Summary: Intervention & Options

Department /Agency:	Title:	
HM Treasury	**Impact Assessment of reforms to North Sea fiscal regime to encourage "Change of Use" projects"**	
Stage: Final Proposal/Implementation	**Version:** 1.0	**Date:** 22 April 2009
Related Publications: "Supporting Investment: a consultation on the North Sea fiscal regime"		

Available to view or download at:

http://www.hm-treasury.gov.uk

Contact for enquiries: **Mike Crabtree** **Telephone:** 0207 438 6576

What is the problem under consideration? Why is government intervention necessary?

There are a number of activities that could make use of North Sea infrastructure for purposes other than oil and gas production. Several of these purposes, including gas storage, Carbon Capture and Storage and wind energy can help to meet the Government's wider energy policy aims, such as ensuring a secure and sustainable energy supply. Currently, the North Sea fiscal regime may create barriers to these "Change of Use" (CoU) activities by deterring the re-use of North Sea infrastructure. This package of changes is aimed at removing these barriers. If these projects are brought forward it will also extend the life of North Sea assets, thereby delaying the considerable cost to Government and industry of decommissioning.

What are the policy objectives and the intended effects?

To ensure that the North Sea fiscal regime does not prevent Change of Use (CoU) projects going ahead.

What policy options have been considered? Please justify any preferred option.

Option 1: Do nothing

Option 2: Change the Petroleum Revenue Tax (PRT) rules to ensure that (a) PRT is not levied on income relating to Change of Use activities; (b) there is no deemed disposal arising from a CoU activity and (c) likewise there is no reduction in relief for decommissioning. For Ring Fence Corporation Tax (RFCT): provide for the relief of decommissioning costs of ex-ring fence assets which are used for a change of use activity, on the same basis that would have been available had the assets remained within the ring fence trade. **PREFERRED OPTION**

Option 3: Option 2 + remove any balancing charge resulting from a deemed disposal for capital allowances purposes when an asset moves from a ring fence to non-ring fence activity.

Option 4: Option 3 + remove the potential for a capital allowances clawback for RFCT when assets are used for a CoU trade within 5 years of acquisition.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The effects of the policy will be closely monitored on an ongoing basis.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

> ***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.***

Signed by the responsible Minister:

Angela Eagle

Date: 3/4/09

Summary: Analysis & Evidence

Policy Option: 1	**Description: Do nothing.**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups' No change compared to the current position
One-off (Transition)	**Yrs**	
£ 0		
Average Annual Cost (excluding one-off)		
£ 0		**Total Cost** (PV) **£ 0**

Other **key non-monetised costs** by 'main affected groups' No change compared to the current position

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' No change compared to the current position
One-off	**Yrs**	
£ 0		
Average Annual Benefit (excluding one-off)		
£ 0		**Total Benefit** (PV) **£ 0**

Other **key non-monetised benefits** by 'main affected groups' No change compared to the current position

Key Assumptions/Sensitivities/Risks Instead of engaging in change of use projects, operators will decommission their assets when they reach the end of hydrocarbon production. The wider energy policy benefits on offer from change of use projects will be lost.

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) **£ Neg**	**NET BENEFIT** (NPV Best estimate) **£ Neg**

What is the geographic coverage of the policy/option?			UKCS	
On what date will the policy be implemented?			N/A	
Which organisation(s) will enforce the policy?			HMRC	
What is the total annual cost of enforcement for these organisations?			£ 0	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	N/A	N/A	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ 0 Decrease of £ 0 **Net Impact** £ 0

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Summary: Analysis & Evidence

Policy Option: 2	**Description: Reforms to: PRT disposal rules, liability of CoU income to PRT, and Ring fence Corporation Tax (RFCT) and PRT decommissioning relief after CoU activities**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'	
One-off (Transition)	**Yrs**		
£ Negligible			
Average Annual Cost (excluding one-off)			
£ Negligible		**Total Cost** (PV)	**£ Negligible**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' Admin burden savings will be negligible.	
One-off	**Yrs**		
£ Negligible			
Average Annual Benefit (excluding one-off)			
£ Negligible		**Total Benefit** (PV)	**£ Negligible**

Other **key non-monetised benefits** by 'main affected groups' If projects such as gas storage and Carbon Capture and Storage go ahead this will create significant beneficial effects in terms of providing a secure and sustainable energy supply for the UK.

