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UT (Tax & Chancery) Case Number: UT/2021/000185

Upper Tribunal
(Tax and Chancery Chamber)

Rolls Building, London

PETROLEUM REVENUE TAX — Oil Taxation Act 1975 Schedule 3, paragraph 8—Expenditure by gas terminal owner on terminal modifications to comply with environmental regulations—Reimbursement by owners of oil fields using the services of the terminal of a pro rata share of that expenditure pursuant to contractual arrangements—Whether the expenditure was to that extent "met directly or indirectly" by a person other than the terminal owner—no—appeal dismissed

Heard on: 20 and 21 April 2023
Judgment date: 19 July 2023

Before

MRS JUSTICE BACON
JUDGE MARK BALDWIN

Between

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Appellants

and

PERENCO UK LIMITED

Respondent

Representation:

For the Appellants: Elizabeth Wilson KC, of counsel, instructed by the General Counsel and Solicitor for His Majesty's Revenue and Custom

For the Respondent: John Brinsmead-Stockham KC, of counsel, instructed by CW Energy LLP

DECISION

Introduction

1. This is an appeal by HMRC against the decision of the FTT in *Perenco UK Limited v HMRC* [2021] UKFTT 254 (TC) (the **Decision**) in which the FTT allowed an appeal by Perenco against a decision of HMRC in relation to Perenco's liability to petroleum revenue tax (**PRT**) during the period 1 January to 31 December 2015. The FTT refused HMRC permission to appeal. Permission was then given by this Tribunal (Judge Jonathan Richards) on 22 November 2021.

2. The issue in dispute is whether expenditure incurred by Perenco during the relevant period was allowable expenditure in the computation of Perenco's assessable profit for PRT, as the FTT found, or fell to be disallowed on the basis of third-party contributions to the relevant costs. The amount of tax at stake is £523,847.75.

Background

3. On 1 November 2012 Perenco acquired from BP a package of assets which included a 100% interest in the Dimlington gas terminal (the **Terminal**), a 100% interest in related offshore facilities, platforms and pipelines (the **offshore system**), interests in various offshore oil fields in the southern North Sea, and the rights and obligations under a number of transportation and processing agreements (**TPAs**). The offshore system consists of three independent systems, which all connect into a single onshore system at the Terminal. Each of the three systems has a number of different offshore fields tied into it.

4. This appeal is concerned only with one of those offshore systems: the West Sole offshore system, which has 22 oil fields tied into it. Although technically referred to as oil fields, they are in fact all gas fields. Perenco has a 100% interest in 10 of these 22 oil fields, including the West Sole field (after which the West Sole offshore system is named), and interests of between 50% and 71.3% in a further five fields. Perenco has no interests in the remaining seven fields, which include the Babbage, Seven Seas and Johnston fields.

5. Raw gas from all the oil fields tied into the offshore system undergoes initial processing in the offshore system before being transported by sub-sea pipelines to the Terminal. The gas is then further processed before being delivered via the national transmission system to various third-party gas distribution companies.

6. The TPAs set out the contractual arrangement between Perenco and the third-party owners (or part-owners) of the 12 fields in which Perenco has less than a 100% interest, for the processing, transporting and metering of the gas from the fields through the offshore system and the Terminal. The TPAs were all already in place when Perenco acquired the package of assets in 2012, and Perenco became a party to these contracts as successor to BP.

7. As a result of new Regulations made in 2009 and 2011 (The Ozone–Depleting Substances (Qualifications) Regulations 2009, SI 2009/2016, and the Environmental Protection (Controls on Ozone-Depleting Substances) Regulations 2011, SI 2011/1543), Perenco was required to replace the cooling plant at the Terminal with a non-Freon cooling plant. It began incurring costs on this project in the planning stage on handover from BP in November 2012, and the works were completed in late 2017.

8. During 2013 Perenco reviewed all of its TPAs, and determined that three of them (the TPAs relating to the Babbage, Seven Seas and Johnston fields) enabled it to require the field owners to make additional payments in relation to the Freon replacement works, on a pro rata basis according to the proportion of the throughput at the Terminal that was attributable to each of those oil fields. Notices of the additional contributions due were given to the operators of the three fields on 20 December 2013, 30 May 2018 and 11 March 2015 respectively. The field operators duly paid the additional sums, which amounted to a total of £6,286,146 for the year ended 31 December 2015: £1,329,583 from Johnston, and £4,956,564 from Babbage and Seven Seas. No additional payments were claimed by Perenco under any of the other TPAs.

9. The additional amounts received by Perenco under the three TPAs in relation to the relevant period (the **additional amounts**) amounted to only a portion of the total expenditure incurred by it on the Freon replacement works in the period. Over the period from November 2012 to July 2017 Perenco incurred £66,069,895 on Freon replacement costs, of which £25,434,272 was incurred in the year ending 31 December 2015, the period for which the expenditure to which this appeal relates arose. Perenco claimed £12,771,089 as allowable PRT expenditure in the West Sole field, having disallowed £2,478,282 (representing 50% of the additional amounts received from Babbage and Seven Seas) pursuant to the provisions of the Oil Taxation Act 1983 (**OTA 1983**) and related HMRC practice described further below. The remaining £10,184,901 expenditure was allocated to other fields in which Perenco had an interest.

10. In decision notices dated 20 May 2016, HMRC disallowed part of Perenco's expenditure claim for the West Sole field. Agreement was subsequently reached between the parties on certain matters, but a dispute remained as to the treatment of the additional amounts received from Babbage, Seven Seas and Johnston. HMRC's view was (and remains) that those amounts are to be treated as a "subsidy" under paragraph 8 of Schedule 3 to the Oil Taxation Act 1975 (**OTA 1975**), such that the allowable expenditure for the relevant period should be reduced by an amount equal to those amounts, i.e. £6,286,146. Perenco's position was (and remains) that the additional amounts do not fall under that provision.

