Summary: Intervention & Options

Department /Agency: **HM Treasury and HM Revenue and Customs**	**Title:** **Changes to the application of chargeable gains legislation to the North Sea ringfence.**	
Stage: Final Proposal/Implementation	**Version:** 2	**Date:** 22 April 2009

Related Publications: Supporting Investment: A consultation on the North Sea Fiscal Regime; Securing a Sustainable Future: 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?

Government has an overall aim to maximise the economic recovery of the UK's oil and gas reserves. Government believes that one important way of achieving this is to reduce the impact of the fiscal regime on investment decisions. One aspect of this relates to asset trades - with Government holding the belief that assets' potential will inevitably be maximised if they are placed in the hands of those most willing to invest. Industry has argued that the current structure of the fiscal regime's treatment of gains arising from asset trades is inconsistent and detrimental to asset trade occurring.

What are the policy objectives and the intended effects?

To prevent the fiscal treatment of chargeable gains from standing in the way of asset trades, without reducing the tax for companies wishing to leave the North Sea by removing the chargeable gains regime from all cash disposals.

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

1. Do nothing - and risk current treatment inhibiting asset swaps and reinvestment of gains, or
2. Remove chargeable gains taxation from asset swaps (and partially achieve desired objectives), or
3. Do 2, and where proceeds from disposal of UK assets are reinvested in another UK asset, convert the holdover gain to an indefinite rollover gain - therefore chargeable gains taxation will only arise at the point where the benefit is taken outwith the UKCS, or
4. **Preferred Option**: Do 2, and where proceeds from the disposal of a UK asset are reinvested in another UK asset then exempt the gain from chargeable gains taxation.

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 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 impacts of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:

Date: 3/4/09

Summary: Analysis & Evidence

Policy Option: Option 1	Description: Do nothing

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	No change compared to the current position.
£ 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'
One-off	**Yrs**	No change compared to the current position.
£ 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

As now, asset trades will continue to be inhibited as a result of their tax treatment, thereby continuing to inhibit the reinvestment of gains and providing a barrier to the rationalisation of asset holdings.

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?			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: Option 2	Description: Remove chargeable gains taxation from asset swaps

COSTS			
ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups' Negligible overall change to business admin burdens, wider business compliance costs and HMRC operating costs.	
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' Negligible overall change to business admin burdens, wider business compliance costs and HMRC operating costs.	
One-off	**Yrs**		
£ Negligible			
Average Annual Benefit (excluding one-off)			
£ Negligible		**Total Benefit** (PV)	**£ Negligible**
Other **key non-monetised benefits** by 'main affected groups' Wider unquantified economic benefits should arise from increased investment in North Sea assets having ended up in the hands of those most willing to invest in them. This stems from the removal of barriers to asset trades.			

Key Assumptions/Sensitivities/Risks Enabling companies to rationalise their North Sea asset holdings will facilitate an increase in production, and consequently tax revenues, that will outweigh any potential future loss of revenue that might otherwise have arisen from an albeit narrowly applied chargeable gains regime.

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?	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	Description:
Option 3	**Gains are rolled-over into a reduced acquisition cost where proceeds are reinvested in a UKCS asset**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	As option 2, negligible overall change to business admin burdens, wider business compliance costs and HMRC operating costs.
£ 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'
One-off	**Yrs**	As option 2, negligible overall change to business admin burdens, wider business compliance costs and HMRC operating costs.
£ Negligible		
Average Annual Benefit (excluding one-off)		
£ Negligible		**Total Benefit** (PV) **£ Negligible**

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

As option 2, but in addition providing greater incentives for increased investment and activity and also providing an incentive not to remove gains from the UK North Sea.

Key Assumptions/Sensitivities/Risks As Option 2, though Option 3 will magnify both potential future loss of yield from disapplying chargeable gains taxation and potential gains from the taxation of higher production.

