HMRC - OT12300 - PRT: Supplement - Substantially Improving The Rate At Which Oil Can Be Won

OTA75\S3(5)(c) allows supplement on expenditure incurred on

carrying out works for

substantially improving the rate at which oil can be won or be transported to the UK or (for claim periods ending after 27 November 1991) to another country, from the field

or preventing or substantially reducing a decline in that rate.

The legislation refers to two separate sets of conditions and both must be satisfied for expenditure to qualify for supplement.

Acquisition of Asset, ‘Carrying out Works’

Firstly the expenditure must be incurred on ‘carrying out works’, or ‘acquiring an asset or an interest in an asset’. Normally, the acquisition of an asset, or an interest in an asset, does not pose any problems of interpretation.

Where the expenditure is not incurred in acquiring an asset, or an interest in one, it will only qualify if it amounts to ‘carrying out works’. It is not sufficient for the expenditure to be capital. The phrase ‘carrying out works’ is not defined but it is the OTO view that, in the context of OTA75\S3(5)(c), it means, broadly, building or engineering operations having the nature of a project, which result in some permanent alteration to the field or the equipment used on it. In other words, a tangible asset is created or improved.

For example, the drilling of injection wells is the ‘carrying out of works’, but once that has been done, the daily injection and compression of gas through those wells to maintain pressure in the reservoirs cannot be characterised as such. Injection is a process which does not result in the creation of anything tangible; it just facilitates the recovery of an existing asset, the oil in the reservoir.

‘Substantially Improving the Rate’ etc.

The expenditure must be ‘for the purpose of substantially improving the rate at which oil can be won or transported to the UK or another country from the field’, or ‘preventing or substantially reducing a decline in that rate’.

While it is not possible to define ‘substantially’ in absolutely precise terms, in the context of OTA75\S3(5)(c) OTO practice is to interpret it as a difference of at least 10%. In addition, where only small amounts of production are concerned, a 10% increase may not be classed as ‘substantial’, i.e. the difference in the absolute amounts produced would not warrant that term. This fits in with the intention to provide relief where major works are undertaken, rather than activities more akin to repairs. (Robert Sheldon, MP, said in the Committee Stage of the Oil Taxation Bill that operating costs were not allowable for supplement because they did not have inherent within them the same charges for interest that one has with capital expenditure (Hansard, Oil Taxation Bill 4 February 1975, page 536).)

OTA75\S3(5)(c) is concerned with both the production and transportation of oil, and the following references apply equally to transportation.

The LB Oil & Gas view is that the comparison that should be made is between the rate of production that the field was capable of before the works were carried out, and the change in the rate of production that the works are expected to achieve. That the works do not achieve their aim is irrelevant. For example, if a field was producing 100,000 barrels of oil per day (bopd), and the works were intended to result in increasing that to 115,000 bopd, supplement would be due on those works. The increase in total field output would be more than 10%, and an increase of 15,000 bopd would in itself be substantial. It would not matter whether, before the works began, the overall trend in production was up or down; the effect of the works would be to increase production.

Each project should be considered separately. For example, unless it can be shown that several wells were drilled as part of a single project, each well is looked at as a separate project. It is the effect of each well on the rate of production from the field that should be considered, not the change in that particular well’s rate of production.

Examples

Costs qualifying for supplement may include

acquiring and installing second and subsequent platforms, see also OT12200

drilling of gas or water injection wells and related compression equipment (but not the costs of injecting the gas or water)

fractionation wells to improve recovery and oil flow

subsea completions

pipelines

work which increases a well’s performance substantially, e.g. well workovers - the correction of an initial well defect etc.

Conversely, costs incurred on an operation which do no more than restore equipment to efficient working, e.g. fishing for lost tools, replacement of worn parts, sealing off, etc. do not qualify under OTA75\S3(5)(c).

On associated overheads, see OT12400.

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