HM Treasury

HM Revenue & Customs

Minutes: Expert panel: Tax issues for late-life oil and gas assets

Meeting date: 20 April 2017

Meeting time: 9.00am – 11:30am

Location: Oil & Gas UK (62 Market Street, Aberdeen / Portland House, Bressenden Place, London)

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Minutes

1. Organisations represented

- HM Treasury (Chair)
- HMRC
- Oil & Gas Authority
- BP
- ConocoPhillips
- CW Energy
- EnQuest
- Ernst & Young
- ExxonMobil
- Ineos
- Oil & Gas UK
- Premier Oil
- Shell
- Total
- UK Oil Industry Tax Committee

2. Introduction

(a) HM Treasury (HMT) welcomed the group to the inaugural meeting, thanking them for their attendance and providing a brief overview of the context of the panel's creation. This explained the importance of late-life assets to the government's strategy of Maximising Economic Recovery (MER). The panel would provide a focus on the technical tax issues associated with late-life assets, supplementing the other responses the government would receive to the discussion paper.

(b) HMT confirmed that the 30 June deadline for returning responses to the discussion paper had not changed, following Parliament calling a General Election and the subsequent start of Purdah. HMT could continue to receive written responses during this period, though further meetings of the expert panel would be on hiatus until after the Election. The group offered to continue working during the hiatus between meetings, and submit contributions in writing.

(c) HMT confirmed that the list of organisations taking part in the expert panel would be published on the gov.uk website on 20 April, which the panel members consented to.

3. Expert panel terms of reference and objectives

(a) The group agreed that the objective of the expert panel would be to offer a collection of views on the technical tax issues identified in the discussion paper: '*Tax issues for late-life oil and gas assets*'. The group would:

- Consider whether the scope of these issues are fully captured in '*Tax issues for late-life oil and gas assets*';
- Determine whether the issue is affecting transfers of late-life oil and gas assets (HMT noted that it was keen to see real-life examples of this, noting that these might have to be discussed outside of the panel, due to commercial confidentiality and sensitivity);
- Identify which potential solutions could resolve the issue and facilitate transfers of late life assets, and consider the feasibility of any potential solutions;

(b) The group agreed with the government's objectives: that changes to the tax regime should only be made if they deliver a sufficient and proportionate benefit for the UK taxpayer, as well as encouraging innovation and maximising economic recovery. Any change would have to ensure there would be no additional net cost to the Exchequer. The group also agreed that any changes should mitigate tax-based obstacles to late-life assets transferring to new owners, but should not affect current decommissioning obligations under existing legislation and treaties.

(c) It was noted that the findings from the expert panel meetings would not be binding on the government, and reiterated that any proposals from the panel would be considered alongside the other responses to '*Tax issues for late-life assets*'.

4. Issues for discussion and future meetings: Transferable tax history

(a) The group moved to discuss a hypothetical example provided by industry representatives, to illustrate the problem of a potential tax value gap created between a seller and different buyers, and which a transferable tax history would attempt to mitigate. The example illustrated a first scenario in which an oil field continues to be retained by an incumbent licensee with a long tax history, and a second scenario in which the field is sold to a new entrant. In the first scenario, the field is eventually decommissioned by the owner, and there is a positive Net Present Value (NPV) for the project economics of the field after decommissioning and tax, despite the decommissioning expenditure creating a nominal cash loss. In the second scenario, the field is sold to a new entrant, who does not have sufficient tax history to get full tax relief on its decommissioning costs. Despite the field costs and income streams remaining the same, the second scenario showed a negative NPV for the project economics of the new owner, illustrating the creation of the tax-driven value gap

between seller and buyer. The group queried whether this was a scenario where, pre-tax, a buyer would be willing to acquire a loss-making field and also whether the seller would share such projections with a buyer. It was noted that there were further examples illustrating problems that had not been covered under this example.

(b) One issue that the group noted was that "interim periods" between agreeing a deal and completion meant that buyers, because of the delay, would effectively be taxed through this period as a result of the typical terms of the sale and purchase agreement, but this would not form part of the tax history of the buyer. This exacerbated the problem already identified.

(c) The group also queried whether consideration could be paid for just the tax history of a selling company – it was noted that the intention to acquire an oil field would come first. A buyer's model would then identify how much they would be prepared to pay, based on the expected future net cash flows. Some commented that nothing should be paid for tax history, whilst others noted that even if a price for tax history was not explicitly stated, it would be implicit in the overall price that a buyer was prepared to pay. The group agreed to revisit the topic of consideration in the second or third meeting, dependent on progress.

5. Issues for discussion and future meetings: PRT and retained decommissioning liability

(a) The group noted that the current rules on Petroleum Revenue Tax (PRT) meant the seller retaining decommissioning liability required unnecessarily complex commercial structuring to provide a sensible result. It was also noted that as a consequence of the decision to reduce the rate of PRT to zero, an unintended cost to the Exchequer could arise. The issue here is that by remaining on the licence without entitlement to profits, a company who retains the decommissioning liability can access PRT repayments which might not otherwise be available. It was noted that some sellers had moved to retaining 0% licence interests before the PRT rate was reduced to nil.

(b) The group agreed to discuss in the third or fourth meeting, dependent on progress.

6. Issues for discussion and future meetings: Losses on transfer of company

(a) It was noted this issue was currently under consideration; constructive comments were welcomed. It was suggested that this was not primarily a late life asset issue, being more related to ensuring MER by encouraging investment in new exploration and development projects, but could also have an impact on late life asset transfers. It was noted that guidance for decommissioning was also being considered.

(b) The group agreed to discuss further in the fourth meeting, dependent on progress.

7. Transfer of tax history

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(a) The group briefly discussed the chronology of the idea of a transferable tax history, touching on previous proposals from industry around tax credits, rate cuts and electable tax regimes.

Tax Credits

(a) The group acknowledged that the concept of tax credits for decommissioning - where government made a payment for a fixed percentage of decommissioning costs, regardless of tax paid – provided certainty but carried certain challenges. The Norway model was discussed, particularly noting that there was relief for unrelieved terminal tax losses (such as decommissioning), but only once a company had ceased trading.

(b) The group raised the question of how tax credits could work under the current tax regime. Several issues were raised, specifically:

- The risk of the seller retaining the full tax history, with the buyer retaining the tax credits, resulting in relief being paid twice;
- The risk of tax credit being paid out where companies have not paid tax;
- The question of whether details of transfer of trade would need to be recorded;
- The risk that companies would not want to give up the stability of the current system, including concerns that there would be no protection against the reduction of the rate of the credit in the future; and
- The interaction of a new tax credit regime with the operation of the existing Decommissioning Relief Deeds (DRDs).

The group considered that this had been discussed in the past and previously discounted, due to the cost it would impose on the taxpayer. Some in the group queried if tax credits could encourage new activity the benefits of which to the taxpayer could outweigh any additional costs of the credit.

(c) The group noted that tax refunds should only be paid where tax has been paid, rather than in response to expenditure; this reflected the principle set out in the discussion paper that there should be no net loss to the taxpayer from any rule change.

Transfer of decommissioning loss to seller

(e) The group discussed an idea where legislation would enable an election to move a tax loss from decommissioning back to the seller. The seller would then be contractually obliged to pass the resulting tax refund to the buyer. The group noted that there may be a lack of willingness from industry for the seller to provide guarantees to buyers for these refunds. It was also noted that the similar loss carry-back of PRT to prior owners had challenges in the mechanics (especially with the risk that the seller may not exist in the future), and wouldn't be a smooth model to replicate. It was also acknowledged that it was the seller as well, not just the buyer, who needed a degree of certainty in transactions.

Transferable tax history (TTH)

(f) Another possibility was transferring the historic taxable profits of the seller in relation to a field to the buyer. The group agreed that companies rarely kept a separate record of the historic taxable profits for each different oil field in a portfolio, (although this could need to be constructed if a participator is transferring an asset to an affiliate, for instance), could make identifying such a history difficult. The group also noted that the buyer and seller would need flexibility around negotiating a mutually acceptable amount of TTH (which could be zero) to be transferred which didn’t necessarily need to be linked to the asset transferred if other protections were available. It was noted that sellers and particularly buyers would need certainty over the amount and value of any TTH at the time they were negotiating the deal if this option was to be effective in facilitating late life asset transfers. If TTH did become a concept, an appropriate tax rate referable to the transferred TTH would need to be identified, due to the different tax rates over the years (noting that in principle this may not have been needed if the tax rate had been consistent). This would need to be mirrored in the sellers’ and buyers’ tax returns to ensure no net loss to the taxpayer.

(g) The group moved on to discuss how a portion of a seller’s tax history could be determined and subsequently transferred to the buyer. The approaches discussed were determining the tax rate attached to the tax history on a “last in first out” (LIFO) basis or apportioning the TTH pro-rata over a certain number of years.

(h) The group discussed an approach of transferring TTH, which involved notionally splitting the purchase price between two components. The purchase price would therefore comprise positive consideration – paid by the buyer, representing the payment for future production and, a negative consideration payment, made by the seller, representing future decommissioning costs.

(i) The payment by the seller would create a loss for the seller, with this loss reducing the seller’s tax history. It would also create taxable profits for the buyer, resulting in a tax history. Any overall positive consideration paid as the purchase price would continue to be treated as normal under the existing tax rules.

(j) While discussing the idea, the group commented that this could:

- Fix the rate attached to the tax capacity transferred;
- Require changing S163 CAA 2001 to give access to relief and repayment;
- The idea would “recreate” a tax history without moving tax history around; and
- The group concluded that there was potential for the transfer to be notional, meaning that the buyer did not make a tax payment and HMRC did not make a tax refund to the seller.

(k) The group considered how the amount of tax history to be transferred notionally would be determined in practice. In particular, some reflected on whether sellers would choose to transfer the most recent tax history on a LIFO basis, with the possibility that a seller would then be able to claim relief for any actual

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decommissioning expenditure on other fields at the higher rates of tax which might be applicable to the tax history which had been retained by the seller.

(l) The group also considered the idea of a notional transfer of tax history from the seller to the buyer. The seller would be treated as though they had incurred decommissioning expenditure, but would not be given the associated tax relief for this amount (beyond reducing their tax history). Further questions were raised about whether the quantum of TTH transferred would need to be determined by the buyer's or seller's economic modelling (which would possibly need to be verified by a third party), or whether this would fall within "commercial negotiations" and would therefore not require third party involvement.

Action point: The group agreed to work on the example scenario that had been provided at the start of the meeting, and to circulate it before the next meeting.

