oil and gas reserves, while ensuring the nation receives a fair return on its hydrocarbon resources. Extending the productive lives of late-life oil and gas fields is consistent with this objective, as it could potentially lead to new investment, delaying decommissioning and supporting activity in the UKCS for longer. It is likely that this will be supported, increasingly, by late-life specialist companies, different sources of finance and new entrants to the UKCS.
- 1.6 Some significant deals for assets in the UKCS have taken place in the past year; these have generally either been corporate deals, or acquisitions where the seller has agreed to retain some or all of the liability for decommissioning. There have been few instances of straightforward deals where the buyer has only acquired the asset. To some extent, this reflects the complexities inherent in transactions of late-life assets and the government recognises that sellers and buyers may adopt different structures for asset deals, but believes that the tax system should adopt as neutral an approach as possible.
- 1.7 The ability of oil and gas operators to access tax relief on their decommissioning costs depends on the extent of their tax payment history. As noted above, in some circumstances, the mismatch in tax positions between potential sellers and buyers of UK oil and gas fields can create an uneven playing field, frustrating commercial negotiations between the parties involved and ultimately giving new entrants a disincentive from purchasing UK oil and gas fields. This is because:
- current UKCS licensees that sell their assets often have decades of tax history to rely upon and can be confident of claiming relief when they come to decommission, and
 - new entrants to the UKCS need to be able to generate sufficient tax history over the remaining life of the acquired asset, to be able to cover the decommissioning costs
- 1.8 TTH would permit a seller to transfer an appropriate amount of their tax history along with an asset. This would provide the buyer with certainty that they will be able to access tax relief on their decommissioning costs, putting them on a similar footing to the seller. This would help encourage transactions, helping to protect jobs and maximise economic recovery from the UKCS.

⁴ <https://www.ogauthority.co.uk/media/3815/ukcs-decommissioning-cost-report-2.pdf>



Tax issues for late-life assets: discussion paper

- 1.9 At Spring Budget 2017, the government announced it would consider the case for introducing a transferable tax history and issued a discussion paper on tax issues affecting late-life oil and gas assets. This built on numerous stakeholder discussions held between July – December 2016.
- 1.10 The discussion paper had the objectives that any change to the tax regime should only be made if it:
- delivers a sufficient and proportionate benefit for the UK taxpayer, as well as encouraging innovation and maximising economic recovery
 - mitigates, as far as practical and achievable, tax-based obstacles to late-life assets transferring to new owners
 - prevents gaming or commodification of tax history or other tax attributes that could result in greater exposure to the taxpayer
 - does not impose disproportionate administrative complexity for either industry or government, and
 - does not affect decommissioning obligations under existing legislation and treaties
- 1.11 The government received 28 responses to the discussion paper; the respondents are shown in Annex A.
- 1.12 In parallel, the government established an expert panel to consider the issues in the paper. The panel was chaired by HM Treasury, and its membership consisted of potential sellers, potential buyers, tax advisers, the Oil and Gas Authority, Oil and Gas UK and HMRC. It met on four occasions and the

minutes of those meetings will be published on the GOV.UK website shortly.⁵

- 1.13 The discussion paper also covered the treatment of retained decommissioning liability under Petroleum Revenue Tax (PRT) and guidance on the treatment of tax losses following a change in ownership of a company.

Next steps

- 1.14 While the government has devised a mechanism for TTH, transferring tax history between companies is unprecedented in UK corporation tax and the mechanism will necessitate a degree of legislative complexity. The draft legislation will require technical consultation before its inclusion in Finance Bill 2018 to 2019. Nonetheless, the government recognises the importance of certainty for companies considering acquiring late-life oil and gas assets. This paper outlines how TTH will work and will also make TTH available for transfers of fields on or after 1 November 2018.
- 1.15 On the PRT treatment of retained decommissioning, the government will publish a technical consultation in spring 2018, with the aim of legislation in Finance Bill 2018 to 2019. In line with the responses to the discussion paper, any change to the PRT regime will not affect any deals that have been previously completed.
- 1.16 On the treatment of tax losses following a change in ownership, HMRC have agreed that further guidance on this will be published in due course.

⁵ <https://www.gov.uk/government/consultations/tax-issues-for-late-life-oil-and-gas-assets>