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

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: Option 4	Description: Remove chargeable gains taxation from asset swaps and exempt gains where proceeds reinvested in a UKCS licence

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups' As Option 3, negligible overall change to business admin burdens, wider business compliance costs
One-off (Transition)	**Yrs**	
£ Negligible		
Average Annual Cost (excluding one-off)		
£ Negligible		**Total Cost** (PV) **£ Neg**

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

There will be a negligible loss in ring fence corporation tax from the transfer of assets within the UKCS that under the current regime might have attracted tax by way of a chargeable gain.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' As option 3 and in addition companies will no longer have a requirement to track assets through the rollover system.
One-off	**Yrs**	
£ Negligible		
Average Annual Benefit (excluding one-off)		
£ Negligible		**Total Benefit** (PV) **£ Neg**

Other **key non-monetised benefits** by 'main affected groups' As option 3, but in addition providing greater simplicity and reducing legislative complexity, with positive implications at the margin for business certainty and admin burdens.

Key Assumptions/Sensitivities/Risks As option 3.

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?			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

Evidence Base (for summary sheets)

Rationale for Intervention

As was acknowledged in the December 2007 Consultation Document 'Securing a sustainable future', Government recognises the importance of reducing any distortionary impact of the fiscal regime on investment decisions and helping facilitate asset trades. Government believes that, where assets are in the hands of those most willing to fully exploit them, then this will be to the benefit of the UK.

Over the course of the consultation referred to above, Industry have argued that the current treatment is inconsistent and complicates asset trades, up to and including the point of preventing otherwise viable asset deals from proceeding. They also argued that the current rules for taxing chargeable gains within the UKCS imposes a unique "double taxation" burden, in that an increase in value in a field that was then sold would potentially give rise to a chargeable gain in the hands of the vendor. As the reserves were then extracted by the purchaser, they would be subject to the special North Sea fiscal regime that is expressly designed to capture a fair share of the value of the natural resource being produced. Companies argued that as vendors they were being taxed on the value of oil they had not produced, and as purchasers they were then caught because they could not offset the capital cost of acquiring the licence interest against the income charge on production.

Analysis suggested that the current legislation was standing in the way of some asset trades, and Government therefore makes the following proposals.

Policy Proposals

Government proposes to undertake the following actions in relation to the treatment of chargeable gains within the North Sea ring fence:

- To build on the existing provision under which pre-development licence interests can be swapped for nil consideration, by providing that where UKCS development licences are swapped, no gain will arise to the extent that the value of the licence acquired franks the value of the licence disposed of.
- That where the proceeds of a UK licence sale are reinvested in other UK licences then the gain on the original sale will be exempt.

These changes will assist in encouraging asset trades that will bring North Sea assets into the hands of those companies most willing and able to develop them to their full potential.

In arriving at these proposals Government did not consider it appropriate that all disposals of licence interests should fall outside the scope of the chargeable gains regime. If a company has benefited from the increase in value of a licence interest during its ownership (and the most common reason will be an increase in the price of oil or gas), then if the proceeds of the sale are not reinvested within the UKCS, it is right that any chargeable gain should be subject to tax. The changes are not designed to remove barriers to operators leaving the basin entirely.

Consultation Responses

Industry has strongly welcomed the proposed changes to CG and is of the view this will significantly benefit the sector as assets are more easily moved into the hands of those most likely to exploit them. HMRC outlined the changes in detail to industry in December 2008 and since then there has been a useful dialogue on the legislative detail of the changes, to ensure they have the intended effect. Industry also recognises the simplification benefits from reducing the number of circumstances in which a chargeable gain will arise.