11. The FTT found in Perenco's favour, and HMRC now appeals that decision.

The relevant PRT legislation

12. PRT was introduced by the OTA 1975. Section 1(2) of that Act provides that a participator in an oil field is to be charged PRT on the assessable profit accruing to them in any chargeable period from that field, as reduced under s. 7 by "any allowable losses." It is common ground that Perenco is a participator in the West Sole oil field.

13. Section 2 OTA 1975 provides that the assessable profit (or allowable loss) is the difference between positive amounts for the chargeable period in question (defined to include gross profit) and the negative amounts (defined to include amounts allowable in respect of expenditure) for that chargeable period. Expenditure (whether or not of a capital nature) other than on a long-term asset is allowable if it is incurred by a person at or before the time when that person is a participator in the field for one or more of the purposes specified in s. 3 OTA 1975. Expenditure (whether or not of a capital nature) on acquiring, creating or enhancing the value of a long-term asset (i.e. one with a useful life beyond the end of the claim period in which it is first used) used in connection with a field is allowable under s. 3 OTA 1983. It is common ground that, but for paragraph 8, Perenco's expenditure on the Freon replacement works would fall within s. 3 OTA 1983 and be allowable, subject to any apportionment under s. 3A OTA 1983.

14. In 1983, as North Sea infrastructure became more complex, PRT was extended to cover profits made from providing facilities to other field owners. To that end, s. 6(1) OTA 1983 provides that in computing the assessable profit in any chargeable period ending after 30 June 1982, the positive amounts for the purposes of section 2 OTA 1975 include any tariff receipts of a participator. Section 6(2) OTA 1983 (**section 6(2)**) defines "tariff receipts" as follows:

> "(2) Subject to the provisions of this section and section 6A below, for the purposes of this Act the tariff receipts of a participator in an oil field which are attributable to that field for any chargeable period are the aggregate of the amount or value of any consideration (whether in the nature of income or capital) received or receivable by him in that period (and after 30th June 1982) in respect of—
>
> (a) the use of a qualifying asset; or
>
> (b) the provision of services or other business facilities of whatever kind in connection with the use, otherwise than by the participator himself, of a qualifying asset."

15. It is common ground that the Terminal was a "qualifying asset" in relation to the West Sole field throughout the relevant period.

16. Section 6A OTA 1983 (**section 6A**) introduces the concept of a "tax exempt tariffing receipt" (**TETR**). Its first two sub-sections provide:

> "(1) An amount which is a tax-exempt tariffing receipt (see subsection (2) below) does not constitute a tariff receipt for the purposes of the Oil Taxation Acts.
>
> (2) An amount is a 'tax-exempt tariffing receipt' for the purposes of the Oil Taxation Acts if—
>
> (a) it would, apart from this section, be a tariff receipt of a participator in an oil field,
>
> (b) it is received or receivable by the participator in a chargeable period ending on or after 30th June 2004 under a contract entered into on or after 9th April 2003, and
>
> (c) it is in respect of tax-exempt business ..."

17. Under ss. 6A(3) and (4) an amount is regarded as relating to "tax exempt business" if it is received by a field participator in respect of the use of a qualifying asset in relation to a new field or oil won from such a field. The Babbage and Seven Seas fields are new fields within the terms of s. 6A. Any payments receivable by Perenco from those field owners, which would otherwise be "tariff receipts", are therefore TETRs under s. 6A(2).

18. The effect of classification of a payment as a TETR is that it is not a taxable receipt. The flipside of that, however, is that expenditure such as Perenco's expenditure on the Freon replacement works, which would otherwise be allowed under s. 3 OTA 1983, is *not* allowable in so far as it is attributable to earning TETRs.

19. Where expenditure is attributable to both tariff receipts and TETRs it is therefore necessary to determine what part of that expenditure falls to be disallowed. The legislative starting point is that the amount of expenditure disallowed is "such part of the expenditure as is just and reasonable to

apportion to" earning TETRs: s. 3A OTA 1983. For practical purposes, however, HMRC has adopted a "modified approach" set out in HMRC's Oil Taxation Manual at 15920–15925. Under the "modified approach", where expenditure is incurred in relation to a qualifying asset which generates a mixture of tariff receipts and TETRs, HMRC does not seek to apportion the expenditure between the two categories of receipts, but simply disallows expenditure equal to 50% of the TETRs received, subject to certain exceptions that do not apply on the facts of this case.

20. The dispute arises, however, because of the provisions of paragraph 8 Schedule 3 OTA 1975 (**paragraph 8**):

> "(1) Expenditure shall not be regarded for any of the purposes of this Part of this Act as having been incurred by any person in so far as it has been or is to be met directly or indirectly by the Crown or by any government or public or local authority, whether in the United Kingdom or elsewhere, or by any person other than the first-mentioned person.
>
> (1A) But sub-paragraph (1) above does not apply to any expenditure for which the relevant participator is liable that has been or is to be met directly or indirectly out of a payment made by the guarantor under an abandonment guarantee.
>
> …
>
> (2) In considering, for the purposes of this paragraph, how far any expenditure has been or is to be met directly or indirectly by the Crown or by any authority or person other than the person incurring the expenditure, there shall be left out of account any insurance or compensation payable in respect of the loss or destruction of any asset."

21. The effect of paragraph 8 is that where expenditure falls within that provision it cannot be claimed as allowable PRT expenditure under s. 3 OTA 1983. Paragraph 8 applies to expenditure otherwise allowable under s. 3 OTA 1983 because of s. 15(5) OTA 1983 (which provides that OTA 1983 is to be construed as one with Part 1 of OTA 1975) and s. 1(5) OTA 1975 (which provides that Part 1 OTA 1975 has effect subject to the provisions of Schedule 3 to that Act).

The parties' calculations of Perenco's allowable expenditure in this case

22. It is common ground that for PRT purposes any tariff receipts received by Perenco in relation to the Terminal are taxable in respect of the West Sole field, and that any expenditure attributable to those tariff receipts should therefore be attributed to the West Sole field. It is similarly common ground that any TETRs received by Perenco in relation to the Terminal are treated as attributable to the West Sole field for the purposes of allocating expenditure incurred in respect of the Terminal.