Key Assumptions/Sensitivities/Risks Reforming the fiscal regime in these areas will remove barriers to CoU projects, thereby helping to deliver the wider energy policy benefits associated with them.

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) **£ Negligible**	**NET BENEFIT** (NPV Best estimate) **£ Negligible**

What is the geographic coverage of the policy/option?			UKCS	
On what date will the policy be implemented?			Budget Day	
Which organisation(s) will enforce the policy?			HMRC	
What is the total annual cost of enforcement for these organisations?			£ 0	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	N/A	N/A	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)						(Increase - Decrease)	
Increase of	£ Neg	Decrease of	£ Neg	**Net Impact**	£ Neg		

Key: Annual costs and benefits: Constant Prices | (Net) Present Value

Summary: Analysis & Evidence

Policy Option: 3	Description: Option 2 + remove possibility of a deemed disposal for capital allowances purposes when moving from ring fence to non-ring fence trade.

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	
£ **Negligible**		
Average Annual Cost (excluding one-off)		
£ **Negligible**		**Total Cost** (PV) £ **Negligible**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' Admin burden savings will be negligible.
One-off	**Yrs**	
£ **Negligible**		
Average Annual Benefit (excluding one-off)		
£ **Negligible**		**Total Benefit** (PV) £ **Negligible**

Other **key non-monetised benefits** by 'main affected groups'

Key Assumptions/Sensitivities/Risks See Option 2

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) £	**NET BENEFIT** (NPV Best estimate) £

What is the geographic coverage of the policy/option?			UKCS	
On what date will the policy be implemented?			Budget Day	
Which organisation(s) will enforce the policy?			HMRC	
What is the total annual cost of enforcement for these organisations?			£ 0	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ 0	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	N/A	N/A	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ Neg	Decrease of £ Neg	**Net Impact**	£ Neg

Key: **Annual costs and benefits:** **(Net) Present**

Summary: Analysis & Evidence

Policy Option: 4	**Description: Option 3 + remove possibility of a capital allowances (CA) clawback if assets are removed from hydrocarbon extraction trade within 5 years**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	
£ Negligible		
Average Annual Cost (excluding one-off)		
£ Negligible		**Total Cost** (PV) **£ Negligible**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' Admin burden savings will be negligible.
One-off	**Yrs**	
£ Negligible		
Average Annual Benefit (excluding one-off)		
£ Negligible		**Total Benefit** (PV) **£ Negligible**

Other **key non-monetised benefits** by 'main affected groups'

Key Assumptions/Sensitivities/Risks

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) **£ Negligible**	**NET BENEFIT** (NPV Best estimate) **£ Negligible**

What is the geographic coverage of the policy/option?			UKCS	
On what date will the policy be implemented?			Budget Day	
Which organisation(s) will enforce the policy?			HMRC	
What is the total annual cost of enforcement for these organisations?			£ 0	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ 0	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	N/A	N/A	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ Neg Decrease of £ Neg **Net Impact** £ Neg

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base (for summary sheets)

Rationale for Intervention

Assets acquired for hydrocarbon recovery in the North Sea can potentially be reused for other activities. Some of these alternative uses, such as gas storage, carbon capture and storage and wind power, could contribute to the Government's wider objectives around providing a secure supply of sustainable energy.

Over the last two years, a number of oil and gas companies have approached HMRC, HMT and DECC seeking clarification of the tax treatment when assets used for the purposes of hydrocarbon recovery or transportation are utilised in some other way. There are tax consequences when assets move out of the ring fence corporation tax and petroleum revenue tax regimes into the mainstream corporation tax regime – in terms of the tax allowances that have already been given, the treatment of future income and expenditure and the availability of relief for decommissioning costs.

