EXPLANATORY MEMORANDUM TO

THE FIELD ALLOWANCE FOR NEW OIL FIELDS ORDER 2010

2010 No. [DRAFT]

1. 1. 1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ('HMRC') and is laid before the House of Commons by Command of Her Majesty.

1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument introduces an oil field tax allowance to support the development of deep water gas fields such as those that are found in the West of Shetland area.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 It may initially appear more appropriate for this Order to amend Schedule 44 to the Finance Act 2009. However this is not the case because the provisions of that Schedule are being rewritten in Corporation Taxes Act 2010 which will come into force on 1 April 2010. This Order is intended to be in force to support developments in the UK Continental Shelf as soon as possible.

4. Legislative Context

4.1 This Order provides for a deep water gas field to be a qualifying oil field for the purposes of Schedule 44 to the Finance Act 2009.

4.2 The UK tax code effectively puts a ring fence around profits from oil and gas production to ensure they are not reduced by non-ring fence activity. This ensures the Exchequer achieves its desired taxation from the exploitation of a national natural resource. Section 492(1) ICTA details the ring fence treatment by providing that certain oil extraction and other activities conducted as part of a trade are to be treated for the purposes of corporation tax as 'a separate trade, distinct from all other activities carried on … as part of the trade'. The usual reliefs for trading losses are available to oil and gas companies, but certain restrictions arise because of the ring fence. In essence, these ensure that non-ring fence losses are not allowed against ring fence profits.

4.3 The rate of corporation tax applicable to "upstream" activity carried on in the UK or UK continental shelf is 30%. The small companies' rate applicable to such activity is 19%. These tax rates were not changed when the non-ring fence corporation tax rates were changed in Finance Act 2007 and Finance Act 2008. Profits derived from upstream activities are also subject to an additional tax, the Supplementary Charge. The Supplementary Charge is currently charged at 20%, having been increased from 10% in 2006.

4.4 The field allowance introduced in Schedule 44 to the Finance Act 2009 achieves the policy aim of providing an incentive to increase the economic production of oil and gas. The field allowance reduces the adjusted ring fence profits for the licensee's accounting period on which the Supplementary Charge applies (Schedule 44 to the Finance Act 2009 paragraph 1). The allowance is mandatory and no claim is required.

4.5 The field allowance is available for companies that are licensees in qualifying fields that receive development authorisation on or after 22 April 2009 and applies to accounting periods ending on or after that date (Schedule 44 to the Finance Act 2009 paragraphs 5(1) and 18).

4.6 A qualifying field is a field that on the authorisation day is a small field, an ultra heavy oil field or an ultra high pressure/high temperature field (Schedule 44 to the Finance Act 2009 paragraph 20). This Order adds a new category of field, a deep water gas field, and provides for the total field allowance in relation to that field.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom including the UK Continental Shelf.

6. European Convention on Human Rights

6.1 The Exchequer Secretary, Sarah McCarthy-Fry, has made the following statement regarding Human Rights:

6.2 In my view the provisions of the Field Allowance for New Oil Fields Order 2010 are compatible with the Convention rights.

7. Policy background

7.1 This Order introduces a fiscal measure whose objective is to encourage the development of remote deep water gas fields.

7.2 This is provided by the Order adding a new category of field, a deep water gas field that qualifies for the field allowance. In order to qualify the field must be more than 60 km from relevant infrastructure, the field must lie below water with a depth of more than 300 metres and more than 75 per cent of the reserves in the field, as determined on the authorisation day, must consist of gas.

8. Consultation outcome

8.1 No consultation has been undertaken although officials have held meetings with interested parties.

9. Guidance

9.1 HMRC will publish guidance on the operation of Schedule 44 to the Finance Act 2009 and guidance on this Order will follow shortly thereafter.

10. Impact

10.1 No impact on business, charities or voluntary bodies is foreseen.

10.2 No impact on the public sector is foreseen.

10.3 An Impact Assessment has not been prepared for this instrument as no impact for business, charities, voluntary bodies or the public sector is foreseen.

11. Regulating small business

11.1 The legislation will not impact on small business.

12. Monitoring & review

12.1 These Regulations will not be subject to specific monitoring or review.

13. Contact

13.1 Hugh Hedges at HMRC Tel: 020 7438 6576 or email: hugh.hedges@hmrc.gsi.gov.uk can answer any queries regarding the instrument.