Your World First

C/M/S/ Law . Tax

Decommissioning and Tax

Philip Reid

Finding Petroleum | 23 June 2017

UK O&G Tax Regime: the basics

- Three O&G specific taxes in the UK:

  - Ring Fence Corporation Tax (**RFCT**)
  - Supplementary Charge (**SC**)
  - Petroleum Revenue Tax (**PRT**)

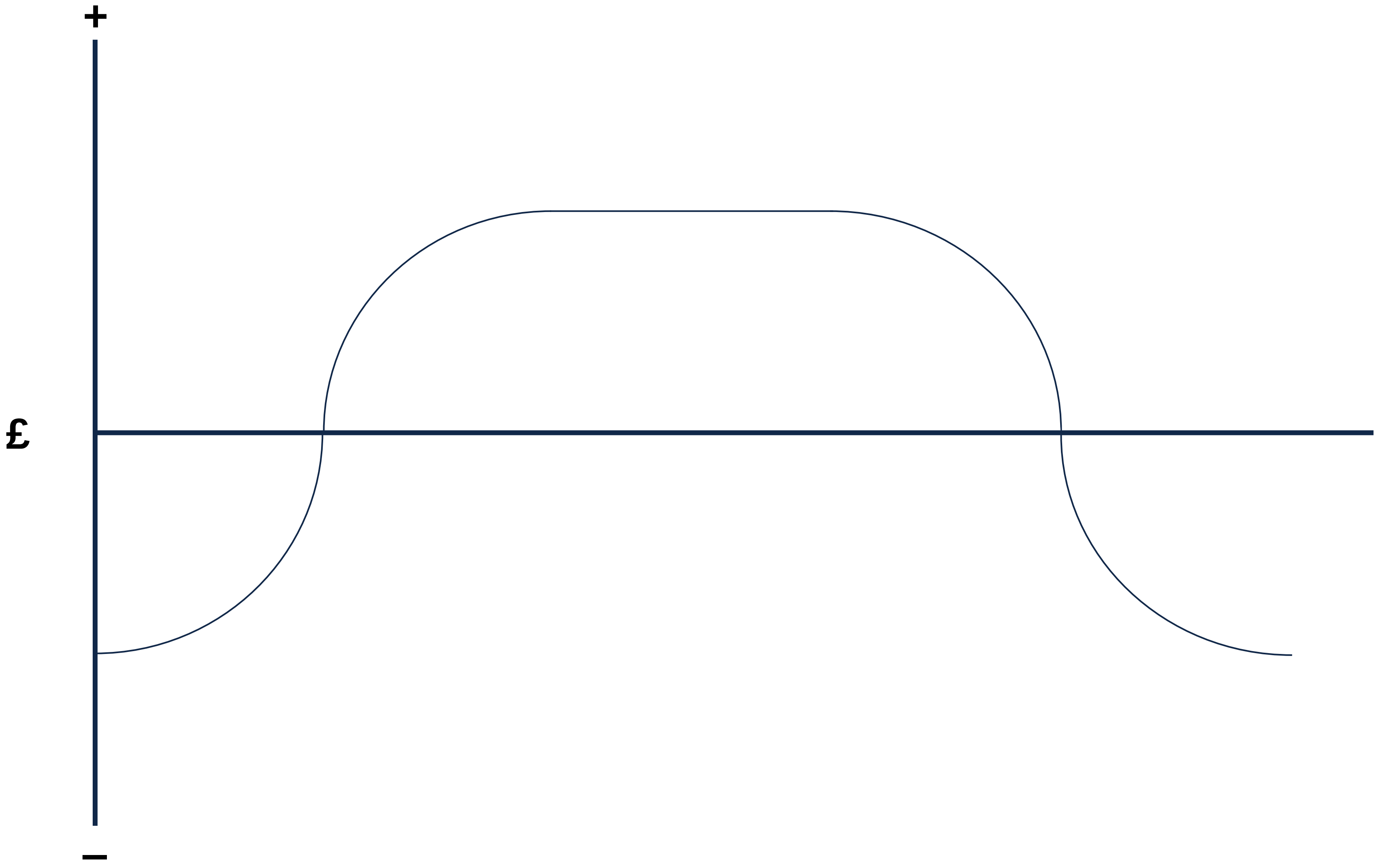
- RFCT and SC are charged on a company’s oil and gas activities in a similar manner to corporation tax, at a current combined rate of 40% (30% RFCT and 10% SC)

