HMRC - OT15920 - PRT: Tax-Exempt Tariffing Receipts - Cost Allocation The Modified Approach

Expenditure related to the use or expected use of an asset, or the provision of any services or other business facilities of whatever kind in connection with that use, for tax-exempt tariffing purposes is not allowable for PRT. Where an asset is used, or is expected to be used, partly in connection with a purchaser’s own field, or fields, and partly for tax-exempt tariffing the expenditure should be apportioned on a just and reasonable basis to the respective uses of the asset (see OT15910).

In most situations where a just and reasonable apportionment of expenditure is required, LB Oil & Gas considers that -

operating expenditure incurred in connection with an asset should be allocated by reference to the throughput of the fields using the asset during the claim period (OT09375).

expenditure incurred for long term assets should be allocated by reference to the fields expected to use the assets on the basis of their expected recoverable reserves (OT11400).

This general approach is modified in tax-exempt tariffing situations (see Modified Approach).

Modified Approach

During the development of the tax-exempt tariffing legislation comments were invited on the draft legislation and the treatment of costs underlying tax-exempt tariffing activity. The Industry Representative Bodies raised several points concerning how cost allocation should apply in tax-exempt tariffing situations, particularly that a throughput basis of apportionment was not necessarily appropriate in all cases and that the throughput basis could reduce the scope for reducing tariffs. It was also considered that a degree of certainty and transparency on the issue of cost allocation was required to facilitate negotiations with potential user fields.

LB Oil & Gas does not accept that these points are valid for all tax-exempt tariffing situations. LB Oil & Gas does, however, accept that there is a case for modifying the general cost allocation approach in tax-exempt tariffing situations in order to ensure that a just and reasonable apportionment of expenditure is achieved. The form of this modified approach was the product of a constructive discussion with the Industry Representative Bodies following which LB Oil & Gas has accepted that, where the modified approach applies, the expenditure allocable to the tax-exempt tariffing use will be the amount equivalent to 50% of the gross tariff from the user field, subject to the limitation that the expenditure allocated cannot exceed average cost or be less than the incremental cost (see OT15940).

The modified approach has been broadly endorsed by the Industry Representative Bodies. While the endorsements do not bind their members there is an expectation that the modified approach will be followed in the majority of tax-exempt tariffing situations. In practice it will be necessary for the responsible person (OT04030) for the host field, or where appropriate the substitute operator, to agree with LB Oil & Gas that the modified approach applies. If, exceptionally, the responsible person for the host field or the substitute operator consider that an alternative approach is required to achieve a just and reasonable apportionment LB Oil & Gas will need to be satisfied that this is the case. A detailed review of the circumstances and the arrangements will be required in all such situations.

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