8. Transferable Tax History - Restrictions on transferable tax history use

(a) An approach to limit the use of TTH to future net losses on the transferred assets was discussed. The group also considered whether TTH transfers could be done without the TTH necessarily being attached to the transferred asset. The group commented that the intent of a TTH should be to encourage investment in acquired assets, and not to crystallise existing tax losses. There was agreement across the group that any proposal should not create any incentive for the seller to give more tax history than is otherwise necessary to try and ensure that the buyer will have sufficient tax history to shelter the anticipated decommissioning costs, nor any incentive for the buyer to acquire more than is necessary. The group felt that proposals should favour simplicity and user-friendliness, expressing concern that streaming profits and losses on acquired assets could result in greater complexity. Conversely, it was noted that tying tax history to an asset with associated streaming would create a self-regulating mechanism, and the group commented that if there was no satisfactory external verification that the transferred TTH represented an accurate estimate of the decommissioning cost, then streaming would be required to prevent abuse. The group queried whether the Oil and Gas Authority would have the capacity to take on this external verification, although there was concern about the timing of such verification even if it could be done.

(b). The group considered whether verification could take place between the buyer, seller and third party at the time a deal was being negotiated, and noted that there could be delays with the verification depending on how it would work.

(c) The group suggested investigating different approaches to verification and streaming in more detail before the next meeting, commenting that:

- If consistent material was supplied, it could become a quick and routine process; but
- Scenarios would always hold a degree of subjectivity; and

- Non-streaming verification could be problematic for the taxpayer.

(d) The group discussed whether using a TTH would be restricted and earmarked to the net decommissioning loss of the asset it relates to. In particular, there was concern as to how any TTH would interact with the tax history being generated from other assets a buyer could have in its portfolio. The group envisaged a scenario where a buyer already had a number of other fields that had paid tax in the past, or that were currently tax-paying. If the acquired field (which had TTH) was decommissioned before the other fields, it could potentially use up all of the company's post-acquisition tax history – both for that field and for its other fields. TTH would therefore need to be available on the acquired field even if the buyer had tax history on its other fields, or be available in the future against existing fields or the buyer could potentially be no better off from acquiring the TTH.

Action point: The group agreed to expand on this before the next meeting.

(f) The group accepted that any form of TTH would need to yield reasonable certainty for the buyer. There would also need to be due diligence to verify any tax history that was transferred from a buyer to seller. The group reflected on whether there would be taxpayer confidentiality concerns for the seller, as any due diligence would almost certainly require companies to disclose information about their tax affairs to one another – although it was noted that the Extractive Industries Transparency Initiative (EITI) disclosures had already made some of this information available. Where smaller, new entrants would be required to perform due diligence, there was a concern they would not have the resources to undertake a large amount of work on this.

(g) The group turned to discuss the interaction of any TTH with DRDs. The group discussed the concern that sellers could make a claim under DRDs for any tax history that had been transferred under TTH. It was noted that the DRDs covered the breadth of expenditure rather than specific rates which might protect the taxpayer. Any proposal would need to take into account the existence of the DRDs and consider any consequential effects, so as not to increase the risk to the taxpayer.

Action point: The group agreed to consider anti-avoidance rules in the DRD and any other possible solutions before the next meeting.

9. Summary

Overall, the group felt that the TTH option outlined above could achieve the objectives set out in the Discussion Paper but needed to be considered more closely, with the importance of no net loss to the taxpayer being emphasised. Panel members agreed to consider the above action points in advance of the next meeting, and to circulate any material to those assembled by the end of May. The panel agreed that the first hour of the next meeting would be dedicated to going through the circulated materials, before continuing to move through the questions in the discussion paper (starting with questions 3, 5 and 6). The group agreed that, if there was a need to

clarify any of the earlier questions with government, then this could also be done in the interim.

Minutes: Expert panel: Tax issues for late-life oil and gas assets

Meeting date: 22 June 2017

Meeting time: 9.00am – 12:30pm

Location: Oil & Gas UK (62 Market Street, Aberdeen / Portland House, Bressenden Place, London)

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Minutes

1. Organisations represented

- HM Treasury (Chair)
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- BP
- ConocoPhillips
- CW Energy
- EnQuest
- Ernst & Young
- ExxonMobil
- Ineos
- Oil & Gas UK
- Premier Oil
- Shell
- Total
- UK Oil Industry Tax Committee

2. Introduction and follow up to the previous meeting

(a) HM Treasury welcomed the group, and asked for approval of the minutes from the last meeting; the motion was passed. The group confirmed that the next meeting would take place on 6 July; no agenda had been circulated yet, but would be sent to the group after the meeting. It was also noted that it was Government's intention to chair the final meeting in Aberdeen, which would take place at the end of July or start of August. ***Action point: the group agreed to pin down suitable dates in August in order to avoid leave clashes.***

(b) Government reiterated the point from the previous meeting that although the group was looking in detail at the mechanics of how Transferrable Tax History (TTH) could work, no decision had been made on whether TTH would be introduced – it would still be a matter of "if", not just "how". Government refreshed the request for real world examples of where TTH would make a difference, emphasising that these should be as specific as possible, as they will be used to support the case for change to Ministers and for costings. The group queried whether previous information provided by 40 entities during the informal consultation process in Q4 2016 was insufficient;

Government clarified that the information previously provided had highlighted the issue, but that further evidence was now needed to support a case for change. It was noted that while new Ministers had joined the Treasury, Ministerial responsibilities had not yet been assigned.

(c) The group asked whether there was any flexibility in the 30 June deadline, and flagged that some specific examples would be commercially sensitive and that it would be preferable to submit these separately; Government confirmed that if it was possible that submissions would be a few days late, that the group should notify Government of this but that late submissions would not be automatically disregarded. They also requested that confidential submissions be marked up appropriately.

3. Expert panel proposal on a draft transferrable tax history regime and the Government response

(a) The group moved to discuss the proposed mechanism that had been circulated around the panel following the previous meeting ***(see action point 7(l) from 20 April minutes)***. Government offered its interpretation of how the model works, specifically noting the points that:

- TTH should be optional and seller and buyer should determine amount transferred between themselves;
- The seller of the field is deemed to incur decommissioning expenditure equal to the transferred TTH. This removes the tax history from the seller's tax history on a last in, first out basis, but there is no actual cash refund made to the seller;
- The buyer is deemed to have taxable profits equal to the seller's "decommissioning expenditure", which creates a tax history. There is no actual cash payment of tax by the buyer; and
- The buyer can't use existing tax attributes against transferred TTH (i.e. no monetising of brought forward losses with TTH).

(b) The group noted the tension in how far to use "deemed profit", commenting that there was a red line in that the buyer should not have to account for cash tax on its deemed profits; the group noted that the intention of using deemed decommissioning, rather than simply transferring tax history, was to minimise the legislative change required.

(c) The group confirmed that the amount of tax history transferred used should be restricted to the net decommissioning loss on the transferred asset(s) ***(see action point 8(d) from 20 April minutes)***, in order to maintain a measure of anti-commodification.

(d) Government provided some further challenge points on the model, on the concept of deemed decommissioning for the seller and deemed profit for the buyer. The group acknowledged that if it was deemed, that there would need to be some way to protect the Exchequer; they noted that they were not wedded to the notion of deemed profit to transfer TTH. The group acknowledged that for Decommissioning Relief Deed (DRD) interaction, an actual reduction in taxable profits would be preferable if reliance was

going to be placed on clause 5.5 of the DRD to prevent a seller potentially making a DRD claim for the tax history they had transferred. Government asked whether the group was content that the seller should lose the ability to access the amount of transferred tax history in order to prevent a double claim, to which the group agreed. Government commented that current tax legislation made it difficult under the proposed mechanism for the buyer on utilisation of transferred tax history to have the same tax rate as the seller. This was due to the buyer's deemed profit arising in the accounting period of the sale, while the seller's deemed decommissioning could be over several accounting periods, with different rates applicable. The group responded that a buyer would need certainty when negotiating the deal on what the rate would be and deemed figures rather than actual were therefore preferable.

(e) Government touched briefly on its COTAX system capabilities, commenting that while there could be operational constraints, these should not prevent discussion but frame it. Possible options included engineering a reverse nominal sale (for buyer and seller, or just for the seller), designing a certification process, or that the system could be used to adjust profits to give effect to TTH and transfer payment records accordingly. The group queried whether there were different issues with ring fence corporation tax (RFCT) and Supplementary Charge (SC). Government responded that the concern was mostly with RFCT, and that it would work with SC as it currently sits on the system.

(f) The group queried whether the issue around "deemed" decommissioning utilising non-ring fence profits could be solved through legislation; it was suggested that it could. Government stated that there were concerns about allowing even a nominal deduction for deemed decommissioning before actual decommissioning costs had been incurred, as its long standing policy had been to only allow a tax deduction when actual decommissioning cost was incurred, and there were concerns that this could set a precedent. The group stated that the deemed decommissioning in this instance would not set any such precedent as it was merely a mechanism of transferring tax capacity, and requested for it to be noted in the minutes; Government have noted this view.

(g) The group moved to discuss the idea of the buyer being given sight of the seller's tax history, and Government questioned whether there was any seller risk in exposing tax history to a prospective buyer. The group responded that generally speaking, there had been openness in the past regarding tax histories in due diligence processes, and that figures were often made available in the public domain through other means e.g. under the Extractive Industries Transparency Initiative (EITI), the EU Accounting Directive, Stock Exchange filings, etc., and therefore it was not considered to be a real issue.

(h) Government raised a separate issue that the notional profits and hence TTH might not be confidential under the tax payment disclosure requirements of EITI. The group noted that EITI only records actual cash payments and that there was no net benefit flow to/from the Government at the point of transfer, and TTH was hence not expected to be in scope of EITI.

(i) It was flagged that there could be issues with tax history for accounting periods where the immediate tax position is not yet settled, such as where HMRC enquiries are ongoing. The group queried who would pick up any difference when accounting periods are finally settled, and the general inclination was that it was better to leave this with the seller. General opinion was that the arrangement with the buyer would mean TTH would be acquired as a fixed lump sum with an agreed tax rate and that the seller would then deal with any subsequent changes to the taxable profit and consequent overall rate change, but the group felt that more needed to be done on the options for this. Others flagged that accuracy on the tax history was not necessarily the question that needed answering during a deal; it was certainty on the amount of TTH transferred and the applicable tax rate while the deal was being negotiated that was the important point. The group suggested that it may be preferable to have a commercial solution that could be applied to whatever the particular position of the seller was.

(j) The group noted that, regarding confidentiality and confirming tax history, this wasn't a question of legislation but of due diligence; further questions were raised regarding when "deemed expenditure" has taken place, whether there would be sensitivity on 1-2% of tax history, and what the level of uncertainty was. Comments returned that as long as TTH applied to accounting periods with submitted returns, it should provide sufficient certainty on figures for a buyer who typically in any event would seek a suitable warranty; the details needed to be worked through, in order to get as close as possible to certainty for the buyer.

(k) The group noted that the seller also seeks certainty, and in the ideal case a "clean break" through any arrangement, and that therefore any residual risk of change in the accounting periods that TTH was transferred from should be left with the seller. The group believed that potential sellers would be comfortable sharing prior tax history – not necessarily previous tax returns – and acknowledged that this would come out as part of a normal commercial discussion either by giving a warranty or giving more visibility of actual information. The group then queried whether it was necessary to have legislation on verification of TTH at all, and whether this could follow a similar process to PRT or whether it could simply all be commercial negotiation and due diligence.