- PRT relates only to certain older fields, and was charged on a field-by-field basis based on a statutory calculation. ‘Effectively abolished’ since 1 January 2016, with a current rate of 0%.

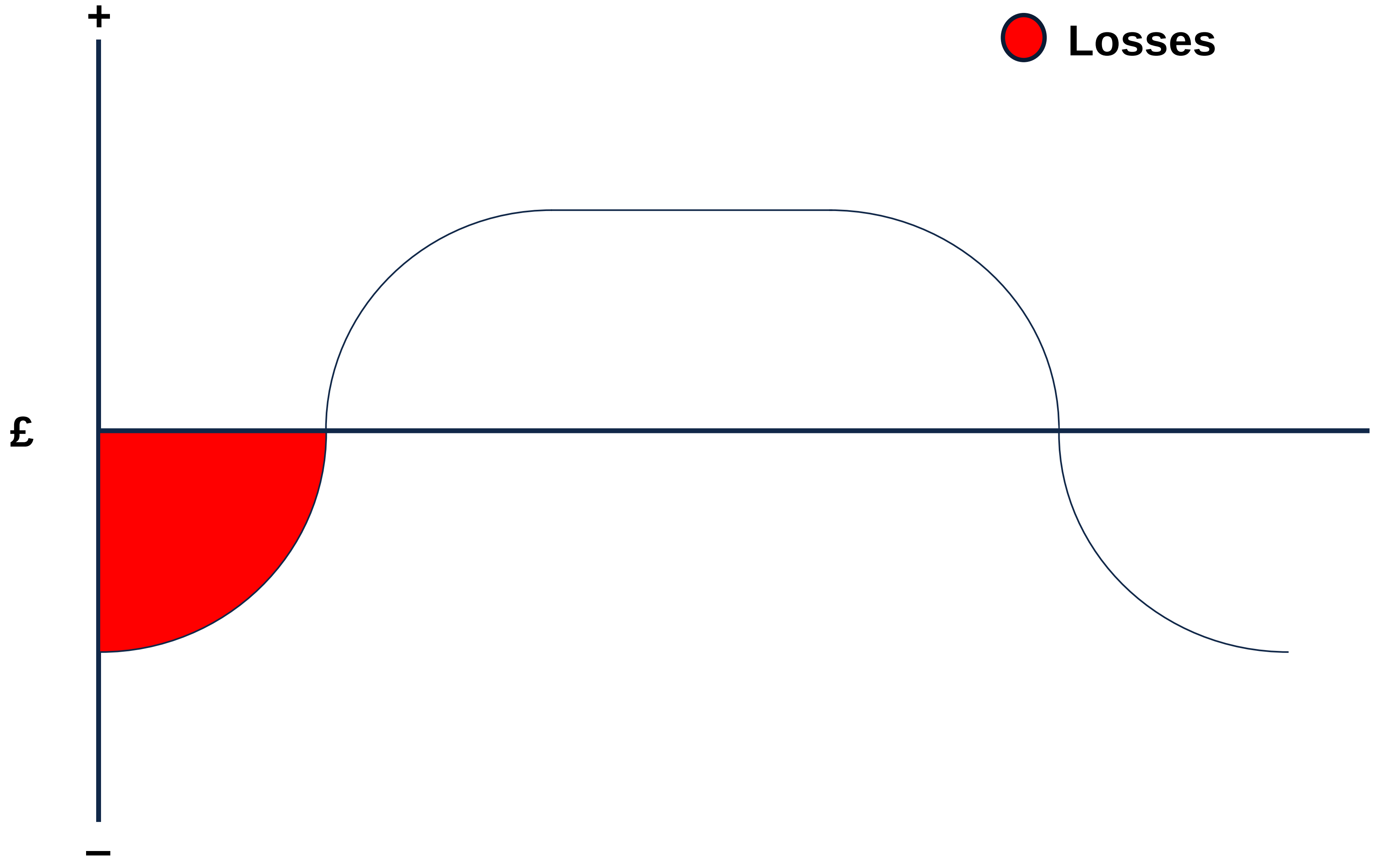
Decommissioning: why is tax so important?

