

FINANCE ACT 2014

EXPLANATORY NOTES

INTRODUCTION

Section 73 and Schedule 16: Oil Contractor Activities: Ring-Fence Trade Etc.

Details of the Schedule

2. Paragraph 1 provides that CTA2010 is to be amended.
3. Paragraph 2 inserts a reference to the new Part 8ZA into the overview section of the CTA. Part 8ZA contains new rules applicable to contractors operating in the offshore oil and gas industry, (who are not also within the Part 8 oil and gas ring fence) who lease assets from their associates.
4. Paragraph 3 inserts a new section into the existing rules for the calculation of profits from Oil and Gas exploration and exploitation activities. This section mirrors the effect of the new Part 8ZA in circumstances where separate contracts have been used and is required to prevent new Part 8ZA being sidestepped.
5. New subsection 285A(1) defines the two conditions that must both be satisfied for payments to be within scope of the new section. New subsection 285A(1)(a) requires that oil contractor activities are carried out, which is defined in new subsection 285A(10) so as to have the same meaning as in new Part 8ZA. New subsection 285A(1)(b) requires that the ring fence company (that is to say one whose activities are within Chapter 4 Part 8) is making payments under a lease as part of obtaining a composite service from a contractor. New subsection 285A(10) provides the definitions for the terms used.
6. New subsection 285A(2) limits the amount that can be deducted in computing the company's ring fence profits. Any amount paid in excess of that limit will be allowed as a deduction from a company's non ring fence profit under new subsection 285A(6).
7. New subsection 285A(3) provides the size of that limitation, referred to as a "hire cap", by reference to the relevant percentage which is further defined in new subsection 285A(5).
8. New subsection 285A(4) provides for the case where more than one contractor or ring fence company are subject to the hire cap in respect of the same asset. The subsection ensures that the total hire cap available is equal to that which would apply if there had been a single entity. The hire cap itself is then allocated to each payer on the basis of their relative contribution as is just and reasonable.
9. New subsection 285A(5) defines "relative percentage" and TC (the cost on which the relevant percentage operates to determine the hire cap) by using the same definitions as in the new Part 8ZA which are to be found in new 356N subsections (5) to (15).
10. New subsection 285A(6) provides that any amount paid in excess of the hire cap will be allowed as a deduction from the company's total profits; or may be surrendered as a trading loss for use against profits by other members of the paying company's group. New subsection (7) prevents any deduction under new subsection 285A(6) from

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profits within either the existing ring fence for producers (under Chapter 4 of Part 8 of CTA2010) or the new contractor's ring fence brought in by new Part 8ZA.

11. New subsection 285A(8) provides a targeted anti avoidance rule to prevent arrangements with a tax avoidance main purpose from frustrating the intended application of new subsection 285A.
12. New subsection 285A(9) defines "arrangements" for the purposes of new subsection 285A(8).
13. New subsection 285(10) provides definitions for terms used in new section 285A by reference to definitions provided in new Part 8ZA. The definition of lease uses that provided by the existing section 868 CTA 2010 which is:

“868 “868 Lease

- (1) This section applies for the purposes of this Chapter.
- (2) A lease is (in relation to an asset) an agreement or arrangement under which payments are made for the use of or otherwise in respect of the asset.
- (3) In particular it includes an agreement or arrangement under which the payments (or any of them) represent instalments of a purchase price or payments towards it.”