(l) Government asked whether tax repayment interest based on the transferred TTH's accounting periods should be included; the group noted that tax history would provide the shelter for a buyer rather than marginal gains through interest, and so it was not critical to build interest in.

(m) It was asked why it was only decommissioning that there was concern over, and questioned whether decommissioning losses could be carried back, and if an asset is profitable why TTH was necessary in the first place; comments clarified that the relief would only be for the net loss of the transferred asset, that the profits of a company should be used before the TTH, and that this was relevant to late-life assets (as opposed to uneconomic assets), and that the intention would be to provide the option of TTH to potential owners who would push decommissioning further into the future,

thus enable maximising economic recovery (MER) from the basin. It was noted that a buyer may not even need to use the TTH (using it as insurance), and that it could be attached to early-life assets even if there was no expectation that there would be a net decommissioning loss to draw on.

(n) Government raised the issue of Exchequer protection, flagging that it would be preferable to prevent a buyer from acquiring excess TTH by restricting the use of TTH to decommissioning the transferred asset and having an objective test to determine if the transferred amount is "excessive". The group clarified that the amount of TTH which could be used (activated) would be restricted to the actual post-acquisition net decommissioning loss of the transferred asset. Once activated, the TTH would then be available to provide relief in respect of costs of decommissioning the transferred asset or legacy assets of the purchaser. The group did not see merit in having an additional objective test as buyers would need certainty, and relying on a third party to provide verification would take time and may in itself create a new deal obstacle. There was also the question around what the test would be and who would verify it.

(o) Government asked whether buyers would consider a limit for fields where cessation of production is expected within a set timeframe, but the group noted that expected cessation of production was not an effective marker if the aim was to maximise economic recovery. The time based deadline did not distinguish between fields that could produce a small amount for a long time and fields that could produce at high rates for a shorter period. There would also be added difficulties in how to "police" a seller's assessment of when the asset would cease production, and the group commented that if this was an optional process, tying the buyer to a set timeline would be unhelpful and may not be in the spirit of MER.

(p) The discussion then moved to cover DRDs: Government noted that while clause 5.5 of the DRD offered some protection, it is possible it could be argued that it doesn't apply (e.g. by arguing that the change is not solely due to the change in tax law, but also due to the sale of the asset). Government asked how sellers would treat a requirement that anyone transferring TTH must amend their existing DRD, and noting that under DRD clause 2.4, HMT would need to offer any amendment to all parties. The group deemed amending the DRDs an unnecessary complication, when there are options available to deal with this without re-opening the DRDs, for example through signing something separate (e.g. a letter or a waiver) during the election process for TTH, and that this could be made a requirement through legislation. There was uncertainty around the validity of using separately signed documents around DRDs, and the group agreed that it required further legal consideration. ***Action points: Government and industry to check with their respective lawyers on the possibility of a side letter to DRDs where the seller undertakes not to make any DRD claim for transferred TTH, and to check if "deemed" decommissioning suggested provides suitable protection.***

(q) The group then worked step by step through three examples provided as part of the proposed TTH regime they had provided – a base case, a sensitive case and an investment case; there was a request to formally recognise the efforts that colleagues had put in to construct the examples, and this is therefore minuted. It was noted that

further examples had been provided prior to the meeting. ***Action point: further examples to be sent through to the panel in Excel format.*** A concern was raised that the base case did not make the case for the need of TTH as an insurance policy, and the group clarified that it was necessary to frame it this way as these were sets of concepts rather than rigid rules, and that it would be counter-intuitive to have an example that proved TTH was not required. Under the first example, Government noted that the inclination was for TTH to be on a year by year basis, as it reflects what would happen if seller had carried back decom loss. Alternatively a flat 40% rate rate could be used. Government were not inclined to use an average rate.

(r) Under the second example, it was noted that there was a tax-based value gap and that TTH was a mitigator. It demonstrated the possible outcome where tax is a contributing factor preventing parties from coming together in a commercial negotiation.

(s) Under the third example, Government queried whether there would be a loss to the buyer if not all the acquired TTH was used. The group suggested that this would not be the case and likened TTH to travel insurance; it would not be considered a loss if travel insurance had been purchased before a holiday but limbs had not been broken during the holiday. It was also noted that sellers would be looking to get buyers "over the line" and would therefore look to offer assistance in scenarios similar to the base and sensitive case examples.

(t) Government asked whether it would be prudent to offer the opportunity for the buyer to bid for extra tax history if subsequently required. The group felt it would not be appropriate to include this as it wouldn't be in keeping with the principle of the "clean break"; a buyer wouldn't expect this (as it formed part of standard commercial risk); and it may incentivise behaviour of under-bidding and revisiting. It was also noted that sellers were selling assets, not tax attributes, and that adjusting TTH further down the line would blur this distinction. It was noted that further examples of actual asset transactions would be helpful.

(u) It was flagged that there was not enough time to discuss the agenda item of TTH administration, and the group agreed to discuss this at the next expert panel. ***Action point: Pre-reading and documentation of administration to be shared with the panel before the next meeting.***

(v) The group moved to discuss the third example in greater detail, and the group raised the question on an asset that produced income that was not taxed due to being offset by losses in the acquiring company, with a tax repayment still being provided due to TTH. The group clarified that the 'net decommissioning loss point' or "activation" of TTH would only occur once decommissioning losses from the transferred asset have been fully set off against the tracked, post-transfer profits of the transferred asset, regardless of whether those profits had been set off against legacy asset losses. The group also indicated that TTH would not apply to transfers of infrastructure outside the ring fence. TTH is only activated to the extent that decommissioning costs of the asset

exceed its tracked profit, and activated TTH can be used against any decommissioning costs.

(w) The decommissioning costs are used against the total post-acquisition tax history of the buyer. If these are fully utilised, the decommissioning costs can be set against any activated TTH. If the buyer's other fields are subsequently decommissioned, the resulting tax losses can used against activated TTH (preventing the issue of transferred fields leaving other fields without decommissioning relief). The group noted that there is no reason to restrict a buyer from using an asset bought in the way it would normally be used following the acquisition, and the proposed mechanism also prevents bad decommissioning behaviour, which may be incentivised by excessive restrictions.

(x) A query was raised on the order to asset decommissioning in terms of legacy assets and TTH assets, and whether it would be an issue for a buyer if it needed to access its overall tax history first. The group agreed that the buyer would need to determine exactly where the decommissioning losses came from and on what grounds, and that there would be a difference between generated losses and TTH activation (much like the Investment Allowance). A question was raised over whether having an extra schedule in a tax return to track cost was an excessive administration burden, but the group did not feel this was the case.

(y) Government asked what the process would be if more than one TTH asset required decommissioning, and what order the TTH would be used; the group agreed that this needed further consideration. It was agreed that if the tax history of an acquired asset was used up on decommissioning and no further tax history was required, that TTH could not be accessed in these circumstances if not activated. Comments noted that loss on legacy assets could be carried back onto TTH, but that the activation rule must be maintained and that the taxpayer should use this proportionately and that there should not be a change to the net tax take. ***Action points: Government and industry to consider how the tracking of TTH costs and the decommissioning streaming suggested by the panel proposal works, to consider multiple TTH asset decommissioning, and to consider the carryback mechanism further, before the next expert panel.***

4. Treatment of seller (Q6 in the discussion paper)

(a) The group noted that TTH would not be shown separately on a Sale and Purchase Agreement, and a question was raised over whether it would fall into the licensing area if it was included in an asset sale price. The group clarified that TTH was an inherent part of the consideration, and if TTH was available it would allow the buyer to value the asset on a post-tax basis, which may or may not result in a buyer being able to offer more in consideration. It was flagged that this would come out as part of commercial negotiations and would not be separately identified. The group noted that once a price had been agreed between the parties based on the buyer's evaluation assuming a certain level of TTH the parties would agree, as normal, a just and reasonable allocation of that price between plant, mineral extraction allowances and the licence. The normal tax consequences of that allocation would then follow.

(b) The Government questioned what would be included in the sale and purchase agreement (relevant for capital gains tax purposes) if TTH was attached to a licence. The group stated that there would be no reference to any value attributable to the TTH and commented that it may be challenging for a buyer and seller to agree a common number for such a value. There was concern that if Government sought to separately tax the value of the TTH this would be akin to double taxation and would simply create a further value gap.

5. Summary

The group summed up the action points for the next meeting, and closed the meeting.

Minutes: Expert panel: Tax issues for late-life oil and gas assets

Meeting date: 6 July 2017

Meeting time: 2.00pm – 5:00pm

Location: Oil & Gas UK (62 Market Street, Aberdeen / Portland House, Bressenden Place, London)

Minutes

1. Organisations represented

- HM Treasury (Chair)
- HMRC
- Oil & Gas Authority
- BP
- ConocoPhillips
- CW Energy
- EnQuest
- ExxonMobil
- Ineos
- Oil & Gas UK
- Premier Oil
- Shell
- Total
- UK Oil Industry Tax Committee

2. Introduction and follow up to the previous meeting

(a) HM Treasury welcomed the group and noted that minutes from the previous meeting had been circulated. A response by Monday 17 July was requested. HMT confirmed that the deadline for submissions to the discussion paper had now passed, and thanked panel members who made submissions. It was noted that Government would follow up on written submissions in the next month or so if it had subsequent questions.

(b) It was confirmed that the next meeting would be on 1 August ***(see action point 2(a) from 22 June minutes)***, and that Government representatives would split themselves across London and Aberdeen sites.

(c) The group agreed to pick up on the points which had not been addressed in the previous meeting's agenda, and that this should cover the remaining questions in the discussion paper. The group reaffirmed the optionality of any potential transferable tax history solution.

3. Further consideration of the carryback mechanism and decommissioning

(a) Government circulated a pre-prepared example, and outlined the way it would work in relation to net decommissioning ***(see action point 3(y) from 22 June minutes)***. In this example, the buyer acquires an asset with transferable tax history (TTH), on a last in first out (LIFO) basis, with first period transferred being the latest filed period. It was noted that it was expected this would not be within the scope of EITI, as any nominal payment would not involve cash and would therefore be outside the scope of EITI. The buyer would calculate tax for post-acquisition periods as normal, including use of brought-forward losses from its legacy business. However, the buyer must track profits of the acquired asset separately, and this must be shown on an additional sheet attached to the annual tax return. When the field ceases production and decommissioning begins, decommissioning costs would be treated as normal i.e. used against all current year profits and then carried back against prior year profits in accordance with CTA 2010 sections 40 and 42, including tracked asset profits. If the decommissioning costs of the transferred asset led to a net decommissioning loss, the TTH would be activated by amount of the net decommissioning loss. Activated TTH could then be used against decommissioning losses from any field, dealing with the issue of the acquired field utilising other fields' tax history.