23. On that basis, in its PRT calculation for the West Sole field, Perenco took into account the additional amounts received from Johnston, which it regarded as tariff receipts. In calculating its expenditure on the Freon replacement works (so far as attributable to the West Sole field), it applied HMRC's "modified approach" and disallowed an amount equal to 50% of the additional amounts receivable from the Babbage and Seven Seas field groups (i.e. an amount of £2,478,282), which it regarded as TETRs. Perenco's position is that it should be entitled to deduct the remaining expenditure incurred in the relevant period on the Freon replacement works that was attributed to the West Sole field, i.e. £12,771,089.

24. HMRC's position is that the additional amounts received from Babbage, Seven Seas and Johnston fall within the terms of paragraph 8, which therefore result in a disallowance of Perenco's expenditure

in the relevant period equal to the total of those payments (£6,286,146). Although HMRC says that the legislation does not explicitly provide that a payment falling within paragraph 8 cannot be regarded as a tariff receipt/TETR, its position is that if a payment is regarded as falling within paragraph 8 then it will not treat that payment as also being a tariff receipt or TETR.

Provisions of the Babbage TPA

25. The terms under which the additional amounts were payable to Perenco under the Babbage, Seven Seas and Johnston TPAs are important in answering the questions raised in this appeal. For these purposes, the parties agreed that the Babbage TPA dated 25 February 2008 should be treated as representative of all three TPAs. Accordingly, while the terms of the Babbage TPA were referred to in detail at the hearings before the FTT and before us, we and the FTT were not provided with copies of the Seven Seas or Johnston TPAs, or any of the other TPAs to which Perenco is a party.

26. The Babbage TPA was concluded between BP as operator and owner of the "System", and three companies having ownership interests in the Babbage field. Those companies are referred to in the agreement as the Babbage Group; for convenience we will refer to them simply as Babbage. The "System" is defined in clause 1.1 of the agreement to mean the Terminal and the West Sole system. Perenco (as successor to BP) is now both the "System Owner" and the "System Operator". We will therefore refer to the System Owner and the System Operator, in the relevant clauses of the agreement, simply as Perenco.

27. The Decision sets out the provisions of the Babbage TPA in detail at §§37–56; they are not repeated here. For the purposes of this appeal, the key provisions are clauses 2.1, 7, 15 and 16.

28. Clause 2.1 provides that, in consideration of and subject to payment of the gas tariff or the operating tariff (see below), Perenco will provide a wide range of services (**System Services**) relating to gas from the Babbage field in accordance with the contract.

29. Clause 7 provides that, in consideration of the provision of the System Services, Babbage is to pay Perenco a tariff calculated in accordance with a formula set out in that clause and Schedule 2, to be adjusted annually (the **gas tariff**). The tariff produced by the formula is an amount per cubic metre of gas processed by the Terminal that is attributable to Babbage. Clause 16.3 states that this tariff is deemed to include the cost of routine planned maintenance. Clause 7.9 provides that in addition to the gas tariff calculated under clause 7, Babbage is to pay Perenco a pro rata share of the costs of purchase of carbon emissions allowances under clause 2.10, and the costs of treatment and disposal of excess water resulting from the processing and redelivery of the Babbage gas, as specified in Schedule 1 to the TPA.

30. Clause 15 sets out a mechanism for Perenco to elect for the basis of charge for any or all of the System Services to change from the gas tariff to an operating expenditure related tariff calculated in accordance with the detailed provisions of clause 15 (the **operating tariff**). Under that mechanism, if triggered, Babbage is required to pay a pro rata share of the operating costs of the System, calculated by dividing the throughput of Babbage gas in the relevant year by the aggregate throughput of all the oil fields using the Terminal during that year. The clause provides for monthly payments of a provisional operating tariff, with an annual adjustment once the actual figures for the operating costs and throughput of each user for the year are known. In the event that none of Perenco's own gas is transported within the West Sole System and the Terminal in the year in question, then an uplift of 15% is payable in addition to the operating tariff.

31. The operating costs chargeable under clause 15 are defined in clause 1.1 to mean the aggregate operating or capital expenditure which is (or which it is reasonably anticipated will be) incurred by Perenco in "operating, maintaining, repairing and/or replacing any relevant part of the Babbage Transportation System to the standard of a Reasonable and Prudent Operator".

32. During the relevant period for purposes of this appeal, services were being provided to Babbage on the basis of the clause 7 gas tariff, rather than the clause 15 operating tariff.

33. Under clause 16, where Perenco is required to modify or repair any part of the System as a result of any amendment to any requirement of any relevant legislation or regulations, and the modification or repair is necessary for the provision of the System Services, Perenco can claim those modification costs from Babbage. If the modification is required solely to transport Babbage gas, then Babbage is required to reimburse Perenco for all of the (reasonably incurred) costs of the modification. If the modification is required to transport gas from both Babbage and other fields using the system, Babbage is required to pay a pro rata share of the costs based on the proportion of the Babbage gas throughput compared to the total gas throughput in the System. Perenco is not entitled to seek recovery of modification costs under this clause unless the costs exceed £25,000 in any contract year. Perenco is required to give Babbage a written notice of its estimate of the modification costs as soon as reasonably practicable, and there is a mechanism for Babbage to dispute the estimate. In the event that Babbage does not agree to bear the costs of the modification within 75 days of receipt of a modification notice, both Perenco and Babbage have a right to terminate the agreement.

