HMRC - OT14050 - PRT: Non-Field Expenditure: Exploration And Appraisal Expenditure: Transitional Provisions: Committed Expenditure

OTA75\S5A(1)(aa), FA93\S188

OTA75\S5A(1)(aa) inserted by FA93\S188 enables transitional relief to be given in respect of certain expenditure incurred between 16 March 1993 and 15 March 1995 (inclusive).

The expenditure must have been ‘committed’ by the company or an ‘associated’ company immediately before 16 March 1993.

See OT13810 on the meaning of ‘associated’.

Committed to expenditure, OTA75\S5A(1A)

A company is regarded as ‘committed’ to expenditure for the purposes of OTA75\S5A(1)(aa) if

(a) it has an obligation under an ‘exploration and appraisal (E&A) contract’ entered into before 16 March 1993 to incur the expenditure or

(b) the expenditure is incurred wholly and exclusively for the same purpose as the contract in (a), and is so incurred under an obligation in an ‘E&A contract’ entered into between 16 March and 15 June 1993 inclusive (for example, this could allow relief where only some of the contracts necessary for drilling a well were in place before 16 March 1993).

Note in particular that obligation wells under arrangements with DECC do not have preserved rights to relief.

Contractual obligation, OTA75\S5A(1B)

Both (a) and (b) are dependent upon a ‘contractual obligation’, a term which is amplified by OTA75\S5A(1B). There are two conditions

(a) If the contract contains a power enabling the company or an associated company to end its obligation under the contract, it shall not be regarded as committed to any expenditure it would not incur as a result of exercising that power. This is the so- called ‘break clause’ test.

(b) Where the company or an associated company has an option to increase its expenditure under the contract, expenditure will not be regarded as committed as a result of the exercise of that option if it was not exercised before 6 March 1993.

It is standard (although not universal) industry practice for E&A contracts to contain various clauses under which the operator can terminate the contract. They may be ‘default’ (e.g. due to contractor’s insolvency) or ‘non-default’. The break clause tests only apply to the ‘non- default’ type that the operator can exercise.

For both pre and post 16 March 1993 contracts the amount of relief is restricted to the expenditure due following the exercise of the break clause. For the pre 16 March contracts the break clause test is applied immediately before 16 March 1993 (unless the contract provides for a later date).

E&A contract, OTA75\S5A(1C)

A contract is an ‘E&A contract’ if it is a contract for the provision of any services or other business facilities or assets for any of the purposes specified in OTA75\S5A(2), see OT13975.

Some companies have sought to argue that a Joint Operating Agreement when combined with the appropriate AFE can be an E&A contract. LB Oil & Gas does not accept this. The provision was discussed extensively with individual companies and representative bodies. Discussion proceeded on the basis that the subject matter of OTA93\S188 was the contract between the operator and the contractor. Indeed changes were introduced at Committee Stage, at the industry’s request, to clarify that the power in referred to in OTA75\S5A(1B)(a) has to be exercised by the operator as opposed to the contractor. These changes were clearly aimed at contracts between the operator and the contractor. Any contention that relief is due on some other basis should be resisted.

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