(b) The group agreed that this was how it would work in principle, but questioned the interaction with the Ring Fence Expenditure Supplement (RFES) in connection with this. It was noted that RFES was included in nominal calculations, and if there was a loss in the company that the amount of RFES should be proportionate. There was a query around a tracked field making an operational loss, which is notionally carried forward, and whether this would notionally include RFES – the group acknowledged that this needed further thought, suggesting an allocation could perhaps be done on a just and reasonable basis. The group queried how tracking for other items could be done, e.g. overheads, and how to allocate real results between various assets. It was noted that this could be covered by guidance or legislation, as it may be necessary to show example calculations. A query was raised over whether carrying RFES forward would make it harder to claim decommissioning relief (due to inflated losses), but it was noted that it shouldn't affect net decommissioning loss, so it would therefore perhaps not affect TTH either.

(c) Government queried what would happen to the TTH if the tracked profit of the transferred asset is actually a loss due to operational costs, rather than decommissioning costs. The group commented that operational loss shouldn't prejudice or enhance access to TTH, if the transferred asset was in a cumulative loss position at the time of decommissioning then the operational losses would not activate TTH, but all decommissioning spend would activate TTH if available (through incurring a net decommissioning loss). Government queried about the possibility of midlife decommissioning, where decommissioning takes place while the field continues to produce afterwards. In response, industry stated that whilst catering for mid-life decommissioning would be preferable, permitting activation of TTH after cessation of production would be simpler to design and implement. There was a question around the OGA's definition of cessation of production, and it was noted that such a scenario already existed for unrelievable field losses UFLs under the PRT rules – it was noted that the last known definition was permanent cessation of trade and all wells

decommissioned. ***Action point: Government to check current definition from the OGA of 'permanent cessation'.*** It was noted that current practice is for the OGA to agree cessation of production with operators where the operator would specify an appropriate timescale acceptable to OGA.

(d) Government queried whether tariff receipts would cause any issues, noting that it would not be ideal to prejudice access to TTH and it would be unfair if defined income streams did in fact prevent this. It was noted that buyers could be concerned by this. It was noted that some midlife decommissioning could take place while extending field life and profit margins. It would be disproportionate if a small amount of tariff income prevented TTH access. The group queried the process in the instance where a field was not producing but was acting as a hub for third party business and using this as its main income stream. The group noted there might be a number of issues connected to tariff income and TTH activation. The group reaffirmed its agreement with the principle that TTH would not be accessible until cessation of production and queried whether something similar to the UFL process could be constructed, to deal with tariff income. In this regard, it was noted that tariff income may be somewhat more predictable than field production income. It was also highlighted that the current incumbent could carry back the decommissioning loss, and an excessive restriction imposed on a new entrant in this respect would be distorting, and may ultimately be to the detriment of MER UK.

(e) Government asked about buyers who already had an interest in the acquired field, and whether TTH could be used for all of the decommissioning costs in the field, including pre-existing interests. It was noted that activation of TTH should be limited to the net loss after cessation of the transferred interest, otherwise the buyer could seek higher TTH amounts to frank existing obligations in relation to the legacy interest in the field. The group agreed with this, particularly in relation to tracking turnover from a specific field.

(f) Government asked whether it would be possible, if a legacy asset is decommissioned first, that subsequent activation of TTH could generate tax history in a period that had previously had its tax history eaten up. The group agreed with this, and noted that the desire would be to keep the rules as normal, as far as possible. The group questioned what would occur when the TTH is activated and it crystallized tax history for loss carryback. It was noted that there would be a series of periods with amounts at certain rates and these would be activated on a LIFO basis. The group considered how to explain, in a simplified manner, such a mechanism to wider general interests. There was a question around whether it would be an issue that the legacy asset had no tax relief for decommissioning once all the tax history had been utilised, and it was noted that as long as decommissioning expenditure activated TTH, this should prevent any gaming. It was noted that returns for earlier periods could be amended, as this would need to take place for decommissioning in the first place. It was also noted that while this wouldn't make much of a difference, clarity on what was filed would need to be explained to management by advisors. The group was not convinced that timing and accounting periods would be an issue, and that this shouldn't result in trapped losses if normal LIFO principles applied. The group also queried how to communicate this commercially when factoring it into deals; the group agreed that it was important not

to focus on the academic details but to address the commercial and mechanical levels. Government asked whether TTH could be incorporated into current economic models, and the group noted that similar practices were already in existence and that it wouldn't be much more complex than existing modelling.

(g) A question was raised on what would happen when the TTH was purchased but never used, even while decommissioning. The group clarified that it wasn't TTH being purchased, but a field asset; it was further asserted that if an asset hadn't incurred a net decommissioning loss, it shouldn't be worse off if TTH was never activated. The group commented that not using TTH would be an example of a success case, as TTH enabled the deal to go ahead and through additional investment in the field obviating the need to utilise TTH entirely.

4. Update on Decommissioning Relief Deed waivers

(a) The group confirmed that it had considered this point ***(see action point 3(p) from 22 June minutes)***. Government affirmed that in most circumstances Clause 5.5 should be sufficient protection. It was reasserted, however, that the possibility of exposure remained. One option could be a legislative requirement that TTH could not be passed without the seller signing a side letter opting out of the DRD for the transferred TTH. The group questioned whether Government had considered the anti-abuse clause already built into the DRD. ***Action point: industry to check this clause for specific wording and implications on anti-abuse provision.*** The group commented that it would be difficult for avoidance schemes to arise if TTH was legislated thoroughly.

(b) Industry then, noted that:

- A side letter or waiver could state that if a seller gives up its tax history, it could not claim under the DRD on that part of the tax history, and that this should be between the seller and HMT, mirroring the parties to the DRD;
- The election of TTH should be given to HMRC, and the waiver to HMT; and
- If the field transfers and the buyer defaults, the seller would not want to be prevented from making a valid imposition DRD claim, but the scope of this would need to be clearly defined.

The wording of any such waiver document would be a point for further investigation, as it would need to balance sufficient protection for HMT against the specificity of what industry required. A question was floated over whether Government could share examples of circumstances where Clause 5.5 would not be sufficient, for the group to review. ***Action point: Government to consider request for Clause 5.5 examples for panel review, and revert with decision in due course***. It was reiterated that TTH was a voluntary part of a field transfer transaction, and only in these circumstances would a DRD waiver be necessary.

5. Administration of transferable tax history

(a) Government drew attention to the administration paper that had been sent to the panel prior to the meeting ***(see action point 3(u) from 22 June minutes)***. It was acknowledged that it had come through recently thus leaving limited time for review,

and written comments could be provided in due course to supplement the panel session discussions. Government invited the group to comment on the high-level detail, with the suggestion of responding to specific details later (while acknowledging that some of the points in the administration paper had already been covered by the earlier discussion).

(b) The panel was asked for its views on using the provisions in Decommissioning Security Agreements (DSAs) as a cap for the amount of TTH transferred. Industry representatives suggested that TTH should use the inputs to a DSA as a starting point. The group noted that the DSAs are a pre-existing and relatively robust mechanism for two parties to agree decommissioning amounts, but acknowledged that a DSA was just an example of a type of mechanism rather than a ready solution. The group commented that the DSA amount would reflect a commercial tension, as the buyer would not want to provide more security than necessary. There was a general query floated over whether there could be a standardised range for risk factors. The group posited a scenario where the data from a DSA could be pulled out, in order to provide pre-agreed amounts of decommissioning expenditure, and that this figure could be the basis of a TTH calculation. Government noted that it would be useful to see a pro forma of a DSA and asked whether a blank example could be provided. ***Action point: industry to look into pro forma documentation and provide to Government. (completed)***

(c) There was uncertainty over whether industry proposed to use amounts for TTH purposes which had been extracted directly from a DSA, and why it appeared to omit making any net value remaining in the field as part of the process. It was also highlighted that future inflation on decommissioning spend would be a factor.

(d) Government asked whether a cap could give a buyer certainty whilst also protecting against the risk of accessing decommissioning relief at higher rates. The group noted that while it was necessary to avoid excessive relief, it would not be ideal to only receive minimal relief and so there may need to be flexibility in defining the cap to provide a reasonable cushion to buyer. The point was reiterated that an excessive transfer of TTH would need to be avoided, and a cap could prevent abuse. The group pointed out that there wasn’t infinite tax capacity in industry, and from a seller’s perspective it would not make commercial sense to risk sacrificing tax history for a highly contingent future gain. Other points noted that there was a more relaxed attitude to the idea of a cap, as there is already sufficient commercial tension between buyers and sellers in commercial negotiations. The group appreciated the fact that this type of mechanism does not exist elsewhere, and there was concern that there must be a mechanism to prevent unintended relief at higher tax rates. The group noted that in reality, tax projection calculations are very sensitive to future assumptions and can therefore produce very different results, but industry respected the need for safeguards for these types of situations, no matter how unlikely. It was also noted that small differentials in the inputs to the DSA formula could result in significant output differences.

(e) The group flagged that DSA data is independent, was subject to commercial tension between independent enterprises with the benefit of expert opinion to deal with

irreconcilable positions, and therefore could form the basis of a TTH cap. Government asked why suggested safeguards could end up understating the amount of TTH that a buyer could access, and was reassured that the intention was not to understate but to come up with criteria that gave both buyer and seller certainty, while protecting the Exchequer against paying out excessive relief. It was flagged that if fields decommissioned now rather than later, the incumbent could access the higher rates, and the group acknowledged that industry would want to avoid subjectivity as far as possible (though this was not always possible), and that the aim was to provide certainty at the point in time when the deal happens.

(f) Returning to the administration paper, Government queried whether a joint election for TTH could be a suitable mechanism, in reference to the administration paper, and the group agreed with this. The group was then asked for views on which accounting period would be most appropriate for activation: the panel noted that the accounting period 2 periods prior to the deal date would provide more certainty, but that they would need further time to review as it was not clear in all cases what the agreed deal date would be e.g. completion dates versus dates that deals were agreed.

(g) The panel was asked whether this would require normal loss carry-back rules to be suspended, for the purposes of calculating TTH transferred alone (as for other losses, normal rules would apply). The group agreed with this in principle, and queried whether there would be a nominal transaction from the seller to the purchaser. It was noted that it was difficult to interface with completion, as under the current rules a company wouldn't necessarily make a loss. The group queried the terminology of 'suspend' in the document; the group noted that it had not considered 'switching off' normal loss carry-back rules, and it was flagged that the rules would not be switched off, but rather normal restrictions wouldn't apply in the creation of TTH. The group commented that this couldn't be catered for under normal rules, and that there must be a standalone system; the group then queried how the tax system catered to tax refunds versus reduced tax liability, and whether this would need to be notional. The group suggested that 3 accounting periods before the deal would be the earliest starting point, and flagged that the seller also had risks in how much tax history is given away (rather than risk being purely centred on the buyer). It was noted that the term 'notional' did not need to be used.