Chapter 2

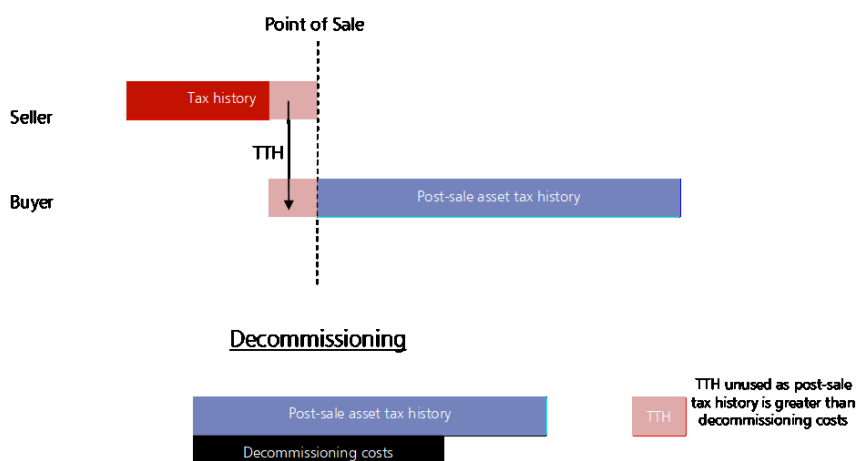
How TTH will work

- 2.1 Outlined below is how the government intends the TTH mechanism will operate. As noted above, this will be set out in draft legislation in a technical consultation paper in spring 2018. Following technical consultation, the government intends to legislate for TTH in Finance Bill 2018 to 2019, with TTH applying to deals where the transfer of the licence has been approved by the Oil & Gas Authority on or after 1 November 2018.
- 2.2 TTH will allow the seller of a UK or UKCS oil or gas field to transfer to the buyer of the field some of its historic profit chargeable to Ring Fence Corporation Tax (RFCT) and Supplementary Charge (SC) (referred to as “tax history”). The transfer of tax history will only occur on the sale of a field and the amount of tax history transferred cannot be subsequently adjusted.
- 2.3 Transfer of tax history will be optional. The precise amount of tax history to be transferred from the seller to the buyer will be a matter of negotiation between the parties involved, subject to overriding safeguards that the amount transferred is not excessive. The government does not consider that sellers need to demonstrate that the transferred tax history is from the field being transferred, because RFCT and SC are based on the profits of a whole company; the tax returns and supporting calculations do not split the profits on a field by field basis.
- 2.4 The transfer of tax history from seller to buyer will take place on a “last in, first out” basis, meaning that tax history from more recent years will be transferred first.
- 2.5 In order to prevent transfer of excess tax history, any transferred tax history would be capped at an estimate of the buyer’s share of the decommissioning cost in the decommissioning security agreement (DSA). This decommissioning estimate will be verified by an independent third-party and commissioned by the commercial parties. The decommissioning estimate will also be subject to a “just and reasonable” test.
- 2.6 If multiple fields are being acquired in a deal, the tax history transferred to the buyer will be allocated to each field at the time of acquisition. Once the transfer has taken place, the tax history transferred to the buyer will no longer be available to the seller.
- 2.7 Once the field has been transferred, the buyer will track the profits and losses generated by the field as a shadow calculation submitted with the buyer’s tax return. This “tracked profit” will not affect the calculation of

taxation while the field is producing; the profits of the field are included in the RFCT and SC profit of the company as normal. HMRC will review the tracked profits of the transferred asset to ensure they are accurate.

- 2.8 On transfer of the TTH, the TTH will not immediately become part of the buyer's tax history. If it did, a buyer with tax losses from other fields could potentially use the TTH to monetise existing tax losses, regardless of whether or not those losses were incurred from decommissioning. Allowing the transferred tax history to become part of the buyer's tax history upon acquisition could therefore give rise to tax repayments that may not otherwise have happened. The government considers this would not be consistent with the intent of the policy.
- 2.9 TTH will only become part of the buyer's tax history (and capable of being used against carried back decommissioning losses) once it is "activated".
- 2.10 Activation of TTH will take place once two conditions are fulfilled:
 - a) The transferred field must permanently cease production
 - b) The total loss incurred on decommissioning the transferred field must be greater than its post-acquisition tracked profits. The difference between the tracked profits and the total decommissioning cost would be the amount of TTH that is activated. (If the post-acquisition profit is actually a loss, it is treated as nil.)

With Transferable Tax History



- 2.11 Once activated, the TTH will be treated as part of the buyer's tax history and can be used against any decommissioning loss within that company, subject to the normal tax rules on decommissioning losses.
- 2.12 The method of tracking field profits and using it to activate TTH will mean that use of TTH remains linked to the field, but does not have the inflexibility of totally ring fencing the profits of the acquired field (which could distort tax paid). It is also more attractive than allowing only the decommissioning loss from the acquired field to be used against TTH; this could result in the

profits of other fields being used up before they are decommissioned, with a potential loss to the company.

- 2.13 Transferable tax history will only be available for intra-group transfers of fields within a short period before and after the asset leaving the group.
- 2.14 If the field is transferred again, transferred tax history can go with it. The post-acquisition tracked history must go with TTH and all parties' tracked history must be worked through before TTH can be activated.

Chapter 3

Next steps

Timeline

- 3.1 Autumn Budget announced the government's commitment to introducing a transferable tax history for oil and gas producers. The government intends to legislate for TTH in Finance Bill 2018 to 2019. Draft legislation will be published in spring 2018 for technical consultation.
- 3.2 In order to bring forward the benefit to the UKCS, the government is proposing that the legislation will have retrospective effect for deals completing on or after 1 November 2018. This will provide certainty to buyers and sellers, in the short term, that TTH will be available for transactions that complete at or after this date.

Annex A

Responses to the discussion paper

Responses were received from the following:

Dr Hafez Abdo

Ashurst LLP

Association of British Independent Oil Exploration Companies (BRINDEX)

BP

Chrysaor

CMS Cameron McKenna

CNR

ConocoPhillips

Deloitte

EnQuest

ExxonMobil

Professor Alex Kemp

Paul Lindop/Interims for Energy

Maersk Oil

Marathon Oil

Oil & Gas Independents' Association

Oil & Gas UK

Oil Taxation Action Committee

Petrofac

Premier

PwC

RespoSinopec

Scottish Government

Shell

Suncor

TAQA

Total

UK Oil Industry Taxation Committee