14. Paragraph 4 inserts new Part 8ZA into the CTA2010.
15. New section 356K provides an overview of new Part 8ZA.
16. New subsection 356L(1) gives effect to the definitions for the purposes of new Part 8ZA. New subsection 356L(2) defines what "oil contractor activities" are for the purposes of new part 8ZA and new section 285A. This excludes activities which are already within the existing ring fence for oil exploration and exploitation. There are two possible legs: new subsection 356L(2)(a) requires that the activities are exploration or exploitation activities which take place as part of the provision of a relevant offshore service, which is defined in new subsection 356L(3). New subsection 356L(2)(b) covers the situation where the activities are carried on alongside the provision of a relevant offshore service.
17. New subsection 356L(3) defines a relevant offshore service.
18. New subsection 356L(4) defines exploration and exploitation activities and requires that those services are in connection with the exploration or exploitation of the natural resources under the sea. (“In connection” takes its natural wide meaning so as to encompass all stages of exploitation and exploration from initial searching for oil to the final decommissioning of extraction plant).
19. New subsection 356L(5) defines “relevant offshore area” for the purposes of new subsection 356L. “Territorial sea” is defined by section 1170 of CTA2010.
20. New section 356LA provides the definition of a "relevant asset" for the purposes of the hire cap. New subsection 356LA(1) identifies three conditions which must all be met for an asset to qualify.
21. New subsection 356LA(2) provides the first of these conditions. New subsection 356LA(2)(a) requires that the asset is a mobile asset. New subsection 356LA(2)(b) restricts the vessels which are a relevant asset by reference to the use to which they can be put. Note that this does not require that they are being so used. New subparagraph 356LA(2)(b)(i) identifies vessels used to drill for oil, whilst new subparagraph 356LA(2)(b)(ii) identifies any vessel used to provide accommodation to workers, **other than those who work on the accommodation providing vessel itself**, where that other structure is itself used in connection with

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exploration and exploitation activities carried on by anyone whether connected with the accommodation provider or not. These workers are termed “offshore workers” for the purposes of new subsection 356LA(3).

22. New subsection 356LA(3) provides an exception to the class of asset which would otherwise fall within the definition of accommodation provider within new subsection 356LA(2)(b)(ii). Where the provision of accommodation to “offshore workers” is only an incidental part of the use to which the asset is put, then the asset as a whole is not within new subsection 356LA(2)(b)(ii).
23. New subsection 356LA(4) provides further definitions for the purposes of identifying the vessel classes in new subsection 356LA(2).
24. New subsection 356LA(5) provides the second condition (Condition A), which is that the asset or any part of the asset, is leased from an associated person. (“Associated person” is defined in new subsection 356LB). It does not matter to whom the asset is leased.
25. New subsection 356LA(6) provides the third condition (Condition B) which is that the asset is of the requisite value as defined in new subsection 356LA(7).
26. New subsection 356LA(7) provides that the requisite value for Condition B of new section 356LA is that the market value of the asset is £2m or more.
27. New subsections 356LA(8) and (9) provide a power for HM Treasury to amend the operation of Condition B in future.
28. New section 356LB provides the definition of “associated person” for the purposes of new Part 8ZA.
29. New subsection 356LB(1) provides four classes of “associated persons” Those classes include the contractor or contractors carrying out the oil contractor activities (new 356LB(1)(a)) and anyone connected with them or who has been connected with them (new 356LB(1)(b)). Connected has the same meaning here as for the rest of CTA 2010, which is provided by section 1122 of CTA2010. The final two classes of associated person are those who act together with the contractor (new 356LB(1)(c)) as well as those who are connected with the classes in (b) and (c) (new 356LB(1)(d)).
30. New subsection 356LB(2) clarifies that simple leasing of an asset to others who carry out relevant services themselves, is insufficient for those persons to be acting together.
31. New section 356LC provides the definition of the term “lease” for the purposes of new Part 8ZA and new section 285A. This uses the existing wide definition in section 868 CTA 2010 as noted in paragraph 12 above.
32. New section 356LD provides the definition of contractor’s ring fence profits for the purposes of new Part 8ZA and new section 285A. This means income arising from oil contractor activities which are themselves defined in new section 356L.
33. New section 356M provides the new contractor’s ring fence. It splits a contractor’s actual trade into two parts by defining the activities carried on which are to be treated as a separate trade for corporation tax purposes. This applies to oil contractor activities which are defined in new 356L. Additional restrictions on how the profits of that separate trade are computed for corporation tax purposes are provided by new sections 356NA to 356NE. These provisions mirror those in place for the existing ring fence in Part 8 of the CTA 2010.
34. New section 356N makes provision for a hire cap. New subsection 356N(1) identifies the circumstances in which the hire cap is to apply.