(h) Government provided an overview of the COTAX/SAFE tax administration computer systems; this noted that no cash would actually change hands (and couldn't accidentally be repaid) if TTH was introduced, and that accounting periods wouldn't need to be co-terminous. The panel was asked for views on a certification process for TTH, and what safeguards would be necessary or advisable. The group suggested legislative entitlement for buyers to make claims, and agreed with the need for an evidence trail, agreeing that it would be sensible to have a certification process. The group asked whether a seller would get anything like a physical certificate, and whether confidentiality waivers would be included and therefore provide the seller with a form of certification. It was noted that if a joint election was made, that this would surely mean a copy of certification could be provided to both buyer and seller.

(i) The group posited a 'disaster' scenario i.e. how a seller could get its TTH back if a buyer defaults. The group commented that this wouldn't necessarily involve giving TTH back, but could invoke the imposition rules under DRDs. The group was asked who should bear the risk of HMRC enquiries affecting the transferred periods, and the group agreed that this should be the seller.

(j) The group was asked if they had views on how tracking should be implemented, and whether buyers have the capacity to implement robust tracking processes. The group agreed that this was possible, as there was no great administrative increase in doing this and administrative burdens should not block TTH in deals. It was noted that complexities could be worked out at a later date, and the group acknowledged that Schedule 6 of the Oil Taxation Act 1975 already provided an example of industry allocating common costs to individual assets. The group highlighted the need for certainty combined with challenge from the tax authority, and considered whether year-on-year tracking would be preferable over a "full pot" being analysed on decommissioning. The group flagged that it was unclear whether the term 'asset' referred to fields or infrastructure – it was clarified that it referred to fields, and that the applicability of the language would need to be clarified.

(k) The panel was asked about the order of use for TTH, and the group responded that the shared understanding was that once the shadow amount of net decommissioning loss was reached and TTH activated, the activated amount of TTH would become actual tax history. The group turned to discuss the displacement of activated Investment Allowance (IA), noting that carried-back losses already displaced claimed IA and industry stated that IA would become available again to the seller as it would then be unutilised. It was suggested that the amount could be apportioned on transfer of an asset. The group queried whether it would be sensible to have a blended rate, but ultimately concluded that the point of TTH would be to have a buyer simulate having a seller's tax history, and effectively being in the seller's shoes. The group asked whether this would be consistent with current loss rules. The group noted that the aim should be to mirror current rules rather than create new ones, and that the position should be that no party would be better or worse off than if the asset had not been transferred. ***Action point: Government to check consistency with loss rules***.

(l) The panel was asked for views on the scenario where a buyer owns existing assets and then acquires a further asset with TTH attached, where it could become disadvantaged if it has significant decommissioning costs on its existing assets before the TTH asset. When the buyer comes to decommission the TTH asset, it would have no access to tax relief until it reaches the asset's own net decommissioning loss point. The group noted that the buyer would be no worse off, but that this could be a different matter if there was mid-life decommissioning. The group commented that the driver would be to get decommissioning costs as low as possible, and a cherry-picking sequence would be unlikely when other decommissioning requirements were taken into consideration. The group also commented that the order of use was irrelevant. If legacy assets were decommissioned first, that spend would utilise indigenous tax history and the transferred asset would then use TTH to the extent it was activated. Conversely, if the transferred asset decommissioned first, the spend would utilise the

indigenous tax history whilst at the same time activating TTH (assuming a net decommissioning loss), making the TTH available for legacy assets. The point was further emphasised that it was difficult to make these kinds of decisions on tax planning as this would require perfect knowledge of the future.

6. Treatment of onward transfer of assets

(a) The panel was asked for views on the subsequent transfer of assets with attached TTH, and how this would work in practice. There was a lack of clarity over whether it could be made mandatory to move TTH with an asset when DRDs and waivers were not mandatory. The group considered whether it may be necessary to move TTH at all after the first sale, and noted that unused TTH couldn't be activated anyway. As such, unactivated TTH would be expected to move with an asset in the first instance.

(b) The group discussed a potential scenario where a company that has acquired an asset with TTH intends to dispose of the asset and retain some element of decommissioning and therefore necessitate retaining some element of TTH, noting that the seller would only want to retain TTH if they were liable to a part of the decommissioning, otherwise it would not be kept. For a subsequent sale of only part of the field, unactivated TTH should be apportioned according to the share in interest in the field transferred. The group also asserted that it should be kept simple, with one buyer and one seller and not being able to claim more than the percentage in the field.

(c) The group acknowledged that TTH should not interfere where the seller wants to retain decommissioning; while some comments noted that this particular area might be too niche, others noted that it was useful to address this now rather than later. It was also noted that it would be unlikely that activated TTH would transfer, as a seller would be unlikely to transfer a field after production had ceased.

7. Summary

(a) The group summed up action points for the next meeting covered so far, and added additional points on the administration paper. ***Action point: Industry to review the administration paper and submit comments in writing to Government before the next meeting.***

(b) The group noted that it would be helpful to prepare for specific issues for discussion in advance of the final meeting. ***Action point: Government to outline specific issues and pressing discussion points, and circulate to the panel in advance of the final meeting.***

(c) The group agreed the final list of action points, and closed the meeting.

	Legacy business	Tracked Field 1	Tracked Field 2	Whole company - actual tax	Notes
					Reflects tax return
					Field 1 decom cost
					Field 2 decom cost 1,500
Year 1 - Field 1 acq					
Loss b/f	NA	-	-	(2,000)	Acquirer's b/f loss
TTH total	NA	500			Transferred TTH, as stated in sale contract
Profit for year	200	500		700	Asset's profit for year; Total profit for year
Utilised b/f loss	NA	-	-	(700)	No tracking for legacy business; Uses b/f loss against whole trade, including transferred asset
Tracked profit for year	NA	500	-	NA	Assumes that loss is c/back where possible, but otherwise is c/f
Total tracked profit	NA	500	-	NA	
Loss c/f	NA	-	-	(1,300)	Unused losses c/f, as in "normal" tax computation
Year 2					
Loss b/f	NA	-	-	(1,300)	
TTH total	NA	500	-		
Profit for year	(500)	500	-	-	Assets' profit and loss net off
Utilised b/f loss	NA	-		-	Although no overall profit, still track asset profit
Tracked profit for year	NA	500	-	NA	
Total tracked profit	NA	1,000		NA	Running total of tracked profit
Loss c/f	NA	-	-	(1,300)	
Year 3					
Loss b/f	NA	-	-	(1,300)	
TTH total	NA	500	-		
Profit for year	2,000	(500)	-	1,500	
Utilised b/f loss	NA	-	-	(1,300)	B/f loss fully utilised
Tracked profit for year	NA	(500)		NA	Assumes that loss is c/back where possible, but otherwise is c/f. In this case, loss c/back, so total reduced
Total tracked profit	NA	500		NA	
Loss c/f	NA	-	-	-	
Year 4 - Field 2 acquired					
Loss b/f	NA	-	-		Second field added and tracked separately
TTH total	NA	500	500		
Profit for year	2,000	(500)	1,000	2,500	
Utilised b/f loss	NA	-	-	-	
Tracked profit for year	NA	(500)	1,000	NA	
Total tracked profit	NA	-	1,000	NA	All of tracked profit used up
Loss c/f	NA	-	-	-	

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Year 5

Loss b/f	NA		-	-		-
TTH total	NA		500	500		
Profit for year		250	(1,500)	250		(1,000)
Utilised b/f loss	NA		-	-		-
Tracked profit for year	NA		(1,500)	250	NA	
Total tracked profit	NA		-	1,250	NA	
Loss c/f	NA		(1,500)	-		(1,000)

As loss can't be carried back, is carried forward

Year 6 -Field 2 decommissioned

Loss b/f	NA		(1,500)	-		(1,000)
TTH total	NA		500	500		
Profit for year		250	1,000	-		1,250
Utilised b/f loss	NA		(1,000)	-		(1,000)
Tracked profit for year	NA		-	-	NA	
Total tracked profit	NA		-	1,250	NA	
Decommissioning cost	NA		-	(1,500)		(1,500)
Tracked profit utilised	NA			(1,250)		
TTH activated				(250)		
Decommissioning loss used vs tax history						1,500
Remaining tax history						1,450
Activated TTH used						-
Loss c/f	NA		(500)	-		-

All of Field 2's post-acquisition history is used up

Only part of TTH is activated

Used against total tax history

If net operational loss at point of cessation of production, treated as neither profit or loss.

As tax history remains, no activated TTH is used, but can be used vs future decom

Minutes: Expert panel: Tax issues for late-life oil and gas assets

Meeting date: 1 August 2017

Meeting time: 2.00pm – 5:00pm

Location: Oil & Gas UK (62 Market Street, Aberdeen / Portland House, Bressenden Place, London)

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Minutes

1. Organisations represented

HM Treasury (Chair)

HMRC

Oil & Gas Authority

BP

ConocoPhillips

CW Energy

EnQuest

Ernst & Young

ExxonMobil

Ineos

Oil & Gas UK

Premier Oil

Shell

Total

UK Oil Industry Tax Committee

2. Introduction and follow up to the previous meeting

(a) HM Treasury welcomed the group and noted that minutes from the previous meeting had been circulated. HMT confirmed that after the fourth set of minutes are circulated and agreed, one final set of the compiled minutes will also be circulated for the panel to review before publication. It was also confirmed that the deadline for receiving responses to the discussion paper (30 June) had now passed; HMT expressed thanks to expert panel members for their responses, and outlined that the intention now is to not receive any further responses unless there are exceptional circumstances. HMT indicated that Government may follow up in detail on some responses in due course.

(b) It was also confirmed that this would be the final panel meeting, which would be the final opportunity for the panel to raise issues; it was noted, however, that there would be the opportunity for the panel to submit a written wrap-up submission, which could cover anything which the panel feel was overlooked or not sufficiently discussed.

3. Treatment of decommissioning liability retention for PRT

(a) The group moved to discuss the remaining two issues cited in the discussion paper, starting with decommissioning liability retention for petroleum revenue tax (PRT), as covered in Question 8 of the discussion paper ***(see action point 3(c) from 6 July minutes)***. Government outlined the issue, and queried whether the panel had a common understanding that:

- In asset disposals, sellers sometimes retain a portion or all of the decommissioning liability.
- This was recognised through the clarification provided at Budget 2016 on the RFCT/SC treatment of decommissioning retention, through HMRC's Technical Note. It was noted that there are still issues on the PRT treatment.
- If a seller retains some or all of the responsibility for decommissioning, they may not be able to claim a PRT deduction for such costs if they are not on the licence at the point when decommissioning begins.
- This is because PRT returns can only be made by participators, as defined in the legislation, which excludes former licensees.
- A buyer could decommission the asset with funding from the seller, but the costs would still not be deductible because of anti-subsidy rules, preventing PRT deductions for subsidised costs.
- Consequently, neither the buyer nor seller is able to claim a deduction for decommissioning costs.

The panel confirmed that this captured the issue.