34. The additional amounts from Babbage were paid under the mechanism in clause 16.

The FTT Decision

35. The FTT found that:

> (1) It was common ground that payments to a participator of amounts that in the hands of the participator constitute tariff receipts/TETRs cannot be regarded as payments that meet directly or indirectly the participator's expenditures in generating those tariff receipts/ TETRs for purposes of paragraph 8 (Decision §70).
>
> (2) The additional amounts paid by Babbage under clause 16 were part of the overall consideration given by Babbage in return for the System Services provided by Perenco pursuant to the Babbage TPA. In other words the additional amounts were "part of the price of the overall bargain". On that basis, the additional amounts were TETRs, and paragraph 8 therefore did not apply to disallow an amount of expenditure on the Freon replacement works equivalent to those additional amounts (Decision §§92, 98).
>
> (3) It was therefore unnecessary to address in detail the other arguments of the parties, which focused primarily on the scope of application of paragraph 8 itself (Decision §99).

36. The FTT had heard evidence from Mr Andrew Sanders on behalf of Perenco. It considered (at §92) that its conclusion that clause 16 was "part of the price of the overall bargain" was consistent with Mr Sanders' evidence that the provisions of the Babbage TPA would not be considered unusual in a TPA agreed between parties operating in the market at arm's length (§§93–4). It also considered that clause 16 would only come into play where the gas tariff was calculated under clause 7; if the basis of charge was instead the operating tariff under clause 15, that would already include the costs covered by clause 16 (§§95–6). This was a potentially important point, because HMRC accepted that payments of the operating tariff under clause 15 would be TETRs (§88).

HMRC's grounds of appeal

37. HMRC's original grounds of appeal were significantly reformulated and reorganised in the skeleton argument and oral submissions of Ms Wilson KC, counsel for HMRC. Four grounds of appeal thus became five main criticisms in HMRC's skeleton argument, and were reformulated again in Ms Wilson's oral submissions. Ms Wilson's skeleton argument also raised a number of points which went beyond the issues raised in HMRC's grounds of appeal, and which Mr Brinsmead-Stockham KC, representing Perenco, objected to on that basis. Ms Wilson's response to that objection was not always entirely clear, but when pressed towards the end of the hearing she confirmed that she was not asking for permission to amend HMRC's grounds of appeal.

38. We will therefore confine ourselves to dealing with the issues raised in the original grounds of appeal, albeit as reformulated in the course of HMRC's skeleton argument and oral submissions, and leaving aside points that were no longer pursued by HMRC at the hearing. Doing the best we can to summarise HMRC's criticisms, they seem to us to consist of the following main points:

39. First, HMRC says that the FTT defined the main issue by focusing solely on the definition of TETRs under s. 6A, without regard to paragraph 8. Although (as we have noted above) HMRC agreed that if a payment falls under paragraph 8 resulting in the corresponding expenditure being disallowed, that payment should not be regarded as a tariff receipt/TETR, there was no consensus as to why that was the case, nor was there any agreement as to where the line should be drawn between payments that fall inside or outside paragraph 8. That being the case, HMRC's position is that the FTT was not entitled to ignore paragraph 8 and its impact on the definition of a TETR under s. 6A. Rather, both provisions should have been analysed fully.

40. Secondly, if paragraph 8 had been properly considered, HMRC says that a person's expenditure could be "met" by simple or complex arrangements of any kind, including by a contractual obligation. Paragraph 8 is not, in HMRC's submission, confined to voluntary payments such as subsidies made by state bodies or others.

41. Thirdly, HMRC says that the FTT misconstrued ss. 6(2) and 6A. In HMRC's submission, the correct approach to those sections is that a payment arising under clause 7 or clause 15 of the Babbage TPA should be regarded as a "tariff receipt" under s. 6(2) or a TETR under s. 6A, on the basis that it is "consideration" in its ordinary contractual sense for the System Services. By contrast, a payment that is made under clause 16 for the purposes of reimbursing modification costs is not "consideration" in the ordinary contractual sense in respect of the services enabled by the reimbursed works, for which a tariff is still charged. The fact that a clause 16 payment operates as a direct reimbursement of an exceptional expense (rather than as a right to vary the clause 7 gas tariff formula, or the clause 15 cost share formula) shows that the clause 16 payment is for something different to a tariff receipt.

42. Finally, HMRC objects that the FTT's finding that clause 16 only applied when the gas tariff was in operation was inconsistent with the Statement of Agreed Facts before the FTT. HMRC also initially contended that the FTT inaccurately described the evidence of Mr Sanders on this point. In considering HMRC's application for permission to appeal, the FTT reviewed the recording of the hearing and confirmed its understanding of Mr Sanders' evidence. HMRC did not then pursue this point before us.

43. In relation to those issues, Perenco's response is that the Decision was correct for the reasons given. Alternatively, if it is necessary to analyse paragraph 8 in more detail than the FTT did, Perenco says that this Tribunal should reach the same conclusion as the FTT, because paragraph 8 applies only to subsidies or payments by way of bounty. The additional amounts, as payments made under a

commercial contract to secure the continued provision of the services under the Babbage TPA, were (Perenco says) neither of these things.

Discussion

44. HMRC's central criticism of the Decision, running through the various formulations of its grounds of appeal, is that the FTT misunderstood the scope of ss. 6(2)/6A and paragraph 8, and the relationship between those provisions. That led the FTT wrongly to characterise the additional amounts as tariff receipts/TETRs falling under s. 6A rather than payments falling within paragraph 8.

45. We agree with Ms Wilson that in considering the scope and effect of paragraph 8 we cannot ignore sections 6(2) and 6A. As Lord Bingham observed in *R (Quintavalle) v Secretary of State for Health* [2003] UKHL 13, §8, "The court's task, within the permissible bounds of interpretation, is to give effect to Parliament's purpose. So, the controversial provisions should be read in the context of the statute as a whole, and the statute as a whole should be read in the historical context of the situation which led to its enactment." While there may not be complete agreement between HMRC and Perenco that a tariff receipt/TETR cannot as a matter of law also fall within paragraph 8, Ms Wilson accepted that it would be "punitive" if it did. For that reason, any analysis of whether the additional amounts fall within paragraph 8 must take place alongside consideration of whether those amounts are properly to be regarded as tariff receipts/TETRs.