Since PBR 2006 a joint industry and Government working group has been exploring and clarifying how the existing tax regime would apply to change of use projects. Officials have now considered the proposals made by industry through this working group and propose to make the changes outlined above under **Option 2.**

Policy Proposal

Having considered industry's requests (reflected in Options 3 and 4 above), the Government will implement the following package of changes:

- **Remove the PRT charge when a qualifying asset is no longer used for a taxable field purpose:** the Government accepts that the "time-apportionment" rule for PRT acts as a disincentive for CoU projects, as it raises the possibility of an additional charge when the asset is no longer used in connection with a PRT taxable field, particularly if the CoU activity continues for some time. When the PRT legislation was enacted it was not envisaged that PRT assets would be used for an activity other than oil or gas extraction, and it seems reasonable to update the legislation to take account of this possibility.

- **Ensure that PRT is not levied on income relating to CoU activities:** In relation to ring fence corporation tax and supplementary charge, HMRC believes it should be possible to properly ascribe income and expenditure either to the ring fence trade or the change of use trade using existing legislation and case law. However, the PRT rules state that any income, no matter what its nature, which is derived from a qualifying asset, is subject to PRT. This leaves open the possibility that, under the current rules, income from a CoU activity could be subject to PRT. CoU activities are not within the intended scope of the PRT regime, and the levying of PRT on CoU income from qualifying assets would pose a significant barrier to CoU projects.

- **Ensure that the abandonment costs are relievable for RFCT and PRT purposes on the same basis as would have been the case had the assets remained within the ring fence trade**:
  The Government recognises that uncertainty over relief for decommissioning costs could have a deterrent effect on CoU projects, given operators' statutory obligation to decommission and the higher rate of relief available for assets decommissioned in the ring fence. This uncertainty could prevent CoU projects going ahead, especially considering the high costs of decommissioning and the uncertainty over profits from CoU activities.

Consequently, the proposal ensures that operators, where they retain the liability, will be able to relieve decommissioning expenditure on ring fence assets subsequently used for CoU activities against RFCT and PRT profits.

Consultation Responses

In general, industry stakeholders have warmly welcomed the proposed changes, acknowledging the progress they make towards removing barriers from CoU projects. However, they did have suggestions for additional changes in some areas.

During the consultation, industry repeated their proposal that assets should be transferred to CoU activities at the tax written-down value, rather than the market value. This proposal was considered in the consultation document published in November 2008, which gave two reasons for rejecting it. Firstly, the Government believes that, as most of the assets used for CoU activities are likely to be low in value, the difference between the market value and the tax written-down value is likely to be small. As a result, bringing in the market value in the case of a deemed disposal will rarely have a significant economic impact. Secondly, the Government feels that transferring assets at the market value gives the correct result in principle. It ensures that the right amount of plant and machinery allowances have been given against ring fence profits, reflecting the amount the assets have genuinely depreciated in the period they were used in the ring fence trade. Stakeholders have not come up with any compelling examples or arguments during the consultation period that suggest the Government's view on this matter should be changed.

However, to assist in arriving at a value of an asset which is being transferred to a CoU project where there is no actual disposal, HMRC will endeavour to give advanced clearance of a company's valuation of an asset.

A question arising from the consultation process is whether it is desirable to create a special tax regime for activities such as carbon capture and storage and wind power. However, this question is beyond the remit of this process.

Costs and Benefits

The proposed changes will not introduce new onerous information obligations on companies operating in the North Sea, and although there will be costs associated with familiarisation with the new legislation these are not expected to be significant. Only a small number of companies are engaged in oil and gas exploration and extraction, and only a proportion of these might find they are ever affected by the legislative changes being made. Consequently, it is considered fair to assume that the overall administrative impact on the sector in regard to the preferred Option 2 will be negligible, both in terms of any transitional costs or recurring annual costs. In any case, additional costs should be judged in the light of the commercial opportunities which the revised legislation is intended to facilitate, as well as eliminating the possibility of unintended tax effects.