(b) Government commented on the hope to remove this distortion in the PRT rules, and noted that there was some added complexity from the PRT rate being reduced to 0% since 1 January 2016. Government outlined that in some instances a company may have no working interest in a field but remain on the licence, which allows the company to still be a participator in the field and hence claim PRT relief on the decommissioning expenditure. It was noted that since the introduction of the 0% PRT rate, this has led to an anomaly by which the 0% licence holders paying decommissioning costs were able to "leap frog" the periods when the buyer holds the producing interest and potentially claim a refund without offsetting the decommissioning costs against the post-acquisition profits. This would not be the case if the decommissioner had retained the working interest in the field. Industry commented that companies which had disposed of field interests but remained on the licence had done so before the announcement of the reduction in PRT rate out of

commercial reasons and that liability retention was generally an action of last resort, and this was noted.

(c) Government opened up the discussion to the panel, asking the group to consider which mechanics could remove this distortion, noting that one of the bigger challenges with PRT retention is ensuring that any change is not to the detriment of existing commercial arrangements, and being mindful of knock-on effects on the anti-subsidy rules and legislation. The discussion paper set out two proposals to address this:

Deemed transfer of licence from 'when decommissioning commences'

This would have the intent of allowing a seller to 'stand in the shoes' of the buyer, or latest participator. The decommissioning loss would be carried back through the current participator's tax history, before being offset against the previous participator's tax history. This would allow the portion of decommissioning costs paid for by the seller to attract a PRT deduction, when previously it would have been lost. This option would also minimise the possibility of the noted anomaly arising where a company retains a licence interest with no associated working interest in the field.

Changing the anti-subsidy rules

Alternatively, a seller could fund the buyer's decommissioning, with costs being treated as having been incurred by the buyer. The resulting PRT loss would be carried back. Anti-subsidy rules prevent this currently, but could be changed for a buyer and seller to make a joint election for costs to be claimable and deductible for one party or the other. Government noted that current understanding was that this would have less of an impact on existing SPAs and commercial arrangements.

(d) The panel commented that any change should not affect existing or announced deals.

(e) The panel commented that the subsidy option was sensible as it is normally possible to make a contribution which is ignored for corporation tax, as decommissioning costs do not fall within the normal corporation tax contribution allowance rules. The panel noted that the outlined possibility would put PRT on the same footing, and noted that it was reasonable that only one person gets a deduction for the net expenditure incurred. It was noted that this could also align PRT and CT treatment, and further comments pointed out that if the switch-off was narrowly defined, that this would prevent any major issues or legislative change.

(f) The group pointed out the possibility of field partners pre-empting the seller returning to the full licence, if a field was at the decommissioning stage. It was noted that it would still be subject to consent, and there was a wariness that any change could potentially be used as a negative tool. The group noted that a buyer would want a seller to be reassured, but a seller would not be reassured if in some way the deal disadvantaged them. The group commented that any change should be another "tool in the toolkit", and that they were opposed to the tax system blocking a seller from retaining decommissioning.

(g) The group queried whether the options presented required one to be chosen, or whether both were needed, as each option addressed different economic scenarios. Comments were made that it would be helpful if any changes did not alter existing or announced arrangements, and the group noted that tax considerations in deals usually only extended to getting the deal done. Government questioned whether retention of decommissioning would be less attractive if TTH was an available option; the group responded that this would depend on the individual buyer's circumstances. They noted that each transaction would have its own fact pattern. It was stated that even with DSAs, there was still risk involved as a seller would have to incur costs in the first place. The group commented on the link between late-life asset stewardship and decommissioning, flagging that an asset would need effective maintenance in order to remain in appropriate condition for cost effective decommissioning. If two parties were each partly liable for decommissioning, this would need to be carefully managed.

4. Major change in nature or conduct of trade

(a) Government outlined their understanding of the issue, and enquired whether industry shared a common understanding that:

- A transfer of assets can be done by selling the company holding the asset, instead of the asset itself (known as the hive-down model).
- There is a concern on availability of the losses in transferred companies, as these can be eliminated under S673 Corporation Tax Act 2010 if there is a 'major change in the nature or conduct of trade', or where the trade in a company with the asset has become 'small or negligible' and is later revived.
- There is uncertainty in industry on what changes in management and business processes will be considered "major", as some changes often happen when ownership changes hands.

(b) It was acknowledged that there have been prior discussions between industry and HMRC on the possibility of clearer guidance being issued; while noting that as S673 is an anti-avoidance measure, guidance is not generally given – as such, limited guidance changes had previously been offered. Government noted that S673 (and its successor) is a key part of the overall CT loss system and that the overall purpose of the legislation should not be undermined.

(c) Government acknowledged the desire for certainty over availability of brought forward losses in acquired companies, pointing out that oil and gas is not the only strategic industry that would like to have more certainty in this area, as this uncertainty meant that there could be a value gap; if losses were unavailable, this may make the asset appear cash-negative in overall terms in deal valuations, and hence not be considered for a deal. Depending on the development stage of the asset, it may be immediately cash-negative, or cash-positive, but will not be tax-paying for several years.

(d) The group noted that this binary outcome of S673 made for unpalatable risk to potential buyers as all losses would be eliminated.

(e) It was noted that HMRC could not provide a blanket exemption for ring fenced activities, as this is not approved practice for anti-avoidance provisions and there had been previous worries with loss-buying, including oil and gas companies in certain circumstances. The position stated was that S673 is a reasonable and proportionate response to some companies undertaking tax avoidance through loss-buying.

(f) The group commented that if companies had tax losses, that may mean they were less likely to have a good portfolio of assets. It was flagged that recent changes to S673 resulted in the section being activated by any change in a five year period instead of three years, as previously, and this could deter investment by private equity backers due to the prolonged time period of uncertainty. It was noted that overall, there was a wider economic benefit in continuity in a business's management e.g. assets working efficiently and being improved, and subsequent opportunities for the supply chain opening up this way.

(g) The group commented that potential cost synergies were being eroded by the five-year window, but when asked how many deals failed due to S673, it was noted that it was difficult to see the whole deal cycle from an advisory perspective, or to see why a deal had not gone through from a seller perspective. The group emphasised the request for tools to bridge the gap, specifically focusing on guidance. A request for a purpose test was noted, and the group added that no buyer would take on an asset and treat it exactly as the seller had done – a buyer would look to create value, but if a buyer could not be certain of loss treatment in five years' time, this could create a value gap and the deal would simply not go ahead.

(h) The group commented that without legislative change, agreement was needed on what does and does not fall within the framework. It was noted that the previous suggestion of the clearance mechanism was preferred by industry. Whilst there was acknowledgement generally that it is difficult for pre-transaction clearances to provide certainty, clearances in such a situation could be treated as personalised guidance. Government further clarified that HMRC does not as a matter of general policy provide assurance on S673 application; but in order to be helpful HMRC could offer a view on the application of S673. This policy will be kept under review, and it is expected that industry will use this channel in a sensible manner.

(i) The group noted that the outlined clearance process would be helpful, and that it amounted to a form of personalised guidance which would provide greater certainty to companies. The group queried whether there was scope for high-level, positive and negative examples that could be shared and reviewed, which advisors would be happy to share. The panel responded positively to this. The group questioned whether certainty or availability of loss relief was more important, and whether losses in oil and gas included pure economic losses. Industry explained that the vast majority of losses are generated through exploration or development activity. Exploration is the industry's equivalent to research & development activity, and are thus of a normal operational nature and an

inherent part of the asset life cycle. Such exploration and development activity is based on legitimate and professional decision-making in a business. The group felt that there should not be a restriction on losses simply because of a concern that industry might create new avoidance schemes with the unintended consequence being a blocking of genuine deals, and Government noted that it was opposed in general to loss-buying (but not organic growth by a new owner – this being the purpose of the 'major change' rules).

It was agreed that any generic, general guidance on S673 that government could provide would also be helpful, as none of the currently available guidance relates to or could be used as an analogue to oil and gas.

5. Follow up to previous meetings – Transferrable Tax History (TTH) proposal

(a) The group moved to discuss outstanding issues on the proposal for TTH ***(see action points 7(a) and 7(b) from 6 July minutes)***. Government again emphasised that no policy decision had been made on TTH, and that the discussions were to determine how a hypothetical model could work.

Intra-group and onward transfers

(b) Government invited views on how TTH could interact with intra-group or onward transfers, noting that this had not yet been discussed in great detail. Government acknowledged that some companies with late life fields may want to sell the fields, but retain the decommissioning liability, even if TTH was introduced. The options for a buyer who has acquired an asset with TTH, who then wants to dispose of the asset, could be:

- Require transferring the asset with the TTH and a record of post-acquisition cumulative profit on the asset;
- Transferring the asset with only the TTH; or
- Transferring the asset, without the TTH.

It was noted that if only the TTH moves with the asset, there may be the possibility of a net loss to the Exchequer when there are onward, subsequent transfers. This would be because the subsequent buyer would be able to ignore the profits generated by the asset in the hands of the predecessor when calculating the extent to which the TTH could be activated.

It was noted that if a record of the post-acquisition cumulative profit on the asset moves on with the asset (alongside TTH), there would be neutrality for the Exchequer (because any activation of TTH would be by reference to the ultimate owner's net decommissioning loss having taken account of the cumulative profits generated on the asset by the predecessor(s)). As any subsequent transfer of the asset and TTH would include an ongoing calculation of the cumulative profits of the asset, there would be no risk of incremental loss to the Exchequer. This could be achieved by transferring the recorded profit, as tracked by the previous owner's CT computation, to the new owner. Otherwise, this could be achieved by repeating the original transfer mechanism but requiring the deemed

expenditure arising to the old owner to be first set against the asset's tracked profits and then the previously transferred TTH.

(c) Government opined that, in order to prevent this, post-acquisition tracked history would have to be transferred with TTH, and that the second buyer would need to work through both their own and first buyer's post-acquisition tracked history before TTH can be activated. Further comments noted that when a record of the cumulative profit on the asset moves with the TTH, this also reduces the risk of tax leakage from intra-group transfers. A group company would therefore not be able to manipulate the net loss on decommissioning, as the tracked post-acquisition profits and TTH are irremovable from the asset.

(d) Government offered questions to the group on partial disposals, querying whether a cap equal to a proportionate amount of TTH and history should be allowed to be transferred. Further questions asked that if decommissioning liability was retained, whether a seller would have to work through buyer's post-acquisition tax history.

(e) The panel noted their agreement, flagging their comments on the paper on how TTH administration could work that was issued at the third panel meeting. The panel noted that onward transfers where the decommissioning liability is transferred should inherit the cumulative tracked position. Upon decommissioning, the subsequent buyer would first go through the transferred asset's cumulative profits (both previous and subsequent buyers') before being able to activate TTH. Where the decommissioning liability is retained by the previous buyer, upon decommissioning equally both the previous and subsequent buyers' cumulative profits would be assessed to establish the extent of activation of TTH.

(f) The group raised the point that once decommissioning commenced, there needed to be a mechanism to ensure HMRC checks TTH use. It was commented that diagrams and guidance in the legislation would be helpful. The point was made around the importance of future-proofing, which did not preclude later legislation.