Some stakeholders suggested that the Chargeable Gains regime should be removed entirely from the North Sea, on the grounds that it would have the same effect as the proposed policy, but would result in a simpler regime. Government rejected this idea on the basis that the rationale for these proposals is to get assets into the hands of those most likely to reinvest in them, and to encourage the reinvestment of proceeds from asset sales in the North Sea. The aim is not to reduce the tax for companies wishing to leave the North Sea by removing the chargeable gains regime from all cash disposals. However, the Substantial Shareholders Exemption (SSE) remains available should companies wish to sell companies containing particular assets. HMRC believe that removing Chargeable Gains entirely would also potentially leave the Exchequer exposed to further compliance risks, particularly arising from “profits into gains” avoidance schemes. The Government therefore intends to retain the approach set out in the consultation document and subsequent communications with industry.

Costs and Benefits

The proposed changes will not introduce new onerous information obligations on companies operating in the North Sea. Although there will be costs associated with familiarisation with the new legislation these are not expected to be significant. There may be some recurring savings in record-keeping for companies where realised gains are now exempted rather than held over. However, only a small number of companies are engaged in oil and gas exploration and extraction, and only a proportion of them 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 relation to the preferred Option 4 will be negligible, both in terms of any transitional costs, recurring annual costs or recurring savings. In any case, additional costs should be judged in the light of the commercial opportunities facilitated by the proposed changes.

Options 2, 3 and 4 all remove barriers to asset trades. In the case of 2 and 4 compliance cost savings should accrue to companies through the removal of a requirement to track gains through the existing rollover system. For all three options tax would be levied in fewer circumstances than at present, but the result of Government’s analysis suggests that the result will be to encourage more investment and activity, leading to a greater recovery of North Sea oil and gas reserves and hence to an additional tax yield overall.

Compared to Option 2, this effect is likely to be magnified by Options 3 and 4, as they provide more restrictions on the current application of tax and as a result should encourage greater investment and activity compared to Option 2.

Option 4 largely achieves the same ends as Option 3 but does so in a much simpler way, i.e. providing a pure exemption from chargeable gains taxation (following reinvestment in the North Sea) rather than enabling holdover gains to be converted to rollover gains. Option 4 has the additional benefits of providing greater clarity and simplicity and, at the margin, more business certainty and reduced admin burdens. The Government proposes Option 4.

In all cases the change in business admin burdens and compliance costs is likely to be small per business and negligible in total (in part because a maximum of only around 160 companies are likely to be affected). Widespread or significant changes to IT systems and other business systems are not anticipated. Familiarisation costs are likely to be negligible, more so for Option 4 than for Option 3 because the former is much simpler, including in terms of the legislative change required.

To the extent that additional business costs are incurred this would largely be because the removal of a tax barrier has encouraged greater activity. In general we would assume that if a business chooses to engage in greater activity and investment they would have formed the view that the costs of doing so would be outweighed sufficiently by the benefits to them.

The changes to HMRC’s own administrative and operational costs are also expected to be negligible.

Impacts

Results from the Specific Impact Tests can be found in the Annexes 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

Specific Impact Tests: Results

Competition Assessment

The proposed change will remove a fiscal barrier that could prevent North Sea companies wishing to rationalise their asset holdings from being able to agree mutually acceptable terms. As such the preferred Option 4 promotes the exchange of assets on normal commercial terms. It should also make it more likely that new investment will be attracted into the North Sea.

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 Chargeable Gains taxation.

Legal Aid

The proposed changes will have no implications for legal aid.

Sustainable Development

The proposed changes should improve the sustainability of the economy by helping to increase production of oil and gas from the North Sea, and consequently ensuring a secure and affordable energy supply.

Carbon Assessment

The Government remains committed to moving towards a low carbon economy, however, while low-carbon energy solutions are developed, oil and gas will continue to play a central role and the Government has a clearly stated objective to maximise the economic recovery of the UK's oil and gas resources.

The marginal impact of the proposed changes on carbon emissions is likely to be very small, and impossible to measure.

Other Environment

Waste management, air quality, habitat and wildlife will not be affected by the proposed changes. The effect of the proposed changes on the landscape and noise levels will be ameliorated by the fact that the oil and gas fields in question are some distance offshore. Climate change will not alter the impact of the proposal.

Health Impact Assessment

The proposed changes will have no health 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.