Summary: Intervention & Options

Department /Agency: HM Treasury and HM Revenue and Customs	Title: North Sea fiscal regime: New Field Allowance	
Stage: Implementation	**Version:** 1.0	**Date:** 22 April 2009
Related Publications:		

Available to view or download at:

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

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

The Government has an objective to maximise the economic recovery of the UK's oil and gas reserves. The remaining new opportunities in the North Sea are increasingly either small in size or are technologically challenging. Many projects that are economic are commercially marginal in the context of global investment opportunities. To assist in encuring the realisation of the North Sea's potential, the Government believes the best solution is to introduce a fiscal incentive.

What are the policy objectives and the intended effects?

To incentivise investment in economic, but currently commercially marginal fields.

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

Option 1: Do nothing

Option 2: Introduce an across the board uplift on capital expenditure for new fields of 25 per cent

Option 3: Introduce a volume allowance

Option 4: Introduce a New Field Allowance, available to new small fields, Ultra High Pressure High Temperature and Ultra Heavy Oil fields **(Preferred Option)**

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 monitored to assess its effectiveness 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: 14/4/09

Summary: Analysis & Evidence

Policy Option: 1	Description: Option 1: Do nothing

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups' No change compared to 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 current position

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' No change compared to 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 current position

Key Assumptions/Sensitivities/Risks As now, economic but commercially marginal North Sea developments may lose out to investment opportunities elsewhere in the world, and consequently fail to receive the investment needed to proceed.

Price Base Year	Time Period Years	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

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?			n/a	
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**

Summary: Analysis & Evidence

Policy Option: 2 | **Description: Introduce an uplift of 25 per cent on all capital expenditure**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	There would be significant cost to HMRC as the option would not function within the current legislation and administrative processes. A capital uplift would be a departure from the normal SC computation and for companies accessing it would result in modest implementation as well as recurring costs.
£ Negligible		
Average Annual Cost (excluding one-off)		
£ Negligible		**Total Cost** (PV) **£ less than £50k**

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

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	Companies would benefit from additional tax relief against CT and SC for new expenditure in the North Sea.
£ 0		
Average Annual Benefit (excluding one-off)		
£ Investment related		**Total Benefit** (PV) **£ related to sum of new investment**

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

Key Assumptions/Sensitivities/Risks Although Option 2 might attract North Sea investment that would otherwise not take place it would be a significant change from the normal operation of the capital allowances regime and would be very difficult for HMRC to administer. For projects that were already commercially viable the Exchequer would incur a significant deadweight cost.

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

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?	£			
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?	No	No	N/A	N/A

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

Increase of £ < 50k | Decrease of £ 0 | **Net Impact** £ < 50k

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

Summary: Analysis & Evidence

Policy Option: 3	Description: Introduce a Volume Allowance

	ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
COSTS	**One-off** (Transition)	**Yrs**	A field production-linked volume allowance would be a departure from the normal SC computation and for companies accessing it would result in modest implementation as well as recurring costs.
	£ Negligible		
	Average Annual Cost (excluding one-off)		
	£ Negligible		**Total Cost** (PV) **£ 50-100k**
	Other **key non-monetised costs** by 'main affected groups'		

	ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
BENEFITS	**One-off**	**Yrs**	Companies developing new fields would be able to reduce their SC liability in accordance with how much they produced up to a fixed amount.
	£ Negligible		
	Average Annual Benefit (excluding one-off)		
	£ Negligible		**Total Benefit** (PV) **£ production related**
	Other **key non-monetised benefits** by 'main affected groups'		

Key Assumptions/Sensitivities/Risks The volume allowance, where *x* barrels would be free of SC, would deliver more value to companies as the oil price increases. This would have the perverse effect of delivering the most support when companies need it the least.

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?			£	
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?	No	No	N/A	N/A

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

Increase of £ 50-100k Decrease of £ 0 **Net Impact** **£50k to 100k**

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

Summary: Analysis & Evidence

Policy Option: 4	Description: Introduce a New Field Allowance for small fields, Ultra High Pressure High Temperature fields and Ultra Heavy Oil fields

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	A new field allowance would be a departure from the normal SC computation and for the companies accessing it would result in modest implementation as well as recurring administrative costs.
£ Negligible		
Average Annual Cost (excluding one-off)		
£ Negligible		**Total Cost** (PV) **£ circa 50k**

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

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	Companies developing new small fields, High Pressure, High Temperature fields and Heavy Oil fields will be able to reduce their SC liability.
£ 0		
Average Annual Benefit (excluding one-off)		
£ New field profit dependent		**Total Benefit** (PV) **£ New field profit dependent**

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

Key Assumptions/Sensitivities/Risks Introducing a New Field Allowance for the types of fields mentioned will encourage production from these fields. If the oil price increases, companies will use up the New Field Allowance more quickly and will then return to paying SC at the full rate.

There will be a small annual deadweight cost to the Exchequer resulting from fields that receive the incentive but would have gone ahead anyway.

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?			£ Circa 20k	
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?	No	No	N/A	N/A

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

Increase of £ c. 50k   Decrease of £ 0   **Net Impact** £ circa 50k

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

Evidence Base (for summary sheets)

Rationale for Intervention

Hydrocarbon extraction from the United Kingdom Continental Shelf (UKCS) is facing increasing challenges as the basin matures. The easy to recover hydrocarbons have generally been exploited and the remaining opportunities are, increasingly, either small in size or require the use of cutting edge technologies to enable extraction. One result of this is that many potentially viable projects have become commercially marginal under the existing fiscal regime and as a result are unable to compete for investment with other projects around the globe. These challenges are exacerbated by the current uncertainty over future oil prices and the difficulty in raising finance.