46. We therefore address the grounds of appeal by considering the following four questions:

> (1) In isolation (ignoring paragraph 8) were the additional amounts tariff receipts under s. 6 or TETRs under s. 6A?
>
> (2) In isolation (ignoring ss. 6(2) and 6A) did the additional amounts fall within paragraph 8?
>
> (3) If the answer to both questions (1) and (2) is "yes", can a payment be both a tariff receipt/TETR and a payment falling under paragraph 8? If not, how is the apparent conflict to be resolved?
>
> (4) Having regard to the answers to questions (1), (2) and (3), did the FTT approach the issue before it in the wrong way?

In isolation (ignoring paragraph 8) were the additional amounts tariff receipts/TETRs?

47. HMRC says that ss. 6(2) (defining a tariff receipt) and 6A(2) (defining a TETR) are concerned with "consideration", which is not defined in OTA 1983 and so should have an interpretation which is most consistent with the common law. In HMRC's submission, the additional amounts paid under clause 16 were not consideration in its ordinary contractual sense for the services provided under the TPA, because the gas tariff continued to be charged under clause 7 for those services.

48. Perenco points out that the phrase used in s. 6(2) is consideration "in respect of". That phrase was considered in *Paterson v Chadwick* [1974] 1 WLR 890, where Boreham J (at 893C–H) cited with approval the following comment of Mann CJ in the decision of the Supreme Court of Victoria, Australia in *Trustees Executors & Agency Co Ltd v Reilly* [1941] VLR 110:

> "The words 'in respect of' are difficult of definition, but they have the widest possible meaning of any expression intended to convey some connection or relation between the two subject matters to which the order refers."

49. That, in Perenco's submission, indicates that s. 6(2) has a very wide ambit. In addition, looking at the policy underlying the provision, OTA 1983 sought to bring into charge to PRT amounts that were not previously within the charge to the tax. On that basis, one would expect the statute to cast the net widely (as it already does by drawing no distinction between income and capital).

50. We agree that the phrase "consideration … in respect of the use of a qualifying asset" should (absent any alternative definition in OTA 1983) be given an interpretation that is consistent with the common law understanding of consideration. The FTT correctly noted at §80 that a contractual payment may be consideration in respect of particular obligations even if it is not described as such in the contract. As Lewison J explained in *A1 Lofts v HMRC* [2009] EWHC 2694 (Ch), §40:

> "… the identification of the parties' obligations is a matter of contract. But once their obligations have been identified, the nature or classification of those obligations, and in particular whether they answer a particular statutory description, is not necessarily concluded by the contract. … The court is often called upon to decide whether a written contract falls within a particular legal description. In so doing the court will identify the rights and obligations of the parties as a matter of construction of the written agreement; but it will then go on to consider whether those obligations fall within the relevant legal description."

51. It follows that in order to identify whether a payment made by Babbage under the TPA is (or is part of) the consideration provided in respect of the relevant obligations, namely the System Services, it is necessary to look at the provisions of the TPA as a whole.

52. In that regard, the starting point is that, where the gas tariff under clause 7 is the basis of charge for the System Services, the core consideration for those services will be paid via that tariff. Under clause 16.3, that tariff includes the costs of routine planned maintenance, which Perenco is required to carry out to the standard of a reasonable and prudent operator.

53. As the FTT correctly observed, however, in a long-term contract it may be impossible to foresee all of the future eventualities that might impact on the costs of providing an ongoing service. Contracts may therefore include provisions which allocate risks and costs between the parties in the event of particular circumstances arising during the lifetime of the contract, and which may also provide the parties with a right to terminate the contract (Decision §90). Clause 16 is such a provision. The effect of clause 16 is that Perenco can claim a pro rata contribution towards its costs of modification of the System equipment that is necessitated by legislation or regulations. If Babbage does not agree to pay a contribution claimed under clause 16, both Perenco and Babbage are entitled to terminate the agreement.

54. Accordingly, what Babbage received for its payment of the additional amounts claimed by Perenco in the present case was the continuation of the System Services under the TPA. If it had not agreed to make those payments, Perenco could have terminated the TPA, and Babbage would then have ceased to be entitled to receive the System Services. The FTT was therefore correct to say (at §86) that the only way in which Babbage could maintain its ongoing contractual right to receive those services was to pay the additional amounts. In short, the payments enabled the continuation of Babbage's entitlement to receive the System Services. On their face, therefore, the additional amounts paid under clause 16 were part of the "consideration received or receivable … in respect of" the

provision of the System Services in connection with the use of the Terminal to process and deliver gas from the Babbage fields, within the meaning of s. 6(2).

55. Ms Wilson contended that a distinction should nevertheless be drawn between payments made under the clause 7 gas tariff, which she said are the usual payments for the System Services and which continue unaffected by any additional payments, and payments under clause 16, which uses the terminology of "reimbursement" and provides for a specific mechanism for payment consistent with that terminology, different to that of the clause 7 gas tariff.

56. We do not think that the existence of different payment mechanisms under clauses 7 and 16 changes the analysis. The Babbage TPA sets out a package of obligations, negotiated as a whole. The fact that different payment mechanisms are specified for different categories of payments by Babbage to Perenco does not alter the fact that both the clause 7 gas tariff and any payment under clause 16 are payments which entitle Babbage to continue to receive the System Services. Both categories of payments therefore represent consideration paid by Babbage in respect of the use of the Terminal for the Babbage gas.

57. It is also instructive to consider (as the FTT did at §95) what would have happened if, instead of paying the gas tariff under clause 7, Babbage had been charged on the basis of an operating tariff calculated in accordance with clause 15. In that case it is undoubtedly the case that the costs of the Freon replacement works would have fallen within the definition of operating or capital expenditure incurred in "operating, maintaining, repairing and/or replacing any relevant part of the Babbage Transportation System". As recorded above, HMRC accepts that payments by Babbage of the operating tariff under clause 15 would be TETRs (Decision §88). If clause 15 operating tariff payments by Babbage incorporating a pro rata share of the costs of the Freon replacement works would have been TETRs, there is no discernible reason why the same should not be the case for Babbage's payments to Perenco during the relevant period, which were made via the combination of the clause 7 gas tariff and the clause 16 reimbursement mechanism.