(g) The group queried the circumstances where intra-group transfers might be needed, such as hiving down an asset in preparation for an onward sale. It was noted that some groups may not have previously rationalised their group structure, with fields held by multiple group companies, for fear of losing tax history which would otherwise be utilised on decommissioning. If TTH could be utilised for intra-group asset transfers it would enable group rationalisation and simplification without creating any risk of loss to the Exchequer. Government acknowledged the concern that this was a barrier to simplification, and industry's desire to minimise risks.

Cap on TTH

(h) Government offered its thanks for sight of the Decommissioning Security Agreement (DSA) pro forma ***(see action point 5(b) from 6 July minutes)***, and moved to discuss how the amount of TTH transferred from seller to buyer could be regulated, to protect the Exchequer.

(i) Government reiterated that limiting the amount of TTH transferred minimises risk of gaming. It would be important to ensure that the amount of TTH transferred is "just and reasonable", otherwise a seller could possibly be motivated (although there would be a commercial risk in doing so) to transfer excess TTH to be able to access earlier, 'more valuable' tax history. Industry members felt that the parties needed flexibility to ensure both were comfortable with the level of TTH to ensure as many deals are possible could happen, but one option would be to use a reference source for a decommissioning estimate which can be used by buyer and seller to agree the amount of TTH to be transferred, which would need to be simple and realistic. The previous meeting raised the idea of using inputs to the DSAs to be used in calculating any cap on the amount of TTH to transfer ***(see points 5(b)-5(e) from 6 July minutes)***. It was noted that the DSA formula was already familiar to practically the entire industry (the DSA is subject to arm's length commercial negotiation providing a natural commercial tension), and so the DSA would therefore provide a generally accepted arm's length data set.

(j) The panel discussed factors within the DSA formula in further detail, and invited further comments on the merits of using DSAs. For the purpose of commercial sensitivity, the full discussion involving the DSA formula is not disclosed in these minutes. General comments on each section of the DSA formula were:

- TTH would require a one-off calculation at the point in time of the transaction rather than being revisited, and so the calculation should be based on input data at that point in time only;
- DSAs were not purely bilateral arrangements between buyer and seller but could in fact be field-wide;
- A seller would want a DSA included as part of a divestment to mitigate their S29 exposure;
- A one-size-fits-all risk profile would not be appropriate, as where there is a long asset life before cessation of production, the risk factor may diminish as the asset approaches cessation of production;
- Intra-group transfers would not necessarily result in a DSA, in which case an alternative calculation or mechanism would be needed for a cap;
- If companies were rationalising their group structures it was important that there was no cap imposed on the TTH. The TTH mechanism would itself ensure that there was no loss of tax to the Exchequer;
- In this case, TTH would need to be allocated to each asset and tax returns would need to reflect this.

Panel comments on administration paper

(l) Government invited views from the panel on the administration paper which was circulated for the previous July meeting, and thanked the panel for their comments thus far.

(m) The group queried whether there was a difference in interpretation over the clawback of Investment Allowance, and requested an action point to clarify. It was subsequently concluded that industry and Government are in agreement that where activated IA is displaced by losses carried back, these amounts are carried forward and are only unavailable for use where a company has no more relevant income.

(n) Other comments on the administration paper were noted as having been covered elsewhere in the discussion.

Interaction with DRDs

(o) The group then moved to discuss the potential for interaction between TTH and the Decommissioning Relief Deeds (DRDs) ***(see action points 4(a) and 4(b) from 6 July minutes)***.

(p) It was noted that, following legal consultation, clause 5.5 of the DRD may provide the Exchequer with sufficient protection, but HMT was concerned that a company may seek to test this, and therefore the perceived risk remained. Government flagged that it could be argued that the transfer of TTH from seller to buyer arises not only from a change in tax law, but also due to a contractual arrangement (disposal) entered into by the buyer and seller. Government acknowledged that the appetite for legislative change to close off DRD risk is minimal. The previous panel meeting had also raised the proposal of a seller signing a side letter or waiver ceding DRD rights in respect of transferred tax history, to reinforce protection for Exchequer. Government noted that in light of initial legal apprehension, it would be important to try to establish a mechanism that provides sufficient Exchequer protection, does not change the DRDs, and takes into consideration English contract law.

(q) The panel confirmed that they are currently engaging with industry legal representation. ***Action point: industry to submit note of industry legal views in due course***.

6. Summary and concluding remarks

(a) HMT thanked the panel for their participation, informed opinions and hard work, and reiterated that there would be an opportunity for the panel to submit a written wrap-up submission. It was noted that this could cover anything on TTH, PRT retention and S673 which panel felt was overlooked or not sufficiently discussed.

(b) The aim would be to respond at Autumn Budget. Government stated that if a decision was made to proceed, that a technical consultation would be required, and that industry would be able to take part in this. Furthermore, if it did proceed to legislation, the expectation – but not a guarantee – would be that this would occur in Finance Bill 18-19. It was acknowledged that there would be considerable pressure on the Parliamentary timetable in light of activity in spring 2019 and if means of an accelerated timetable were identified these would be considered.

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(c) It was confirmed that once the fourth set of minutes and final compilation of minutes had been checked and approved, these would be uploaded to the discussion paper website.

(d) The group agreed the final list of remaining action points, and closed the meeting.

Administration of Transferable Tax History

This note sets out the possibilities available in administering the TTH proposal introduced by the Panel which are achievable using existing HMRC mechanisms (albeit with some adjustments.)

Identifying and transferring the tax history

1. For the purposes of this note, transferable or transferred tax history (TTH) is used to refer to historic amounts of taxable profit (tax history) for a company, on which cash tax was paid at a specified rate.

   Industry's approach has been to suggest a direct link to the actual tax suffered by the Seller on the required transferable profits. Industry could accept a set rate but that is unlikely to fully address the tax value gap between buyer and seller, and may give HMT concerns that it is increasing its exposure to decommissioning tax relief. The key issue is that there should be as much certainty as possible over the rate at the time the deal is being negotiated.

2. An amount of TTH (to be agreed between the seller and buyer) is identified which does not exceed the expected amount of total decommissioning cost of the asset which is the subject of the sale and purchase agreement. Each separately identifiable asset within a sale and purchase agreement is to have a specific amount of TTH attached to it.

   The amount of TTH transferable will be subject to a 'just and reasonable' test, which may include objective indicators such as the amount held in a DSA. A separate election may be necessary to give effect to the transfer of tax history.

   Industry believes that as much flexibility as possible is needed to cater for all possible scenarios. A buyer will want to factor in some downside protection, e.g. a catastrophic failure of the asset soon after transaction completion. Industry would therefore prefer that HMT rely on the restriction of use of TTH on the buyer for the protection it needs. If this is not acceptable, then a limit based on the operator's estimate of decommissioning costs, uplifted for risk, used for example as input data for the purposes of any relevant decommissioning security agreement could be used, or if no such agreement existed a just and reasonable test.

3. A reduction of the TTH amount is made to the seller's taxable profits in that accounting period (Q1). This reduction of taxable profits may then create a loss which is then available to be carried back into preceding APs, reducing the tax history by the required amount. (Q2)

   ***Q1**. Does the panel have a view on which accounting period would be most appropriate? Starting from CY-2 would allow the seller to operate normal 1 year loss carry-back rules without displacing any loss carried back from CY to CY-1.*

   Industry believes that having "C" as the economic date agreed between the parties, or the date of signing the SPA, would be preferable as there are examples of deals taking significant amounts of time to complete, in excess of a year in some cases.

   Buyers have a commercial drive to have as great a degree of certainty as to the tax suffered on the TTH as is possible. The proposal of CY-2 would be very helpful. However, as CY-1 return has a statutory filing deadline of the end of CY is the proposal actually CY-3?

   Any arrangement should not interfere with the normal operation of the loss rules for any other purpose for the Seller.

   ***Q2**. Does the panel agree that this would require normal loss carry-back rules to be suspended, for the purposes of TTH alone? For other losses, normal rules apply.*

Industry doesn't have a strong view on whether the TTH is deemed to be expenditure under s.163 which meets the requirements of that provision or whether there is a discrete mechanism. In either case normal rules should continue to apply to profits excluding the TTH following the transaction.

A disadvantage to using the existing rules is that a deduction under s.164 does not have to result in a loss carry-back under s.42 CTA 2010. Where there are sufficient profits in the accounting period in which the transaction takes place, then the decommissioning costs would be deducted against those profits in the first instance. With no loss carry-back there is no nominal repayment generated for the Seller. This suggests that a discrete mechanism may be the preferential solution.

4. For the seller, the loss then generates a nominal repayment, which is not paid in cash by HMRC. For the buyer, an equivalent amount of TTH is nominally recorded as profit in CY and equally cash tax will not be payable on this. In the hands of the buyer, this amount of taxable profit is ringfenced and becomes the TTH for that asset. [The proposal, as borne out by the further comment below, is that the TTH would, in the hands of the Buyer, mirror the AP's it had been displaced from in the hands of the Seller.]

   HMRC would record the transactions as follows: for the seller, the reduction of taxable profits occurs on COTAX. However, the repayment which would be automatically generated by COTAX is diverted to SAFE (Strategic Accounting Framework) which is an integral part of HMRC's contract settlement system and regularly deals with miscellaneous charges.

   For the buyer, the tax history is not recorded in COTAX but is recorded on SAFE. HMRC could issue a Certificate showing the amounts of TTH, the applicable accounting period and the rate of tax (Q3).The increased nominal profit for the buyer is settled by reallocating the cash tax paid by the seller in respect of the TTH to the buyer's account on SAFE. No demand for tax is therefore generated by the system. This in effect ringfences the TTH, separating it from the buyer's existing COTAX record. The buyer's and seller's accounting periods need not be coterminous, providing that legislation is drafted to deal with the allocation or apportionment of decommissioning loss for non-coterminous periods.

   ***Q3**: What are the panel's thoughts on a Certification process? What safeguards would be necessary / advisable?*

   Certification would add some certainty for buyers but it is not thought critical and therefore industry does not believe it should be a condition of TTH transfer. Buyers will do due diligence to the extent sellers are prepared to release past returns, and will typically obtain a warranty over the amount and value of the TTH. Warranties will typically be subject to some de minimis limits but this is a small commercial risk that buyers are used to accepting.

<u>Dealing with enquiry risk</u>

5. There is a possibility that the accounting period from which the seller intends to transfer tax history will be under enquiry by HMRC. The current proposal is that 'enquiry risk' will stay with the seller.

   Example: Seller agrees with buyer that it will transfer 500 of tax history. On a LIFO from CY-2 basis, this is split as follows – CY-2=200; CY-3=200, CY-4=100. This reduces taxable profits in both of CY-2 and CY-3 to zero, and profits in CY-4 to 100. HMRC has open enquiries into all years, with a final result that profits in CY-3 are increased by 50 but decreased in CY-4 by 20. As a result of the TTH changing hands, the seller's taxable profits in CY-3 becomes 50 and in CY-4 becomes 80. The seller becomes chargeable to tax on the 50 in CY-3 and is entitled to a repayment on the 20 in CY-4. <u>There is no effect on the buyer.</u>

   That proposal has the support of Industry as it ensures the TTH on the buyer's side is not subject to change.

