HMRC - OT17750 - PRT: Safeguard - Deferred Expenditure Claims

OTA75/S9A

Disallowance of Expenditure, OTA 75\S9A(1) and (2)

OTA75\S9A was inserted by FA00\S139. It prevents participators obtaining additional relief by deferring claims for operating expenditure during safeguard.

The provision applies to all Schedule 5 and 6 claims for ‘operating expenditure’ incurred on or after 21 March 2000 that

is incurred during a chargeable period to which safeguard applies (‘the relevant chargeable period’) and

is incurred in a claim period which coincides with that chargeable period (‘the relevant claim period’);

and is claimed more than four months from the end of that claim period.

Where those three preconditions are met, the operating expenditure will usually be disallowed. Expenditure can only be allowed to the extent that it would have been tax effective had it been allowed before the making of an assessment for the relevant chargeable period.

There are a number of factors that may need to be considered when looking at the overall tax effect of a deferred claim. For example, it may be that the expenditure in the deferred claim, had it been allowed, would have had the effect of moving the net profit period forward by virtue of FA81\S111(4) (see OT12700), and therefore of extending safeguard. Even if it cannot be allowed under OTA75\S9A(2) when first submitted, its tax effect on any future safeguard period(s) will still need to be taken into account. In such circumstances, where the tax effect depends upon future events, reservation of a decision may be necessary until the amount of the participator’s liability becomes clearer.

See Examples (1) and (2) at OT17760 and OT17770 below which, respectively, illustrate full and partial disallowance.

Treatment of Oil Allowance, OTA75\S9A(3)

OTA75\S9A (3) provides for the ‘adding back’ of oil allowance where deferred claims have been disallowed. If companies have used oil allowance in the relevant, or subsequent, chargeable periods, which they would not have used had the expenditure been claimed and allowed before the making of an assessment for the relevant chargeable period, the metric tonnes in question are added back to the total amounts available for future field use per OTA75\S8(6).

See Example 3 at OT17780 below.

Operating and Capital Expenditure, OTA75\S9A(5)

OTA75\S9A only applies to ‘operating expenditure’. Operating expenditure is defined in OTA75\S9A(5) as expenditure which is not capital expenditure. Capital expenditure is defined as expenditure on the acquisition or construction of an asset which is to be used for any of the following purposes in relation to oil in a field:

‘ascertaining’, see OT09100

‘winning’, see OT09125

‘transporting’, see OT09175

‘initial treatment or initial storage’, see OT09200.

The full definition in OTA75\S9A(5) of the above categories follows the statutory wording in the respective subsections of OTA75\S3(1).

Provided one of the above purposes is met, capital expenditure will include the cost of new infrastructure (platforms, pipelines etc.), the tangible and intangible costs of drilling wells and the acquisition of seismic surveys and processing. On the other hand, operating expenditure will include repairs, enhancements of existing assets, the costs of maintaining and using capital assets such as the ongoing costs of operating wells (e.g. well workovers, injecting water or gas into a reservoir etc.). Neither list is exhaustive.

Enhancement on its own does not qualify as capital expenditure. However, if the enhancement involves the construction or acquisition of a separate asset and meets one of the specified purposes, it will be capital. In determining whether an asset is separate, LBS Oil & Gas will consider a number of different factors including size, relative importance, function and cost. On occasion it may be appropriate to consider the formal treatment of the expenditure in the company’s accounts.

Intangible drilling costs (e.g. direct labour costs, fuel, repairs, supplies, transportation etc) qualify as capital expenditure to the extent that they are ‘directly attributable’ to a particular drilling project that also qualifies as capital for the purposes of OTA75\S9A (5). There would be a presumption that they would be capitalised for accounting purposes per the recommendation of the Oil Industry Accounting Committee.

Interaction with Licence Transfers, OTA75\S9(4)In between the relevant chargeable period and the actual making of the claim, the claimant may have disposed of all or part of its interest in the licence to a new participator. OTA75\S9A(4) ensures that, when applying the tests in subsections (2) and (3), reference to a participator includes both old and new participator, unless there has been a successful application under FA80\SCH17\PARA4, see OT18030.

Twelve-Month Claim Periods, OTA75\S9(6)Claim periods may be for twelve months rather than six, see OT04420. In such cases OTA75\S9A(6) prescribes that the period should be split into two deemed periods of six months to ensure that each coincides with the six-month relevant chargeable period. The expenditure is apportioned on a just and reasonable basis between the two deemed periods.

Confidentiality

Where the deferred claim is made under Schedule 5, there may be issues of confidentiality between the participators. They will inevitably have different tax liabilities in the field and may, therefore, be affected differently by the application of OTA75\S9A. Such difficulties are not novel and several ways of protecting a taxpayer’s confidentiality are considered at OT04450. Any company likely to be in this position should therefore discuss with LBS Oil & Gas the various possible practicalities.

Previous page

Next page