58. Ms Wilson said that this analysis turns on clause 16 being applicable only when the basis of charging is the clause 7 operating tariff. But she noted that a contribution had been demanded from Johnston on the basis of a clause 16-type reimbursement arrangement, despite the fact that the Statement of Agreed Facts records that Johnston had moved to payment under an operating tariff. On that basis, Ms Wilson contended that a clause 16 payment is not a payment of something that could otherwise fall under clause 15, but rather has a "different role to play in the TPA".

59. We disagree with this submission. Although the parties have proceeded on the basis that the Babbage TPA is representative of all three TPAs, the Statement of Agreed Facts indicates that the provisions of the three TPAs are not identical. In particular, while it appears that the Seven Seas TPA contained, in clause 17, a provision similar to clause 16 in the Babbage TPA, the Statement of Agreed Facts records that "Under the Johnston TPA a notice comparable to the Babbage and Seven Seas TPAs was not required to be given by the Appellant". Instead, it appears that Perenco simply notified Johnston that it had proceeded with the Freon replacement works and that the field owners were liable for a share of the costs. Accordingly, while Perenco was able to claim a contribution to the costs of the works from Johnston, it appears that the precise mechanism for doing so was different. The Johnston TPA is not, however, before us; we cannot therefore reach any conclusion as to the analysis of the relationship between clauses 15 and 16 by reference to the way that the Johnston TPA worked. Our determination must instead be reached on the basis of the Babbage TPA alone.

60. On that basis, while the Babbage TPA does not provide in terms that clause 16 does not apply where payments are made by Babbage under the clause 15 operating tariff (as Mr Brinsmead-

Stockham expressly accepted), the evidence of Mr Sanders for Perenco (as recorded at Decision §63) was that clause 16 only applies when the gas tariff is in operation. As noted above, HMRC's challenge to the accuracy of that was not pursued before us. In any event, even leaving aside that evidence, if (as we have found) the costs of the Freon replacement works would have fallen within the definition of the costs that are part of the operating tariff under clause 15, then it is inconceivable that the Babbage TPA could be construed in a way that would allow Perenco to recover these costs a second time under clause 16.

61. In agreement with the FTT, therefore (Decision §96), we consider that the proper construction of the Babbage TPA is that clause 16 operates only when the gas tariff under clause 7 is being charged. The function of clause 16 is to provide a mechanism for obtaining a pro rata contribution to the costs of modifications to the System required by changes in relevant legislation or regulations, in circumstances where such costs are not recoverable under the clause 7 gas tariff formula. The fact that the same contributions would, if paid under a clause 15 operating tariff, be regarded by HMRC as TETRs strongly supports the conclusion that clause 16 payments should also be regarded as TETRs or (where applicable) tariff receipts.

62. The FTT's construction of the obligations under the TPA, and the legal consequences of those obligations, was therefore in our judgment entirely correct. Our answer to the first question we posed ourselves is that (looked at in isolation, ignoring paragraph 8) the payments of the additional amounts by Babbage, Seven Seas and Johnston were tariff receipts/TETRs within the meaning of ss. 6(2) and 6A. The FTT did not, therefore, misconstrue ss. 6(2) and 6A; nor was its conclusion inconsistent with the Statement of Agreed Facts.

In isolation (ignoring ss. 6(2)/6A) did the additional amounts fall within paragraph 8?

63. We have set out paragraph 8 at §20 above.

64. In HMRC's submission, paragraph 8(1) is drafted in broad terms to reflect the underlying policy of the PRT legislation. HMRC says that the general PRT rules are broadly framed to allow a deduction for any expenditure (capital or revenue) incurred by a participator for the purposes of listed activities in or connected with oil fields. That generous treatment is, however, subject to paragraph 8 which ensures that where an item of expenditure is or will be reimbursed or otherwise "met" by someone else, that item of expenditure should be disregarded in computing liability to PRT. The underlying policy is that the person who in fact meets the expenditure should claim any deduction.

65. HMRC's case is that an item of expenditure incurred by a person, A, is "met" by another person, B, if B makes the payment or reimburses A for the expenditure, or because B contributes to the amount being paid by A, or otherwise puts funds in A's hands to enable A to meet the expense. The fact that paragraph 8(1) includes any payments made "directly or indirectly" anticipates that a person's expenditure can be "met" by arrangements of any kind and irrespective of timing. There is no prescribed method of payment and no prescribed method of enforcement. Paragraph 8 is not, HMRC says, limited to subsidies or voluntary payments by public bodies. The tailpiece to paragraph 8(1) extends the scope of the provision to payments made by "any person other than the first-mentioned person". This confirms that it is the nature of the payment made that matters, and not the status of the paying party or its character as voluntary or otherwise. The references in paragraph 8 to insurance payments and payments under an abandonment guarantee confirm that the provision must extend to payments made pursuant to pre-existing rights including contractual rights negotiated on a commercial basis.

66. Perenco argues that paragraph 8 operates to disallow expenditure that has been met directly or indirectly by way of a payment amounting to a subsidy. The heading of paragraph 8 reads "Certain subsidised expenditure to be disregarded". The heading in the predecessor capital allowances legislation is "Subsidies etc". The drafting of paragraph 8(1) also focuses on "expenditure…met" by "the Crown or by any government or public or local authority, whether in the United Kingdom or elsewhere". Construed purposively, this part of the provision should be read as referring to expenditure met by subsidies from the various public entities identified. The tailpiece to paragraph 8(1), "or by any person other than the first-mentioned person", should then be construed in a similar way, due to its association with the earlier part of paragraph 8(1).

