HMRC - OT05375 - PRT: Valuation Of Non-Arm's Gas - Valuation Of Light Gases From 1 January 1994 - Legislation

Under OTA75\SCH3\PARA3A, the market value of any light gases is the price at which, having regard to all the circumstances relevant to the disposal or appropriation in question, light gases of that kind might reasonably have been expected to be sold under a contract for sale satisfying the following conditions:

the contract is for the sale of the gases at arm’s length to a willing buyer;

the contract requires the gases to have been subjected to appropriate initial treatment before delivery; and

the contract requires the gases to be delivered:

\* in the case of gases extracted in the United Kingdom, at the place of extraction; or \* in the case of gases extracted from strata in the sea bed and subsoil of the territorial sea of the United Kingdom or of a designated area, at the place in the United Kingdom or another country at which the seller could reasonably be expected to deliver the gases or, if there is more than one such place, the one nearest to the place of extraction.

If the circumstances of the disposal or appropriation are such that the price might reasonably be expected to include take or pay or capacity payments as referred to in FA84\S114 then that section shall apply as it applies in an arm’s length sale. It follows that ‘the price’ is a term that encompasses all the pricing terms of a typical gas contract (e.g. prevailing contract price, shortfall price, excess price and take or pay or capacity payments).

An amendment to OTA75\SCH3\PARA3A was included in the Finance Act 1998. This provided a new sub-paragraph 3A to amplify the meaning of ‘circumstances relevant’ by stating that these include:

the timing of the making, and any subsequent variations, of the actual contract or other arrangements under which the disposal or appropriation was made;

the terms of the contract or, as the case may be, of those arrangements, and the terms of any such variations; and

the extent to which the circumstances to which regard is to be had by virtue of (a) and (b) above are circumstances that might reasonably have been expected to exist in the case of an arm’s length contract.

This sub-paragraph makes it clear that, when the valuation rules are applied, the timing and terms of any contract or other arrangements are taken into account when determining the arm’s length price. Thus, for example, if a company has entered into a contract to sell gas to an associate over a five year period, it will ensure that each disposal of gas under this contract is valued at the price under a comparable five year contract between unconnected parties.

‘Light gases’ are defined in OTA75\S12 as oil consisting of gas of which the largest component by volume over any chargeable period, measured at 15 degrees centigrade and one atmosphere, is methane or ethane or a combination of those gases. This definition covers most gas which falls to be valued apart from LPG and perhaps some raw gas which is valued under OTA75\SCH3\PARA2.

The legislation is very short compared with the previous rules on gas elections. It sets out only the principles which are to apply, the essential ones being that the gas is to be valued on an arm’s length basis and having regard to all the circumstances relevant to the disposal or appropriation in question. What must be done is to establish all the relevant facts about the gas to be valued and the circumstances of the disposal and to hypothesise that a similar supply of gas is sold in an arm’s length contract to a willing buyer. The market value is then the price (as defined above) which might reasonably be expected in such a contract.

The legislation does not make specific provision for long term valuations but under the general principle of having regard to all the relevant circumstances, if the market for the gas in question is such that a long term contract would normally be expected, the valuation may be made on the basis that the hypothetical contract is a long term one. For the circumstances in which LB Oil & Gas will be committed to a long term valuation, see OT05392 and OT05412.

The hypothetical contract must assume that the gas has been subject to appropriate initial treatment before delivery. This, and OTA75\SCH3\PARA3A(4), tie the valuation methodology into the general principles of PARA2A. These provisions define the position of the ring fence in respect of gas and ensure that fractionation is regarded as an upstream process (see OT05305).

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