Option 1 was rejected on the basis that inaction would do nothing to remove barriers imposed by the tax regime to projects that re-use North Sea assets for CoU projects. This could restrict the benefits gained towards wider Government policy objectives such as ensuring a secure and sustainable energy supply.

Option 2 is the Government's preferred package of changes. Having listened to the industry's proposals, the Government believes that the three changes detailed above remove real barriers to CoU projects without:

- imposing disproportionate costs on the exchequer;
- adding substantially to the administrative burdens of industry or HMRC

- doing wider damage to the tax system
- or requiring major legislative change.

Option 3 reflects industry's proposal that no balancing charge for CA purposes should arise when an asset is subject to a deemed disposal from the ring fence trade (by transferring assets at their tax written-down value rather than there market value, for example). As discussed in the "Consultation Reponses" section above, the Government stands by the responses to this point outlined in the consultation document published at PBR (and summarised above). Consequently **Option 3 was rejected.**

Option 4 reflects industry's proposal that there could be circumstances where expenditure was incurred for the purposes of a ring fence trade, but was used for a CoU activity within 5 years, thereby resulting in a clawback of 100% First Year Allowances. Industry proposed that, in such a scenario, a clawback should not occur, as it would act as a disincentive to CoU activities. However, HMRC's view was that the likelihood of expenditure on plant and machinery being incurred wholly for the purposes of a ring fence trade, yet within five years that same plant and machinery being used for some other purpose, seems very remote. Consequently, as the clawback provision would not pose a significant barrier to the vast majority of CoU projects, **Option 4 was rejected.** Following the publication of the PBR consultation document, industry accepted Government's arguments, and dropped this request.

Impacts

Results of Specific Impact tests can be found in the annex below.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	Yes
Sustainable Development	No	Yes
Carbon Assessment	No	Yes
Other Environment	No	Yes
Health Impact Assessment	No	Yes
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	Yes
Rural Proofing	No	Yes

Annexes

Competition Assessment

The change does not directly or indirectly limit the range of suppliers, or limit the ability of suppliers to compete. It also does not limit suppliers incentives to compete vigorously.

Small Firms Impact Test

There are no small businesses involved in North Sea oil and gas extraction that are affected by the proposals.

Legal Aid

The proposed changes will have no implications for legal aid.

Sustainable Development

The aim of this policy is to remove barriers to the use of North Sea infrastructure for other activities, such as Carbon Capture and Storage, gas storage and wind energy. Widespread engagement in these activities will ensure the UK has a more secure, more sustainable energy supply, an essential component of a sustainable economy.

Carbon Assessment

As discussed above, if, as intended, the proposed changes remove barriers to CoU projects such as Carbon Capture and Storage and wind energy, the overall effect on emissions could be to reduce them substantially.

However, it would be impossible to estimate the exact effect of the policy on carbon emissions, as this will rely on the number of change of use projects brought forward. Estimates of the number of such projects are impossible to make at this stage.

Other Environment

The proposed changes will remove barriers to the re-use of North Sea assets for other activities. This “recycling” of assets will prevent the need for the construction of new assets, thus saving on the materials, emissions and other waste that the construction of new infrastructure would require.

The proposed changes will have no effect on: waste management; air quality; the appearance of landscape or townscape; habitat or wildlife; or noise levels. Climate change will not affect the impact of the proposal itself.

Health Impact Assessment

The proposed changes have no health related impacts.

Race Equality

The proposed changes have no implications for race equality.

Disability Equality

The proposed changes have no implications for disability equality.

Gender Equality

The proposed changes have no implications for gender equality.

Human Rights

The proposed changes have no implications for human rights.

Rural Proofing

The proposed changes have no implications for rural areas.