67. While a heading in a statute may assist an understanding as to the mischief which the provision aims to address, we should be wary of reading too much into a heading: see the comments of Lord Hodge in *Project Blue Ltd v HMRC* [2018] UKSC 30, §42. We therefore agree with Ms Wilson that it is going too far to use the heading of paragraph 8, on its own, to justify an interpretation of "met" as meaning met by way of a subsidy. Nevertheless, there clearly must be some limit to the meaning of "met directly or indirectly by … any person other than the first-mentioned person". Generally, businesses finance their expenditure from the proceeds of their sales, as the FTT noted at Decision §69. It might therefore be argued that any customers, when paying for goods or services supplied by a business, are thereby indirectly meeting the expenditure of that business. Ms Wilson and Mr Brinsmead-Stockham both agreed that such a reading would be plainly incorrect, since it would mean that no expenditure used to generate tariff receipts or TETRs would ever be allowable.

68. Ms Wilson suggested that the answer lies in looking at what the payment is intended to effect in the hands of the recipient. In other words, a payment from an ordinary business customer is not intended to meet (directly or indirectly) a particular item of expenditure. The difficulty with that analysis is that many payments, for example in a cost-based or cost-plus pricing model (such as the clause 15 operating tariff in the Babbage TPA, payments under which HMRC accepts are not within paragraph 8), are intended, indeed are calculated, to reflect the specific costs of the recipient business.

69. *Stokes v Costain Property Investments Ltd* [1983] STC 405, cited by both parties, is the only case which comes close to helping to resolve this issue. The main issue there was whether plant and machinery installed in buildings on development sites, which had become the landlord's fixtures, could be said to "belong" to the taxpayer tenant, Costain, so as to qualify for first-year and writing-down allowances. Harman J decided that point against Costain; his decision was upheld on appeal ([1984] 1 WLR 763); and that decision was sufficient to dispose of Costain's claim in the proceedings. Having decided that issue, however, the judge went on to express a view on a further point regarding the scope of s. 84 of the Capital Allowances Act 1968, which was drafted in identical terms to paragraph 8. The specific question was whether a financing arrangement under which a bank had paid development costs by way of a loan to Costain meant that the bank had "met" Costain's expenditure for the purposes of s. 84. The complicating factor was that under the terms of the loan, Costain undertook to procure the grant of the headlease for the development to the bank, and it was agreed that if Costain satisfactorily completed the development, the debt to the bank would be discharged.

70. Against that background, Harman J commented at pp 413–414:

> "It seems to me that the truth of this matter was that, although the financing arrangements were somewhat odd, there was a genuine incurring of the expenditure by the taxpayer, who was at risk of having to repay the loans, the advances, made from time to time by Fleming by payment of the expenses, and that had any event occurred which prevented the taxpayer from procuring the grant to Fleming, eventually, of the headlease, plainly and beyond any question the taxpayer would

> have been liable to repay Fleming all the moneys advanced. In those circumstances it seems to me impossible to say that the moneys advanced by Fleming were in any genuine sense of the words being paid for the work done. Those payments, at the time they were made, were undoubtedly, in my judgment, loans. The loan was discharged by the procuring of the grant of the headlease. In no proper sense did Fleming 'meet' the taxpayer's expenditures. In my judgment the taxpayer's argument is right.
>
> That seems to me to accord with the policy, so far as I can perceive it, of s. 84. The section's reference to meeting the expenditure of another is one which is plainly primarily directed to cases of government grants or local authority contributions and such matters. It includes the reference to expenditure being met 'by any person other than' the taxpayer, but that is a tailpiece thrown in to catch any other such meeting of expenditure. The concept as it seems to me of that whole subsection is of the provision of money to meet expenditure by way of, in effect, bounty. 'Bounty' may be an inappropriate way to describe the grants made by a government department, remembering that the government have no money save what they take from taxpayers and then give back to other taxpayers. Nonetheless, it seems to me that a transaction whereby a financier lends money to meet a taxpayer's bills and as a result a valuable asset is transferred from the taxpayer to the financier is not appropriately described as the financier 'meeting' the expenditure of the taxpayer. He has bought an asset, paid for an asset, or whatever other phrase of the English language one may care to use, but he has not, in my judgment, met the expenditure of the taxpayer in any proper use of that term in the context in which it appears."

71. Mr Brinsmead-Stockham said that paragraph 8 should be interpreted in essentially the same way.

72. We note that the above comments were *obiter*, and that Harman J himself expressed some reservations with the term "bounty". We would not, ourselves, use that term to describe the scope of paragraph 8: "bounty" is a word which, in a tax context, is more often associated with settlements and similar personal arrangements far removed from the world of commerce. We also note that paragraph 8 expressly excludes payments made under an insurance policy or an abandonment guarantee (and s. 84 included a similar provision in relation to insurance payments). Whatever else, those provisions suggest that the draftsman did not regard it as obvious that payments under an insurance contract could never be regarded as payments that met expenditure. We therefore agree with Ms Wilson that a payment cannot fall outside paragraph 8 simply because it is made under a commercial contract; rather, it is necessary to look at the nature or character of the payment.

73. Nevertheless, the heading of paragraph 8 taken together with the emphasis in paragraph 8(1) on payments by state or public entities indicates that – as Harman J found in relation to s. 84 – paragraph 8 is directed to payments by way of, or akin to, government or public authority grants or subsidies. We agree with Mr Brinsmead-Stockham that the words "or by any person other than the first-mentioned person" at the end of paragraph 8(1) should be construed consistently with the preceding examples, all of which refer to state or public bodies. If paragraph 8 had been intended to refer to any arrangement, of whatever nature, the effect of which is that funds are provided by anyone other than the claiming taxpayer which help the taxpayer to meet a particular cost, then it could have been drafted to say, simply, "in so far as it has been or is to be met directly or indirectly by any person other than the first-mentioned person". The fact that the provision is not drafted in those terms, but specifically starts by referring to payments by state or public bodies, therefore provides guidance as to the type of payment that is envisaged.