- Tax losses can generally be used to reduce profits in a current period, carried forward into future period, or (to a limited extent) carried back against previous profits
- At the time of decommissioning there will be significant costs incurred, which is likely to generate significant losses. However, it's likely that there will be no current or future profits to set these against, meaning the effect of the relief would be lost under the normal rules
- Losses arising on decommissioning can therefore be carried back and set against:
  - **For RFCT/SC**: profits in accounting periods going back to 2002
  - **For PRT**: indefinitely, but only in relation to a particular field
- The reduction in any profits on which tax has been paid will trigger a repayment of that tax

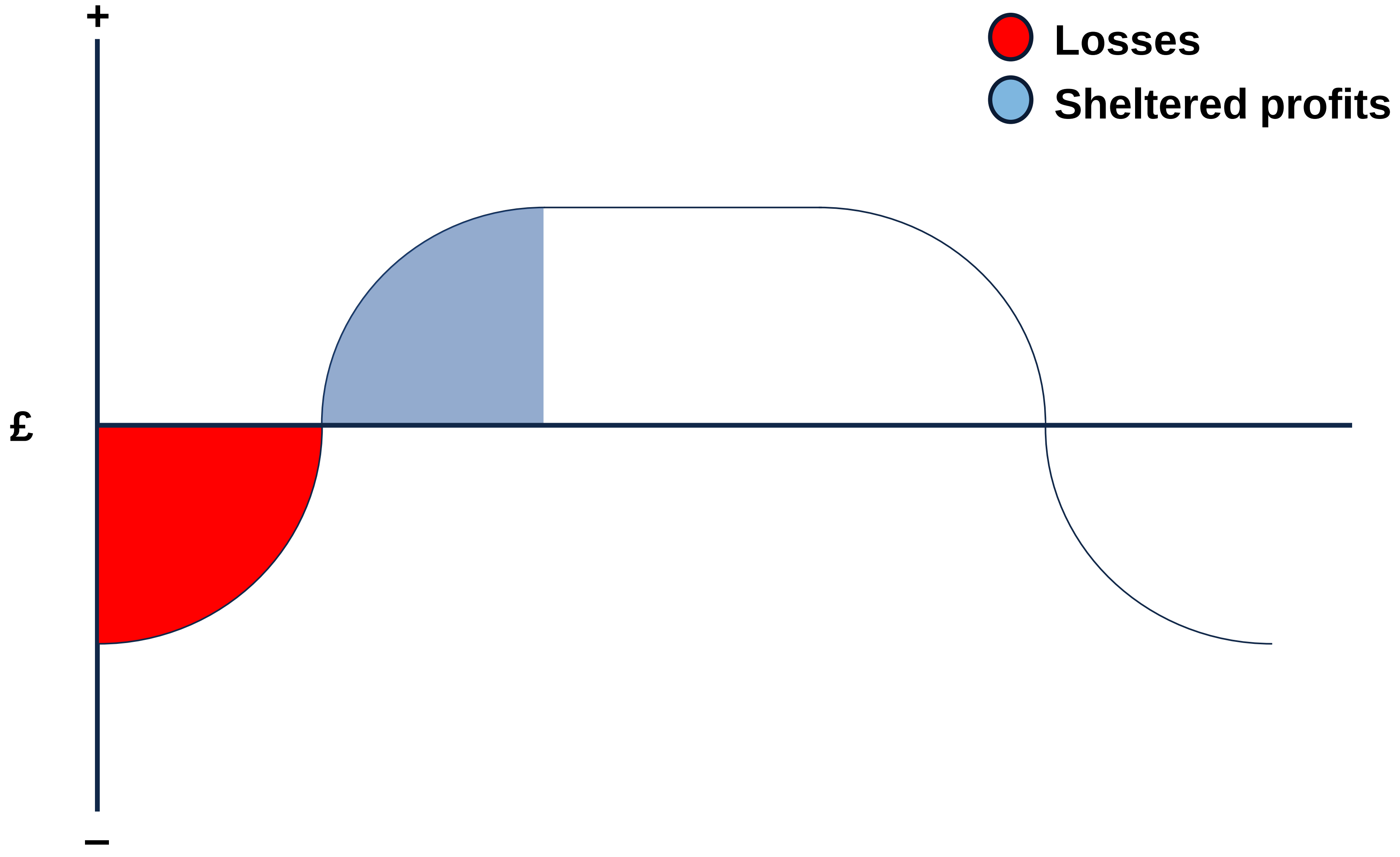
(Very) simplified economic life cycle of a field