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35. New subsection 356N(2) limits the amount that can be deducted when computing the contractor's ring fence profits. Any amount otherwise allowable as a deduction is dealt with under new subsections 356NA(3) and (4).
36. New subsection 356N(3) provides the size of that limitation (the hire cap), by reference to the relevant percentage (further defined in new subsection 356N(5)), which is applied to qualifying total costs (as further defined in new subsections (8) to (16)).
37. New subsection 356N(4) applies in the case where more than one lessor would be entitled to a deduction and therefore subject to the hire cap in respect of the same asset. The subsection ensures that the total hire cap does not exceed that which would have been available had there been a single lessor. The hire cap is to be allocated amongst the lessors as a whole in such a way as is just and reasonable.
38. New subsection 356N(5) provides that the relevant percentage is a proportion, calculated according to the formula provided, of 7.5%. The effect of the formula is to reduce the relevant percentage in cases where a relevant vessel is in fact in use somewhere other than the UKCS or territorial waters during an accounting period (the greater the number of days it is used elsewhere, the lower the relevant percentage, and so the lower the hire cap).
39. New subsection 356N(6) confirms that, if the vessel is not used at all anywhere in the world - including UK waters - for the whole of an accounting period, then the hire cap is reduced to nil.
40. New subsection 356N(7) provides that, where the accounting period is less than 12 months, the amount of the hire cap provided by new subsection 356N(2) is reduced proportionately.
41. New subsection 356N(8) provides the formula for computing total qualifying costs (to which the relevant percentage is to be applied, under new subsection 285A(3) and new subsection 356N(3)) to determine the hire cap. It is made up of two components, the original cost (OC) which is defined in new subsections 356N(9) to (13) and certain subsequent capital expenditure (CE) which is defined in new subsections 356N(14) to (16).
42. New subsection 356N(9) provides the base rule for determining OC. The amount has two components. The first (new subsection 356N(9)(a)) is the original acquisition cost by an associated person (as defined in new section 356LB). This effectively provides for the cost to the contractor's group as a whole. It does not recognise intra group transfers since the asset was first acquired. The second component (new subsection 356N(9)(b)) is any acquisition expenses incurred at the time of first acquisition, but does not include any finance costs. This is subject to new subsections (12) and (13).
43. New subsections 356N(10) and (11) provide for an alternative computation in certain circumstances. New subsection 356N(12) sets out those circumstances as being when the relevant asset has never been acquired by an associated person, but instead has been leased from a third party. (It follows that a relevant asset which was once owned by an associated person cannot qualify under this section, even if it subsequently leased from a third party).
44. New subsection 356N(11) provides the alternative calculation of OC when making the computation in new subsection 356N(8). OC will be based on the cost that would have arisen at the time the relevant asset was first leased, if the associated person had acquired the asset at that point rather than leased it (new subsection 356N(11)(a)). That cost is increased by the expected incidental costs of acquisition that would have arisen, other than financing (new subsection 356N(11)(b)). This is also subject to new subsections (12) and (13).