74. It follows that, in our judgment, paragraph 8 does not encompass a payment made in return for the provision of goods or services. The essence of Harman J's analysis was that a financier who loaned money to meet a taxpayer's bills, as part of an arrangement under which it acquired a valuable

asset for full consideration, was not "meeting" the expenditure of the taxpayer on creating that asset. Likewise, we consider that, in principle, if A pays a sum of money to B in order to receive goods or services in return, on the basis of an arm's length commercial contract, A's payment is properly to be regarded as consideration for what A receives and not as a way of meeting B's expenditure, even if A's payment is calculated to reflect B's expenditure attributable to those goods or services (with or without the addition of a profit margin).

75. Our approach to this point is very similar to that of the FTT in *Quinn (London) Limited v HMRC* [2021] UKFTT 437 (TC). That case concerned a company's claim to enhanced research and development allowances under Part 13 of the Corporation Tax Act 2009. HMRC argued that the company's expenditure was subsidised expenditure within s. 1138(1) of that Act, which provides that expenditure is subsidised if a notified state aid is obtained in respect of it or to the extent a grant or subsidy is obtained in respect of it or "to the extent that it is otherwise met directly or indirectly by a person other than the company". HMRC's argument was that the company carried out the R&D in the course of providing construction services to clients, for which it was entitled to payment which covered the claimed expenditure. The FTT regarded the relevant words in s. 1138(1) as operating as a form of sweep up provision to catch cases where expenditure is not "met" by notified state aid or some other grant or subsidy but is met "in a similar sense". In that context the FTT observed (at §47(3)) that a subsidy or grant "generally involves the provision of funds to a recipient who either provides nothing in return or provides something which, viewed from the perspective of parties acting on an arm's length basis, does not represent a commercial return commensurate with the value of the funds provided (albeit that, in some cases, such as where a public or government body provides the funds, that body may consider it is in the wider public interest to fund the relevant R&D)."

76. There will no doubt be other cases in which the boundaries of the principle will need to be explored. The above points are, however, sufficient for us to determine the present case. As we have already concluded, the additional amounts are paid under the Babbage TPA as the price of ensuring that Perenco continues to supply the services contracted for under the TPA. They are calculated by reference to Perenco's expenditure, but they are made in order to secure the continuing provision of the System Services. As such, we do not consider that the additional amounts "met" Perenco's expenditure on the Freon replacement works within the meaning of paragraph 8.

77. For these reasons, our answer to the second question we posed ourselves is that (looked at in isolation, ignoring ss. 6(2)/6A) the payments of the additional amounts did not fall within paragraph 8.

Can a payment be both a tariff receipt/TETR and a payment falling under paragraph 8?

78. We have already noted that there is not complete agreement between HMRC and Perenco as to whether a tariff receipt/TETR can as a matter of law also fall within paragraph 8. HMRC accepts that it would be punitive if it did, and Ms Wilson said that HMRC was not asking us to reach such a conclusion, although she did not accept that such a conclusion was impossible.

79. Because we have concluded that the additional amounts do not fall within paragraph 8, we do not need to go on to decide this point. Indeed, on the basis of the conclusions we have reached as to the scope of paragraph 8, it may well be that the issue does not in practice ever arise.

The FTT's approach to the issue before it

80. In our summary of HMRC's criticisms of the Decision set out above, HMRC's first objection (§39 above) was that the FTT defined the main issue solely by reference to section 6A, did not express

a view on paragraph 8 and so rejected HMRC's case that the additional amounts fell within paragraph 8. We treat that as (primarily) a criticism of the approach which the FTT adopted to reach its conclusions. Given our conclusion that the FTT did not make an error of law in finding that the additional payments were tariff receipts/TETRs and did not fall within paragraph 8, an exploration of the precise route which the FTT took to reach that conclusion is not a particularly useful debate.

81. In any event, we do not accept HMRC's criticism. It is clear that the FTT was well aware of the relevance of paragraph 8 to its analysis. Decision §17 described the issue in dispute between the parties as being whether the additional amounts "met directly or indirectly" Perenco's expenditure on the Freon replacement works within paragraph 8. There was then a discussion of the interpretation of paragraph 8 at Decision §§67–69, at the outset of the discussion of the FTT's findings, in which the FTT made similar comments to those we have made at §71 above.

82. It appears from Decision §§70–71 that the FTT then turned to consider the application of ss. 6(2)/6A because of what it understood to be agreement between HMRC and Perenco that a payment could not be both a tariff receipt/TETR and within paragraph 8. It does not follow from that, however, that the FTT ignored paragraph 8 or left it out of account: it had already addressed it at the start of its discussion, and expressed a view on the scope of that provision which then led to its analysis of ss. 6(2)/6A.

83. The one significant point on which we respectfully part company from the FTT is in the relevance of the judgment of Harman J in *Stokes v Costain Property Investments*. The FTT did not regard that decision as of significant assistance, given the conclusions that it had already reached and the fact that the comments of the judge were *obiter* remarks made in a different context. Our view is that the judge's comments are of some assistance, given that the judge was considering a provision drafted in identical terms to those of paragraph 8. That is not, however, the only basis (or even the decisive basis) for our conclusions. Rather, our conclusions turn primarily on a consideration of paragraph 8 on its own terms.

Disposition

84. In conclusion, for the reasons set out above:

> (1) The FTT did not err in law in concluding that the additional amounts did not fall within paragraph 8, and did fall within ss. 6(2)/6A as being tariff receipts/TETRs.
>
> (2) While we have articulated our reasoning slightly differently, there is no flaw in the FTT's approach to the analysis amounting to an error of law; and even if there was, given our conclusion above, it would not cause us to remake the FTT's decision.

85. This appeal is therefore dismissed.

MRS JUSTICE BACON
JUDGE MARK BALDWIN

RELEASE DATE: 20 July 2023