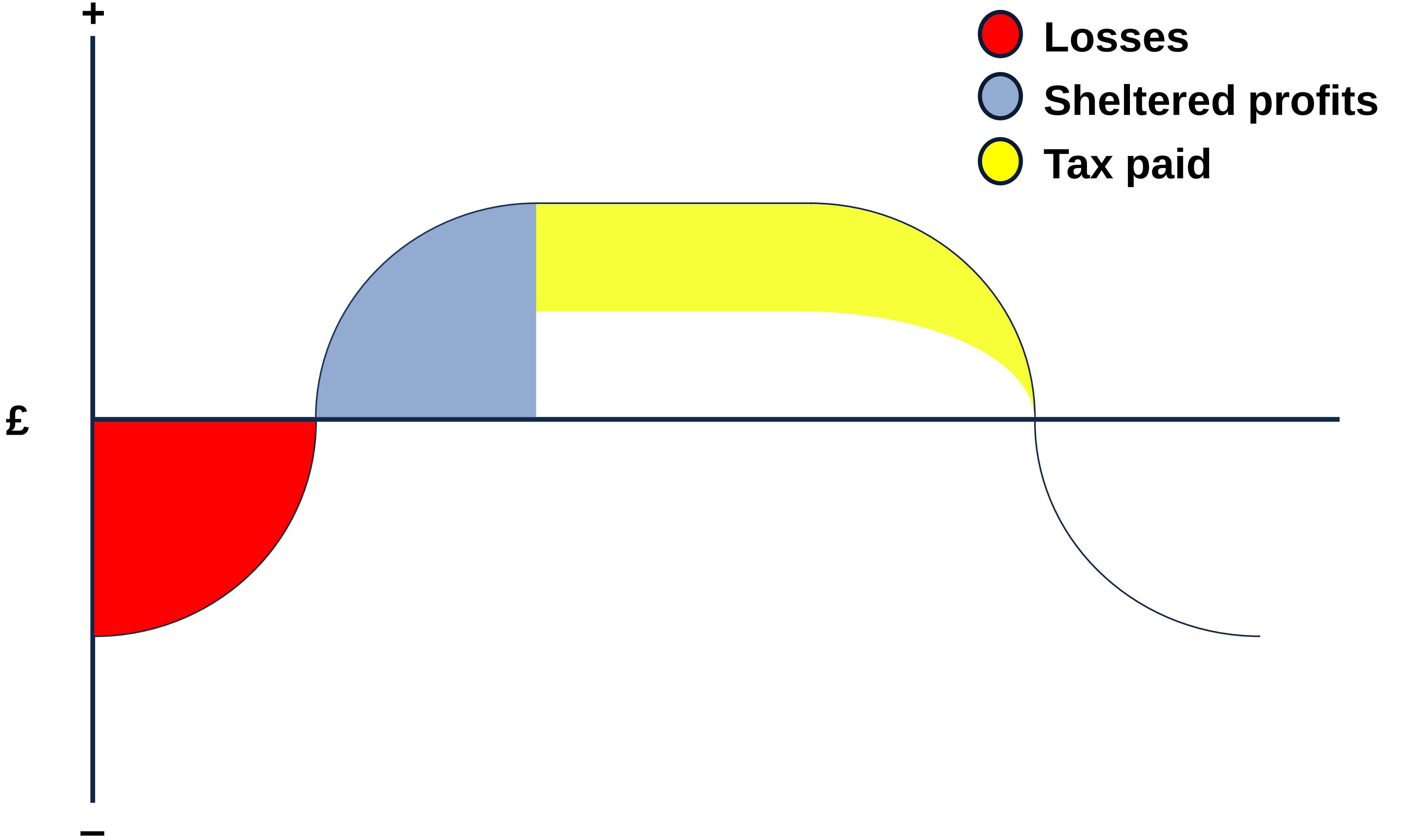
Development: high costs and no revenue, leading to losses