The Government believes that a correctly targeted incentive will lead to both an increase in investment and a subsequent increase in production, thereby aiding the security of the UK's energy supply.

Policy Proposal

The preferred option, Option 4, will take the form of a "New Field Allowance." Each new field that meets the qualifying criteria will have a New Field Allowance, which can, over a period of time, be put into a pool of allowances (from all qualifying fields). The amount of allowance that can be put into the pool from each field in each year will be limited to a statutory maximum. The overall allowance allocated to each field will be determined by the type of field in question.

At the end of each accounting period (AP), the allowances in the pool can be offset against profits liable to Supplementary Charge (SC). If the allowances are greater than the SC profits, then no SC is paid. Any unused allowances remain in the pool and are carried forward for use against SC profits of the next AP. The carried forward pool is then augmented in the next AP by further allowances based on production from qualifying fields in that next AP.

The basic principle therefore is to calculate the allowance by reference to the income of the field, pool the allowances of all qualifying fields and offset against SC.

The Government believes that this provides the most effective and simplest delivery mechanism for a field-based incentive through the existing company based SC tax framework.

When the qualifying field starts producing, it will already be clear from the legislation how much New Field Allowance the field will be eligible for. Where a qualifying field has more than one partner then each partner's share of that allowance will be based on their equity interest in the field. Each year each partner compares their income from the field with their maximum annual allowances for the field, to calculate how much allowance goes into the pool. The calculation of the allowance going into the pool, the calculation of the size of the pool at the end of the accounting period, the offset against SC and any carry forward should be capable of being run on a simple spreadsheet. This should keep administrative costs to a minimum.

Consultation Responses

A range of stakeholders contacted the Government to give their view of the New Field Allowance proposal announced at PBR 2008. The Government received many useful contributions on the proposed magnitude of any allowance, the types of field on which it should be targeted and how it would affect particular projects. The Government has drawn on these contributions in coming to its final decision.

Some companies have suggested that removing SC from qualifying fields would be an easier way of achieving the same effect. However, the Government believes a New Field Allowance is preferable as it a) enables the Exchequer to collect a fair share of the upside for the UK taxpayer if, for example, the oil price rises; and b) allows companies to continue to relieve costs at a tax rate of 50 per cent, rather than the 30 per cent that would be available in the absence of SC, thereby supporting further investment.

Some companies also indicated a preference for a capital uplift or a volume allowance. Government's reasons for rejecting these arguments are outlined below.

The Government believes that the preferred option proposed here strikes the best balance between encouraging investment and production from the North Sea and ensuring a fair return for the UK taxpayer, and is therefore in line with the Government's wider objectives for the fiscal regime. However, the Government will monitor the Allowance to ensure its effectiveness on an ongoing basis.

Costs and Benefits

Option 1 was rejected on the basis that inaction would not help the development of the UKCS' remaining oil and gas resources, and would consequently not help to meet the Government's energy objectives.

Option 2, an across the board uplift on capital expenditure was rejected because:

- It would represent a blunt instrument as it would apply to all capital expenditure, including already sanctioned expenditure. It would not therefore effectively target support on those fields facing the greatest challenges within the UKCS.
- It would involve significant deadweight cost. Whilst it was argued in the course of the discussions that this deadweight cost could be offset by the resulting increased production, more detailed analysis has suggested that this is unlikely to be the case. This proposal would therefore also undermine the principle of maintaining a fair return to the UK taxpayer.
- Implementation of such an incentive would be neither simple to design nor operate. Giving relief for more than 100 per cent of capital costs would require either a fundamental rewriting of large parts of the capital allowances rules or the introduction of a whole new relieving mechanism. Either would require considerable additional legislation, and additional ongoing compliance obligations for both HMRC and companies.

Option 3, the introduction of a volume allowance would have the disadvantage of increasing in benefit to industry, and in cost to the Exchequer, as the oil price increased, thereby giving the most support to investment when it was least needed. This is obviously not a desirable result.

Option 4: The Government believes that the method which seems to have the greatest potential for achieving the desired result is a "New Field Allowance". This has the advantage of:

- Allowing support to be targeted on those economic but commercially marginal fields facing the greatest challenges within the UKCS.
- Benefiting both producers and taxpayers, and minimising the deadweight cost.
- Simplicity, clarity and certainty, meaning industry can take account of it when drawing up investment plans.

In the case of Option 4, it is anticipated that minor changes will need to be made to HMRC processes, and that there will be a small increase in companies' recording obligations. However, it is expected that for affected companies the tax saving from the allowance will far outweigh any small increase in administrative burdens.

Any additional administrative burdens and compliance costs are likely to be small in total due to the small number of companies who will be affected (around 70 companies have a production interest in the North Sea) and the simplicity of operating the scheme.

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

This proposal will ensure that the North Sea remains an attractive place to invest both for new entrant as well as established companies.

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 negatively affected by these proposals.

Legal Aid

The proposed changes will have no implications for legal aid.

Sustainable Development

The proposed change will support the sustainability of the UK economy by helping to ensure a secure supply of affordable energy.

Carbon Assessment

In 2007, the average CO_2 emissions per barrel of oil equivalent for production from the UK Continental Shelf was 0.02 tonnes. However, average emissions figures are not a good guide to emissions caused by marginal production, which will depend on a wide variety of factors.

As it is difficult to predict the extra production resulting from these proposals, attempting to give an accurate carbon impact is not feasible.

Other Environment

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

Health Impact Assessment

The proposed changes have no implications for race equality.

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.