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45. New subsection 356N(12) excludes from the calculation of OC, any element of that consideration which it is reasonable to attribute to a part of the asset which has been removed as at the beginning of the accounting period.
46. New subsection 356N(13) makes provision for the calculation of OC for assets newly acquired in an accounting period. It applies a fraction to the value of OC based on the number of days during which the asset was owned or leased. This fraction is applied for the whole of the accounting period.
47. New subsection 356N(14) provides the definition of the CE used in the computation of total cost by new subsection 356N(8). CE includes any subsequent capital expenditure on the asset (such as subsequent modifications).
48. New subsection 356N(15) excludes from the computation of CE any expense related to items which are effectively no longer part of the asset. This includes items which have subsequently been removed or items which, whilst still present, are otiose.
49. New subsection 356N(16) makes provision for new expenditure during an accounting period. It applies a fraction to the value of that new expenditure based on the number of days during which the asset was owned or leased. This fraction is applied for the whole of the accounting period.
50. New section 356NA makes further provisions for the calculation of the hire cap.
51. New subsections 356NA(1) and (2) allow HM Treasury to make regulations to modify the relevant percentage for the purposes of new section 356N or new section 285A in specified circumstances.
52. New subsection 356NA(3) provides that any amount paid in excess of the hire cap will be allowed as deduction from the contractor's total profits; or may be surrendered for use against profits by other members of the paying company's group, as a trading loss.
53. New subsection 356NA(4) prevents any deduction under new subsection 356NA(3) from profits of the existing ring fence for producers (under Chapter 4 of Part 8 of CTA2010) or the new contractor's ring fence.
54. New subsection 356NA(5) provides a targeted anti avoidance rule to prevent arrangements with a tax avoidance main purpose from frustrating the intended application of new subsection 356N(2).
55. New subsection 356NA(6) defines 'arrangements' for the purposes of new subsection 356NA(5).
56. New sections 356NB to 356NG provide rules as to who the new contractor's ring fence operates. These are based on similar rules which operate the existing ring fence in Part 8 CTA2010 (which applies to oil production and is referred to as the "production ring fence", below).
57. New section 356NB modifies the loan relationship rules in the case of a ring fence trade. It is based on section 286 of CTA2010, which applies to the Part 8 CTA10 ring fence for oil producers. New subsection 356NB(1) ensures that non-trading debits from a company's loan relationships cannot be set against the company's contractor's ring fence profits, unless the loan relationship represents money borrowed to finance oil contractor activities under new subsection 356NB(2). The loan relationship rules are in Parts 5 and 6 of CTA 2009.
58. New subsection 356NB(5) provides that where a non-trading debit is restricted in this way the legislation allows the company to have relief for the debit against other profits other than those of the contractor's ring fence.
59. New section 356NC ensures that exchange gains in respect of loan relationships are not treated as part of the contractor's ring fence profits where the exchange gains do not

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arise from money borrowed to finance oil contractor activities. It is based on section 287 CTA 2010, which applies to the production ring fence. The section operates in a similar way to new section 356NB. Where a credit is excluded from the computation of ring fence profits it is brought into account by new subsection 356NB(5).

60. New section 356ND prohibits a deduction for expenses of management of an investment business against a contractor's ring fence profits.
61. New section 356NE prevents losses that arise in trades outside the contractor's ring fence from being set off against a contractor's ring fence profits.
62. New section 356NF concerns claims for group relief. New subsection 356NF(1) prevents group relief arising from losses, allowances or expenditure outside the contractor's ring fence trade from being set against profits from that ring fence trade.
63. New subsections 356NF(2) and (3) provide that where a company cannot use certain amounts against its contractor's ring fence profits, those contractor's ring fence profits are disregarded in calculating how much the company can surrender as group relief.
64. New subsection 356NF(4) provides the definitions required for group relief claims.
65. New section 356NG ensures that capital allowances arising from "special leasing" cannot be deducted from a company's contractor's ring fence profits.
66. Paragraph 5 inserts the definitions provided by this measure into Schedule 4 of the CTA2010.
67. Paragraph 6 provides the commencement for the measure, which is 1 April 2014.
68. Paragraph 7 provides that activities defined by section 356L (oil contractor activities, relevant offshore services and relevant offshore area) relate to activities carried out on or after 1 April 2014.
69. Subparagraph 8 (1) provides that an accounting period which would otherwise straddle the 1 April 2014 commencement date, is split into two accounting periods with the first treated as ending on 31 March 2014.
70. Subparagraph 8 (2) makes additional provision for group payment arrangements. Where accounts periods have been split under subparagraph 8(1), they can continue to be treated as a single accounting period for the purposes of allowing the surrender and receipt of tax refunds.
71. Paragraph 9 provides the rules which apply to losses which have accumulated before commencement. The only losses which can be used against subsequent profits within the new contractor's ring fence are those which would have been losses within that ring fence, had the ring fence existed when the loss arose. Other losses can continue to be carried forward, but cannot be used against profits of the new contractor's ring fence.