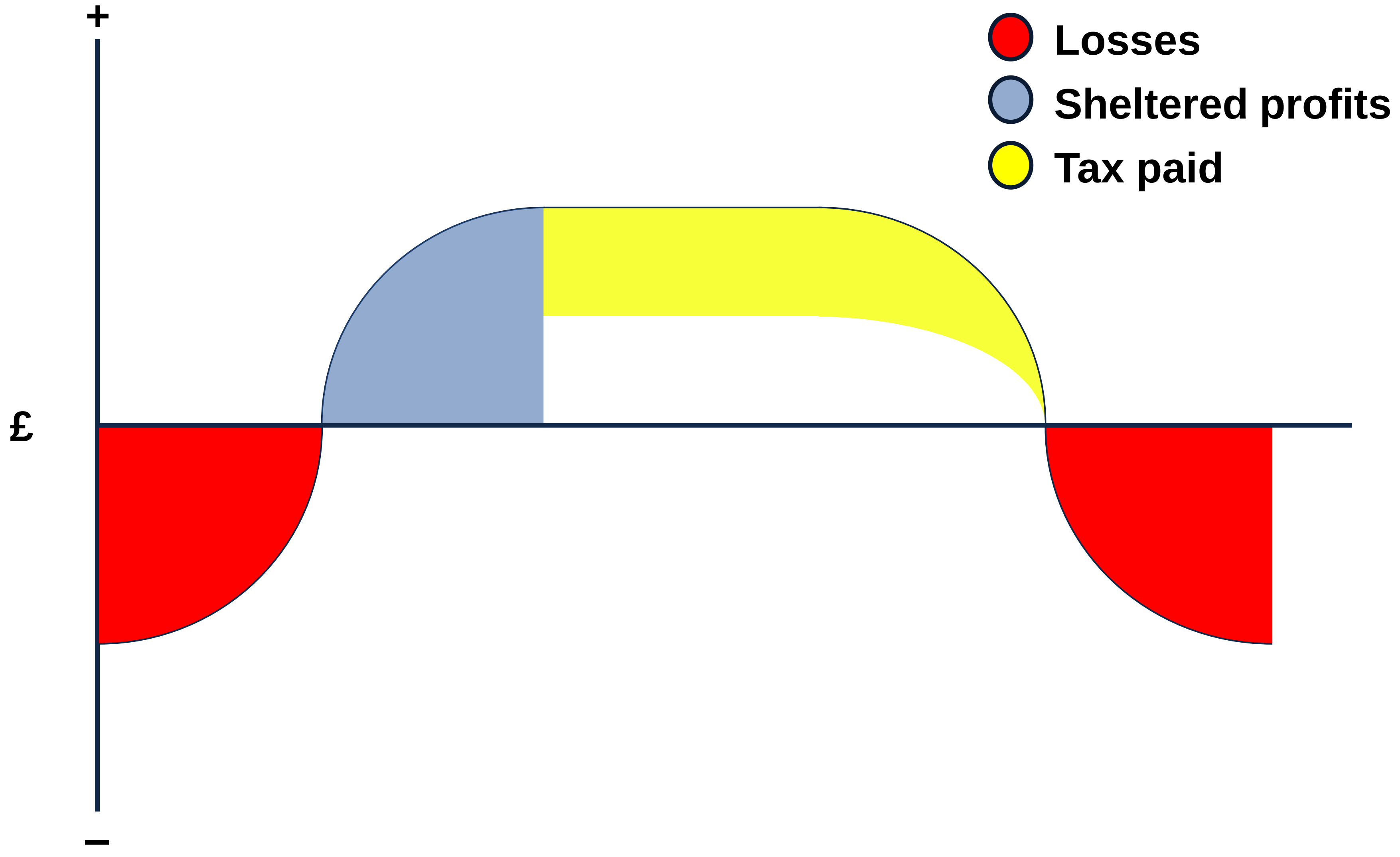
These losses can be carried forward to shelter early profits



