HMRC - OT13960 - Non-Field Expenditure - Abortive Exploration Expenditure: 'Is Not, And Is Unlikely To Become Allowable For A Field'

OTA75\S5(1)(c)

Application to non-taxable fields, OTA75\S5(2A)

In this context the term ‘field’ refers to taxable and non-taxable fields alike and for the purpose of OTA75\S5 only expenditure is deemed to be allowable in non-taxable fields, even though in reality under OTA93\S185(4)(e) it cannot be.

Criteria for applying the test

The onus is on the participator to establish that the expenditure is not or is unlikely to become allowable as field expenditure, the test being applied in relation to the circumstances prevailing at the time the claim is made. If expenditure is disallowed and that disallowance is then the subject of an appeal, settlement of the appeal should therefore proceed on the basis of the factual evidence and criteria at the date of the claim, not some later date.

The participator does however have the option of withdrawing its appeal and lodging a later claim for the same expenditure when the facts might be more supportive of its case.

The following kind of questions need to be raised in testing whether or not the claim can be allowed:

What has been discovered? The fact that oil has been found is not in itself reason to deny relief if economic development is unlikely.

On the basis of present day technology is there a prospect of economic development?

Is there research afoot likely to produce the technology required for economic development?

Having regard to the likelihood of the required technology becoming available, what oil would be necessary to make development an economic prospect?

Has any development scheme been discussed with DECC?

Seismic expenditure

A point often made by participators, particularly in relation to seismic expenditure, is that only a certain proportion of expenditure generally leads to oil discoveries and that therefore a corresponding percentage of current expenditure should be allowed immediately it is incurred. However, the question is one of fact based on the particular circumstances in which the expenditure has been incurred and which are relevant at the time the claim is made. Expenditure on a seismic survey cannot be said to be ‘abortive’ until the data has been interpreted (this may take some time), any remaining obligation wells drilled and any further relevant studies carried out.

Drilling

For a dry hole drilled in open acreage with no further wells planned in the immediate vicinity i.e. 5,000 metres there is normally no question of not giving relief provided the well report supplied by the participators supports its case and confirmation is given that no work of any nature is to be done on that block.

Where a well is suspended temporarily or plugged after establishing or suggesting the presence of oil in quantities which, though not sufficient to justify commercial development are sufficient to indicate a structure exists, then no relief should be given until all work on the prospect has ceased. The participator should be asked, in such circumstances, to submit detailed evidence such as well reports, management reports, economic analysis based on a range of oil prices and recoverable reserves, likely development scenarios etc., and confirmation that no further work is planned on the block. Sometimes a practical test is whether, in the light of drilling results, a participator would be willing to include the location in the area which he is required to surrender at certain stages in the life of each production license. This, however, is only one of a number of relevant indicators.

No relief should be given for expenditure on a block until all the obligation wells for that block have been completed and evaluated.

The withdrawal by a participator from a licence group does not confer an automatic entitlement to relief under OTA75\S5 in respect of pre 16 March 1983 exploration expenditure. If all the licensees surrender their interests in whole or in part then OTA75\S5 relief becomes allowable to all of them. However, the position may be somewhat different where one or more of these licensees choose to retain an interest. It is a question of fact, to be decided at the date of any claim, whether a field development will take place.

If such a development is likely to occur all past exploration costs will become allowable to the remaining participators in the field under OTA75\S3. This entitlement is established by the rule in OTA75\S3(1) that the expenditure must have been “incurred by a person at or before the time when he is a participator in the field” and the definition of a participator in relation to an oil field and any chargeable period in OTA75\S12(1) as “a person who is or was at any time in that chargeable period a licensee in respect of any licensed area then wholly or partly included in the field”. OTA75\S1(3) defines the first chargeable period as including an unlimited time ending at the end of the “critical half year”. It follows that a company which withdraws from a license group before a field which includes any part of the licensed area is determined is nonetheless a participator in that field in relation to the first and next two chargeable periods.

Account should be taken of technological advance and proximity to existing infrastructure. The 1990s saw the development of some very small fields, some less than 5m barrels. The possibility of a small development, based on one well, tied back to another fields infrastructure should be considered.

Abortive wells within 5000 metres of an existing field, but targeted at a different structure were considered in CIR v Amerada Hess. The High Court held that expenditure on said wells could be claimed against the field. It follows that such expenditure will not qualify under OTA75\S5.

Licences

Premium payments may have been paid to DECC on the occasion of acquisition of a license interest. Where such a licence is partially surrendered there is no automatic entitlement to relief in respect of that proportion of the premium payment corresponding to the surrendered fraction. The test for relief in OTA75\S5(1)(c) is whether the expenditure - which in this particular instance is the whole licence premium - is unlikely to become allowable under OTA75\S3(1)(b) for any field within the licensed area. There is no provision for proportionate relief for part licence surrenders. Any payment made by one company to another for an interest in a licence does not fall within OTA75\S5(1)(c).

The licensee register will give details of the licence round for each block and Appendix 2 of this manual (see OT19275) gives details of the terms, including obligation wells of that licence. The “Wood MacKenzie” map section will provide details of the location of oil wells prospects in the block and provide a brief description of the potential of oil shows.

Previous page

Next page