HMRC - OT15940 - PRT: Tax-Exempt Tariffing Receipts - Cost Allocation Calculation

For details of the circumstances in which the modified approach to cost allocation in tax-exempt tariffing situations applies see (OT15920).

Where the modified approach applies the amount of expenditure allocable to the tax-exempt tariffing use is:

the amount equivalent to 50% of the tariff from the user field, or

if the average cost attributable to the tax-exempt tariffing use is lower than the amount equivalent to 50% of the tariff - the average cost attributable to the tax-exempt tariffing use, or

if the incremental cost attributable to the tax-exempt tariffing use is higher than the amount equivalent to 50% of the tariff - the incremental cost attributable to the tax-exempt tariffing use.

Expenditure allocable to tax-exempt tariffing use is not allowable (OT15910).

The terms “Tariff from the user field”, “Average cost” and “Incremental cost” for the purpose of the modified cost allocation approach are explained below.

Tariff from the user field

In the majority of situations 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, in connection with a user field for tax-exempt tariffing purposes will be fully reflected in the level of the tariff received or receivable by the participator or participators owning the asset. In these situations the “Tariff from the user field” is the tariff received or receivable for the use or services provided. Where however the amount of the tariff received or receivable does not fully reflect the value of the use or services provided it will be necessary to consider if the cost allocation should be calculated by reference to the gross tariff that would have been receivable or if the modified approach should only be applied to that part of the expenditure attributable to the use that relates to the net tariff.

A tariff may include an element intended to recover capital costs incurred by the host field. Where the expenditure incurred is not allowable to the host (for example user field tying-in costs - see OT15920) the gross tariff should be reduced by the amount intended to recover these capital costs for the purpose of ascertaining the “Tariff from the user field”.

Average cost

For the purpose of the modified cost allocation approach “Average cost” is:

for operating expenditure - the user field’s share of non-field specific expenditure incurred in connection with the asset allocated by reference to the throughput of the fields using the asset during the claim period,

for long term asset expenditure - the user field’s share of the long term asset expenditure allocated by reference to the fields expected to use the asset on the basis of their expected recoverable reserves.

Incremental cost

For the purpose of the modified cost allocation approach “Incremental cost” is:

for operating expenditure - the additional non-field specific expenditure incurred in connection with the asset as a consequence of use in relation to the user field during the claim period,

for long term asset expenditure - the additional long term asset expenditure incurred as a consequence of use or expected use in relation to the user field.

Practical Application

The responsible person (OT04030) may wish to discuss the practical application of the modified approach with LB Oil & Gas in advance of claims being made. The modified approach requires a comparison of 50% of the tariff, incremental cost and average cost over the period of use by the user field. It is envisaged that in most situations it will be clear from the outset if an amount equivalent to 50% of the tariff will exceed incremental cost. Where an amount equivalent to 50% of the tariff does not exceed incremental cost LB Oil & Gas will be willing to take a view as to the likely proportion of incremental costs and to agree an appropriate cost allocation on a forward basis.

It is also envisaged that it should be possible to determine if an amount equivalent to 50% of the tariff is likely to exceed average cost or fall below average cost. In order to reduce the need for period by period comparisons LB Oil & Gas will therefore be prepared to agree with the responsible person whether the cost allocation to be used for future periods should be an amount equivalent to 50% of the tariff or average cost as appropriate.

Where a responsible person wishes to agree a forward basis LB Oil & Gas will need to consider the tariffing arrangement and underlying cost projections relating to the new business. Where it is not possible to determine at the outset what the appropriate cost allocation basis should be, or the responsible person does not opt to agree a forward basis, it will be necessary for comparisons to be made on a cumulative basis each claim period. LB Oil & Gas will need to review the basis used to calculate the amount equivalent to 50% of the tariff, incremental cost and average cost at the outset and at periodic intervals.

Where the modified approach applies expenditure claims made by the responsible person and claims by the participators should identify the restrictions made to exclude the costs attributable to tax-exempt tariffing and should include a calculation of the appropriate disallowance. Where possible, LB Oil & Gas will normally expect the full disallowance for tax-exempt tariffing in a chargeable period (OT04005) to be reflected in the Schedule 5 claim for the claim period (OT04420). Where this is not possible, or there are reasons why this is inappropriate, LB Oil & Gas will be prepared to discuss with the responsible person alternative ways of ensuring that the full disallowance is reflected in the claims for the field.

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