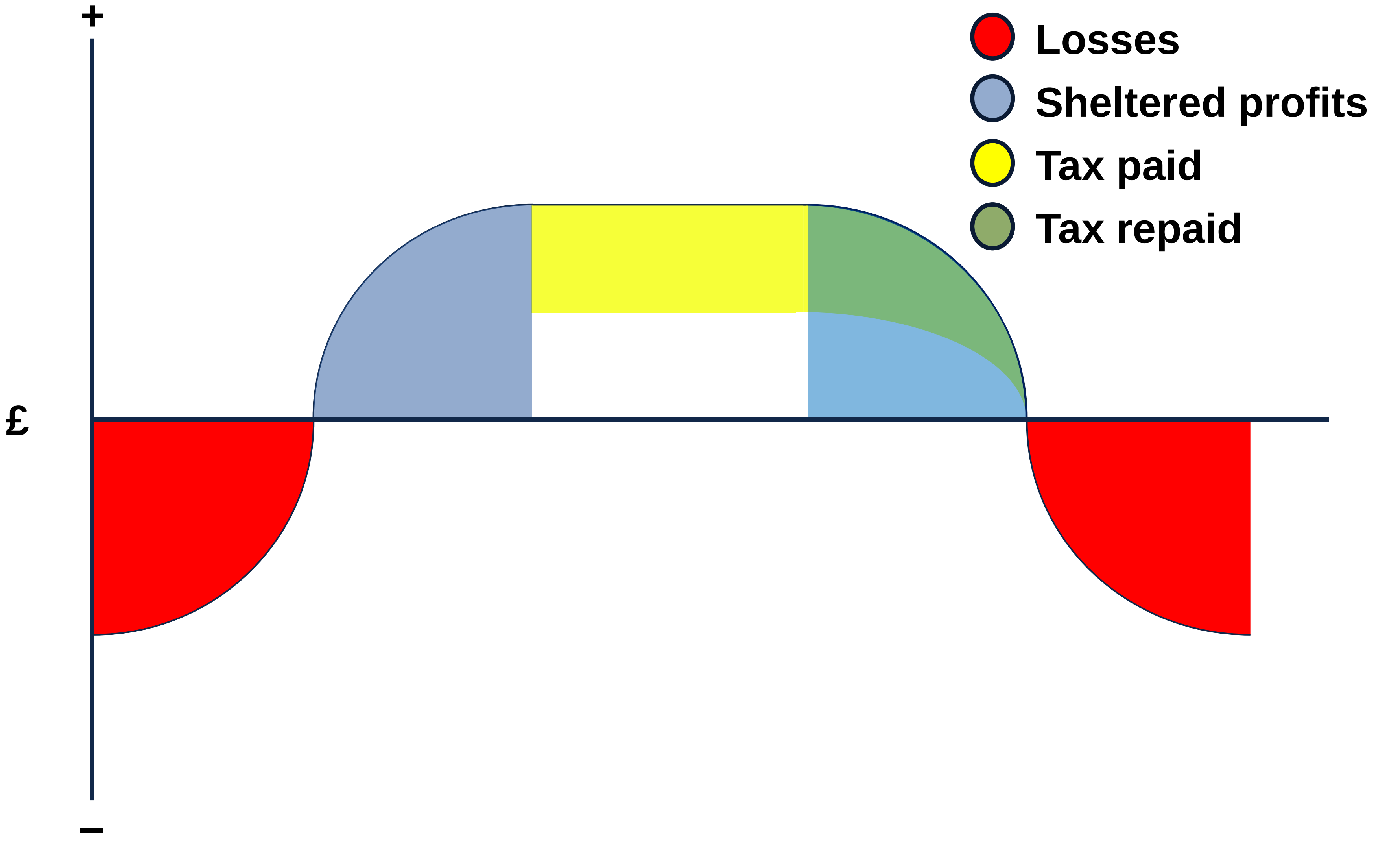
Tax payable on profits during production



