HMRC - OT12575 - PRT: Supplement - Contractor Financing

FA81\S115

Prior to the introduction of FA81\S115, it was possible to circumvent the prohibition of relief for interest (OTA75\S3(4)(a), see OT09475) by having the contractor effectively finance the project. Contracts could be made with extended or deferred payment terms in such a way that the contractor bore the financial cost that would otherwise have fallen on field participators. In return, the contractor would be compensated by an increased price for the contract, the price including a disguised interest element.

FA81\S115 applies to contracts made after 1 July 1980 and tackles the problem by denying supplement on expenditure incurred under contracts where payments are extended or deferred. The actual contract has to be judged against certain payment terms. If the contract fails to meet the necessary criteria, none of the expenditure incurred under it qualifies for supplement.

Two categories of contract do not prohibit the allowance of supplement however, namely

FA81\S115(2)(a), any contract where the amount required to be paid under it by the person (or persons, if they have entered into the contract jointly) incurring the expenditure is less than £10m. (Note that, where relevant, the £10m limit applies to the whole of a transmedian field, not just the UK sector.)

FA81\S115(2)(b)(i), any contract of which it is reasonable to expect, at the time when it is entered into, that not less than 90% of the amount required to be paid under the contract by the person incurring the expenditure will be paid within nine months of commencement of the work.

Otherwise, by virtue of FA81\S115(3), all contracts are measured against a prescribed yardstick. To qualify for supplement, payments must total cumulatively, at any point after the work starts, no less than 75% of what would have been expected in normal circumstances at the time the contract was made.

In effect a notional contract is envisaged under which

payments due are of amounts proportionate to the work performed up to the dates of payment

the first such payment is required within six months of the commencement of work

and each further payment required at an interval of not more than six months after the previous one (but if the contract provides for delay of up to three months in payment after billing, that period can be taken into account in arriving at the stage payments, FA81\S115(4)).

If the contract distinguishes separate parts of the work for the purpose of stage payments, FA81\S115(5), which relates only to FA81\S115(3), and not to FA81\S115(2), provides that each such part is to be looked at as though it had been the subject of a separate contract. This is a mitigating provision only, which may afford relief where the test in FA81\S115(3) is not otherwise met. It has no application if the FA81\S115(3) test is satisfied.

Example

See OT12600.

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