Q4*: As an alternative scenario, the result of open enquiries is that profits in CY-3 are reduced by 50. One option would be for a loss to be created for the seller for CY-3, which is then available to be carried forward as normal. (Should the loss be available to carry back for one year to CY-4?) Alternatively should the amount of TTH from CY-4 be increased to compensate? This might have a consequential effect on enquiry windows.*

Normal rules for losses in seller's hands ought to apply, i.e. profits deemed to have been reduced by TTH such that 50 in the above example is available for 1 year carry back (or extended carry back if it is qualifying decommissioning cost), with no change to TTH.

Use of the tax history

6. The panel's proposal in brief is that the TTH is ring-fenced and unavailable for use by the buyer until and to the extent that it is 'activated'. TTH for any asset can only be activated once the asset reaches its 'net decommissioning loss point'. The net decommissioning loss point is reached once the asset's decommissioning costs exceed its post-acquisition profits (Q5). A further condition is that TTH can only be activated for an asset once cessation of production is reached (Q6).

Q5*: What are the panel's views on restricting relevant costs for calculating the net decommissioning loss to decommissioning only?*

The principle suggested by industry is that the net decommissioning loss would be the critical amount in order to determine "activated" TTH, being the operating profit generated from the asset, less capex, less a just & reasonable allocation of overheads, less the decommissioning spend Where there has been a net operating loss on the asset, pre-decommissioning expenditure, industry is not proposing that the activation of the TTH could be augmented by that operating loss as the existing rules only provide for the extended loss carry-back as far as it relates to decommissioning expenditure.

Q6*: Would this condition cause any significant difficulties?*

Industry have assumed that as the policy change is to address the tax capacity issue in relation to decommissioning that cessation of production would not be a requirement but that only losses arising from decommissioning expenditure, which meet the legislative requirements in s.163, would qualify.

If mid-life decommissioning expenditure exceeded cumulative profits such that TTH was activated there is a theoretical possibility that subsequent profits from the asset would shelter any further decommissioning costs such that the activated amount ultimately exceeds the overall net decommissioning loss. Industry regard this possibility as very remote given that mid-life decommissioning by its very nature will be relatively immaterial to the overall decommissioning liability for the field.

7. In order to determine when the net decommissioning loss point is reached for each asset, post-acquisition profits and losses for the asset need to be tracked on an annual basis (Q7). HMRC's view is that computations showing the tracking should be submitted alongside the normal tax return, with an amended CT600i to show the brought forward and carried forward amounts of TTH for each asset (Q8).

Q7*: What are the panel's views on the desirability of subsequent transfers of TTH, and thoughts on how this might work practically? (To be discussed as part of main agenda).*

The proposal industry has considered is that the TTH transferred to Buyer 1 can be transferred to Buyer 2, at Buyer 1's option, on a subsequent sale, but that the "activation" of the TTH must be by reference to the cumulative tracked profits (i.e. for Buyer 1 and 2).

While industry is keen for TTH to be transferrable on a subsequent sale, there may be occasions where commercially the retention of decommissioning by Buyer 1 is a requirement for the subsequent sale to Buyer 2 to be agreed. In those circumstances, it would frustrate the commercial arrangement if Buyer 1 did not retain access to the TTH (to cover the decommissioning that Buyer 1 is retaining). It is recognised that there is a difficulty in that positive cash-flows from the asset accruing to Buyer 2 would need to be taken into account such that Buyer 1 did not access more TTH than could originally have been accessed by Buyer 1 (or indeed the Seller) if there had been no onward sale. We do not think this is insurmountable and believe that it is important that TTH does not operate in a way that would prejudice arrangements where the Seller agrees to retain decommissioning for commercial reasons.

Q8*: Does the panel have views on how tracking should be implemented? Do buyers have the capacity to implement robust tracking processes?*

The industry is familiar with such tracking as it is necessary for PRT fields (albeit with slightly different parameters) and it is thought that it should provide few practical difficulties.

It ought to be possible to determine the profits directly attributable to the tracked asset. The allocation of the indirect costs of the trade to that asset needs to be considered. The proposal is that it should be done on a just and reasonable basis and subject to normal HMRC enquiry windows – i.e. if a return is filed and the enquiry window is closed then the tracked profits have been implicitly agreed.

8. Upon activation, the TTH for each asset is then available for use up to the extent of any further decommissioning costs / loss for that asset (Q9).

Q9*: What is the likelihood of further income to be received in respect of the asset once COP has been reached? How should tariffing income be treated? If the test for the extent to which TTH is available once activation has been reached is still 'net decommissioning loss', how should this be calculated when decommissioning costs and income received run in parallel?*

The calculation of the net decommissioning loss should include tariffing income that relates to the acquired asset – so the TTH "activation" will be impacted by that income. Industry assumes that a similar concept as was adopted for future tariffing income in the context of UFL claims in PRT fields could be adopted. By taking into account the net present value of the estimated future tariffing profits in determining the quantum of TTH to be activated, HMT ought to be protected from any excess activation.

Another option would be to follow the actual cash flows as closely as possible in assessing the TTH activation during decommissioning, and subsequent to decommissioning, any excess of TTH activated due to continuous tariff income could be subject to a claw back.

Each option should arrive at materially the same position. It is important that the process is as simple and straightforward as possible as any onerous restrictions placed on access to TTH may in the worst case encourage the decommissioning of a full system to the detriment of hub satellites, which would be against the spirit of MER UK.

<u>Order of use</u>

9. The tracking of profits and losses for each TTH asset is a 'shadow' calculation, and does not affect the buyer's overall tax computations for the intervening periods. This means that there is no

effective separation or ring fence of the TTH asset, and normal rules on losses apply. Once TTH for an AP is activated and available for use, it is transferred to the 'real' tax computation, is treated as any other tax history the buyer holds, and is available to set against decommissioning loss from any asset.

Agreed.

10. One particular point concerns displacement of investment allowance when decommissioning losses are carried back. HMRC's view is that a carried back loss displaces investment allowance and that this is the case regardless of whether the loss is a decommissioning or a non-decommissioning loss.

    In other words, where a company's ring fence profits are reduced by a loss carry-back claim, the company's adjusted ring fence profits will also be reduced accordingly, and so there are no adjusted ring fence profits left for any Investment Allowance that had previously been claimed to cover. The amount of investment allowance displaced is lost, as there is no legislation to allow it to 're-enter' the company's pool of carried forward allowance.

    Our reading of the current legislation reaches a different conclusion. S332EA provides that where activated allowance is greater than the adjusted ring fence profits the allowance is carried forward. If losses are carried back and deducted from the adjusted ring fence profits that must mean that the activated allowance is carried forward even if it had previously been set against the original adjusted ring fence profits.

Particular scenarios – to be discussed more generally (not under admin item)

Q10: *How should a TTH asset with a pre-decommissioning net loss be treated?*

The pre-decommissioning net loss does not activate TTH. It is only the net decommissioning loss that activates TTH.

Q11: *If the buyer already has an interest in the acquired field, can TTH be used for all of the decommissioning costs in the field?*

Only the net decommissioning loss of the transferred share in the field is to be used to assess the activation of TTH.

Q12: *It is possible that if a buyer owns existing assets and then acquires a further asset with TTH attached, it could become disadvantaged if it decommissions its existing assets before the TTH asset. This could occur if decommissioning of the non-TTH assets uses up all of the company's tax history, whilst the TTH asset is still earning income. When the buyer comes to decommission the TTH asset, it will have no access to tax relief until it reaches the asset's own net decommissioning loss point. How should such a situation be treated?*

There is no disadvantage here. If the legacy asset's decommissioning has been set against the acquired asset's profits, the acquired asset loss on decommissioning would be set against activated TTH and any residual decommissioning loss (the amount the actual loss exceeds the net decommissioning loss using the tracked profits calculation) could be offset against earlier periods' tax history of the acquirer entity if these exist. The relief for the decommissioning costs on the acquired asset would be the same as if no other assets were owned.

Q13: *Following on from this scenario, it is possible that non-TTH fields could use up all of an accounting period's tax history, and then new tax history for that AP appears when the TTH is activated. In such a case, the loss would already have been carried back to any earlier period on a LIFO basis – how would the decommissioner access the TTH?*

The purpose of TTH is to permit deals to happen where the buyer would not otherwise have capacity to get effective decommissioning relief. If the buyer has capacity to use all of the decommissioning costs against legacy asset profits TTH is not needed. In the case where the TTH asset decommissioning is set against legacy asset profits it will still activate TTH (to the extent it exceeds TTH asset net profits) and decommissioning costs on legacy assets can be set against the activated TTH.

The original loss carry-back would not change. There would be an amount of profits in excess of the original carry-back claims created by the activation of TTH in the AP (equivalent to the AP from which the Seller's capacity was transferred) based on the net decommissioning loss. There would then be a carry-back of that loss from the later accounting period, where the decommissioning costs were incurred, to offset the restated profit resulting in a refund for the Buyer based on the TTH activated. The following example illustrates this with 200 of TTH activated in Period 3 (in profit terms with 80 tax value) against 200 of decommissioning costs incurred in Period 5:

Tax History before TTH Activated		Period 1	Period 2	Period 3	Period 4	Period 5
PCTCT		300	350	400	400	(900)
Loss carry-back			(100)	(400)	(400)	900
PCTCT after losses		300	250	0	0	0
CT (Paid)	40%	(120)	(100)	0	0	0

Tax History with TTH Activated		Period 1	Period 2	Period 3	Period 4	Period 5
PCTCT		300	350	400	400	(900)
TTH Activated				200		
Loss carry-back			(100)	(400)	(400)	900
PCTCT after losses		300	250	200	0	0
CT (Paid)	40%	(120)	(100)	(80)	0	0

Loss carried back against TTH		Period 1	Period 2	Period 3	Period 4	Period 5
PCTCT		300	350	400	400	(1,100)
TTH Activated				200		
Loss carry-back			(100)	(600)	(400)	1,100
PCTCT after losses		300	250	0	0	0
CT (Paid)	40%	(120)	(100)	0	0	0
TTH Payment				80		

It may be that this calculation is a notional one to take into account factors such as a new entrant with no historic accounting periods.

Q14: *What happens if there are two assets being simultaneously decommissioned; one with TTH and the other without, and there is not sufficient existing tax history to cover relief for both? Will tax considerations drive the commercial decisions on order of decommissioning?*

There should be no problem caused by assets being simultaneously decommissioned where one has TTH (Asset 1) and one does not (Asset 2). Once activation has been achieved on Asset 1, by having a net loss arising from decommissioning, then the available TTH can be accessed by a loss carry-back notwithstanding which asset notionally generated the loss. The important thing is that only activation allows access to TTH. If the TTH is notionally used by Asset 2 decommissioning then TTH, to the extent it has been utilised by Asset 2, is not then available to Asset 1. This should therefore mean that access to TTH would not drive the commercial decision to decommission.