Decommissioning takes place: significant losses incurred



Decom losses can be carried back to trigger a repayment of historic tax



Accessing Decommissioning Relief: a key issue and potential changes

- Given the potential economic impact of these repayments, the availability of relief on decommissioning is a key issue for late life assets. The position differs between the taxes:
  - **For PRT**: expenditure incurred on decommissioning a particular field can trigger tax repayments for previous licensees (which they are often required to pass back)
  - **For RFCT/SC**: a purchaser acquiring a licence shortly before decommissioning may not have sufficient RFCT/SC profits for decommissioning relief to be useful
- This means that there can be a value gap between a seller and buyer caused by the effective cost of decommissioning. Deals have been structured to bridge this gap (for example, by the seller retaining the decommissioning liability).
- This is the subject of a current HMRC consultation on the tax treatment of late life assets. Broadly, this seeks to close the value gap by allowing the buyer to benefit from the seller’s tax history, enabling it to benefit from the relief.

Your free online legal information service.

A subscription service for legal articles
on a variety of topics delivered by email.
www.cms-lawnow.com

Your expert legal publications online.

In-depth international legal research
and insights that can be personalised.
eguides.cmslegal.com

CMS Legal Services EEIG (CMS EEIG) is a European Economic Interest Grouping that coordinates an organisation of independent law firms. CMS EEIG provides no client services. Such services are solely provided by CMS EEIG's member firms in their respective jurisdictions. CMS EEIG and each of its member firms are separate and legally distinct entities,
and no such entity has any authority to bind any other. CMS EEIG and each member firm are liable only for their own acts
or omissions and not those of each other. The brand name "CMS" and the term "firm" are used to refer to some or all
of the member firms or their offices.

CMS locations:
Aberdeen, Algiers, Amsterdam, Antwerp, Barcelona, Beijing, Belgrade, Bogotá, Berlin, Bratislava, Bristol, Brussels, Bucharest, Budapest, Casablanca, Cologne, Dubai, Dusseldorf, Edinburgh, Frankfurt, Geneva, Glasgow, Hamburg, Hong Kong, Istanbul, Kyiv, Leipzig, Lima, Lisbon, Ljubljana, London, Luxembourg, Lyon, Madrid, Manchester, Medellín, Mexico City, Milan, Moscow, Munich, Muscat, Paris, Podgorica, Poznań, Prague, Rio de Janeiro, Reading, Rome, Santiago de Chile, Sarajevo, Seville, Shanghai, Sheffield, Singapore, Sofia, Strasbourg, Stuttgart, Tehran, Utrecht, Vienna, Warsaw, Zagreb and Zurich.

This presentation is intended to highlight potential issues and provide general information and not to provide legal advice.
You should not take, or refrain from taking, action based on its content. If you have any questions, please contact your main contact partner at the relevant CMS member firm.

cms.law