HMRC - OT09325 - Expenditure - Overheads

Most companies involved in exploration and production, ‘upstream’, activities are likely to have a series of support departments, either within the company itself or supplied by a parent or other affiliate. The latter may be non-UK or non-ring fence companies. The costs of these support departments are usually allocated by a variety of means to various project AFEs (authorities for expenditure) or cost centres. Such means include ‘timewriting’ where support staff record their time spent project by project and those times are each translated to a cost. But this is just one of a number of different methods that can be used and there are no hard and fast rules as to how claims should be prepared except that the basis should be ‘just and reasonable’.

Overhead costs are often allocated provisionally on a monthly basis and adjusted at the year end when full details of the actual overhead costs for the year are known. The cost accounting by means of which project charge-out costs are arrived at is often complex and needs to be looked at closely, generally when the first claim for such overheads is submitted, and subsequently on a periodic basis, to ensure that the allocation basis is fair and that the attributed costs are reasonable.

LB Oil & Gas will only allow support expenditure to the extent that it has an identifiable OTA75\S3(1) purpose, such as ‘winning oil’, see OT09125. There must be a direct connection with the project. Costs which are too remote from an allowable purpose or are, for example, concerned with the maintenance of the company are not relievable. During the passage of the Oil Taxation Bill Mr Robert Sheldon, a Treasury Minister, affirmed that any ‘directly attributable onshore control and back-up costs [would] be allowed; sub clause (5) [now OTA75\S3(6), see OT09375)] of the clauses provides apportionment where necessary.’ When pressed in the debate to explain the difference between ‘directly attributable’ and ‘wholly and exclusively’ (ICTA88\S74(1)(a)), he declined and said that the words ‘directly attributable’ could stand as they are and be so interpreted in due course.

LB Oil & Gas accepts that the Minister’s statement provides a basis for giving relief both for onshore costs, which are directly incurred for a specific field purpose, e.g. the costs of the onshore field project team such as the salaries of petroleum reservoir engineers, geologists, geophysicists etc, and for more general support costs such as secretarial and clerical assistance and office overheads etc. Provided an appropriate link can be established between such costs and a field purpose, and the method of allocating them to all of the company’s interests is reasonable, a proportion of them can be allowed. The onus is on the company to demonstrate that there is a direct relationship between the overhead expense and the field qualifying purpose. The view of LB Oil & Gas is that this is not present where the costs in question relate to such activities as maintaining the company or preserving its corporate image.

Disallowable costs

Broadly speaking, the following costs should be identified and dealt with as remote or disallowable items (the list is not exhaustive and merely gives a flavour of the types of expenditure which LB Oil & Gas considers generally to be disallowable):

long-term corporate planning

policy

public and government relations

finance\treasury

tax

advertising, donations, sponsorship

entertaining

legal

intra-group relations.

But not all legal expenses will be disallowable. For example, costs incurred by lawyers or an oil company’s legal department in reviewing project construction or arm’s-length production sales contracts will be allowable. Conversely, those incurred in relation to licence acquisitions will not.

Similarly, not all the costs of the finance department are disallowable. Costs incurred in issuing and responding to billing statements and otherwise recording the financial aspects of a field project will generally be allowable.

Intra-group recharges

Where the company is part of a group it will often make payment to its parent or, as the case may be, another affiliate, by way of a contribution towards that company’s overhead costs which the group considers to have been incurred in connection with the provision of services to, or on behalf of, the payer. The sum paid is usually allocated in the payer’s ledgers to various cost centres rather in the same way as its own overhead expenditure. The basis of any such payment made should initially be examined in detail to ensure that no mark-up is applied. But to the extent that there is a mark-up, the provisions of OTA75\SCH4\PARA2 should be considered, see OT14600.

The view of LB Oil & Gas is that in this type of transaction, it is proper to look through the inter-company payment and to consider the quality of the expenditure when originally incurred. If that expenditure includes, for example

the types of remote and disallowable items listed above, or

an interest element or some other expenditure specifically debarred by OTA75\S3(4) see OT09475, or

non-incurred costs such as a ‘notional rent’,

relief should be restricted accordingly.

LB Oil & Gas will also examine critically the use of simplistic formulae which, for example, allocate expenditure on the basis of the capital expenditure incurred by each of the companies in the group or pro rata to the value of each of their assets.

Supplement on Overheads

See OT12400.

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