

Pre-Budget Report 2008: North Sea Fiscal Regime

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The Government has today published its proposals for further reform of the North Sea fiscal regime. This 66 page paper follows on from a previous consultation document published in December 2007 and builds on changes announced in the March 2008 Budget. This is the latest instalment in a long running discussion between the Government and industry, which first began with the 2005 Pre-Budget Report. The next steps are a period for industry to respond followed by a package of reforms to be introduced at Budget 2009.

1. Fiscal Incentives

The Government has outlined its views on the need for fiscal incentives to stimulate new activity in the North Sea. It has concluded that targeted incentives could lead to an increase in investment and production, but noted that such incentives would need to balance the needs of the taxpayer and industry.

In this respect, the Government has rejected both a broad reduction in the supplementary charge (SCT) and a capital expenditure uplift. Instead, the Government's favoured approach is the introduction of a 'Value Allowance' where a specified amount of upstream profits arising in fields that meet certain criteria would be taxed at a reduced rate.

The Government is seeking further input from industry regarding the best method to deliver the allowance and the types of fields on which the allowance should be targeted.

2. Chargeable gains

In order to reduce distortions created by the current fiscal regime and to facilitate trading assets, the Government is proposing two changes to the existing legislation:

- Where North Sea licences are swapped, no gain will arise to the extent that the value of the licence acquired equals the value of the licence disposed of; and
- Gains on the disposal of North Sea licence interests will be exempt from tax to the extent that disposal proceeds are reinvested in other North Sea licences. Under current rules, gains can only be deferred for a maximum of 10 years.

3. Change of use

The following summarises the Government's proposals in connection with the change of use of the North Sea from predominantly oil & gas exploration and production, to other uses such as carbon sequestration (CCS), renewable energy (offshore wind) and gas storage. These new activities will need to be defined in law (as this will be required for Petroleum Revenue Tax (PRT) purposes) and are referred to as being for a 'change of use' purpose below.

Decommissioning

The Government has proposed that relief for decommissioning costs for ex-ring fence assets which are used for a 'change of use' purpose will be given on the same basis as if the assets had remained within the ring fence. The comments in the consultation document imply that this would mean that relief would be given against ring fence corporation tax, SCT and PRT where appropriate. No detail has been given on the mechanics.

Proposed removal of a disposal for PRT purposes

The Government has proposed that there will be no disposal for PRT purposes where a PRT 'qualifying asset' ceases to be used in connection with a PRT

taxable field, and is then used for a 'change of use'. This is conditional on there being no disposal receipts within 2 years of the last use of the asset in connection with a PRT field. This measure will remove any PRT charge where a qualifying asset is no longer used for PRT purposes.

Taxation of income and expenditure

Proposals have been announced to ensure that PRT will not be charged in relation to assets used for a 'change of use' purpose.

Capital allowances

No changes have been proposed to levels of capital allowances on 'change of use' activities and deemed disposals arising on 'change of use'. However HM Revenue and Customs (HMRC) will endeavour to give advance clearance for the values used.

No changes have been proposed to the '5 year clawback' rule for ring fence first year allowances which requires that assets are used for this period in a ring trade to qualify for the allowances.

4. Petroleum Revenue Tax

The Government is proposing changes to the existing PRT legislation to ensure that companies can obtain PRT relief for decommissioning costs where licences are terminated before decommissioning is completed. This is particularly relevant due to the forthcoming expiry of the 1st round of licences in 2010.

In addition, the Government has sought to simplify the PRT regime by identifying a number of areas where legislation can be improved or removed altogether. These include - provisional expenditure allowance, commingling agreements, spreading of supplement, pre-PRT expenditure and tariff receipts allowance.

On the question of the future of PRT more generally, whilst the Government continues to believe that the abolition of PRT could have benefits for the North Sea and is willing to continue to engage with industry on this question, it has concluded that the abolition of PRT by way of a PRT 'buy out' should not be considered further at this time.

5. Other aspects

The Government is inviting comments from industry on the following areas:

- Impact of changes proposed by industry to remove inheritance tax charges on decommissioning trusts;
- Further discussion regarding the proposals to remove some or all of Coal Bed Methane from the North Sea fiscal regime.

Our view

The proposed changes are more far reaching than anticipated, with the proposed Value Allowance and chargeable gains changes potentially very welcome to maximise the value of the North Sea in a period of declining oil prices.