HMRC - OT19140 - PRT: Appendices - PRT/Accounts Reconciliation (Full Version)

Purpose of this Paper

The following paper was issued to UKOITC (The United Kingdom Oil Industry Taxation Committee, formed in 1965) and BRINDEX on 2 July 1991.

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This paper was produced in order to update the instructions and guidance given to inspectors within OTO. A copy of it has been supplied to UKOITC and Brindex for the help and guidance of their members.

Top of page

Why reconciliations are needed

For most of the taxes dealt with by the Inland Revenue it is not normal to adopt an audit approach to tax returns. Rather computations are submitted by taxpayers based on accounts. In the case of companies of the size dealt with by the Oil Taxation Office these will often be accounts which have been subjected to internal audit and external audit on an ongoing basis. Because of the structure of the PRT legislation however, particularly that part relating to the allowance of expenditure, most expenditure claims are submitted, examined and determined long before accounts covering the claim period are available. Returns of incomings for PRT purposes are also made ahead of audited financial accounts. As regards expenditure, and particularly at the first claim stage, OTO’s examination methods involve some inspection of basic records and consideration of accounting systems, but it has always been recognised that this process falls well short of a full audit and the OTO would need further reassurance as to the accuracy of PRT claims and returns. This can only be achieved by a reconciliation of those claims and returns with the audited accounts and CT computations when they become available.

For PRT as with any tax there will always be some items of income and occasionally some items of expenditure where the taxability or allowability of the payment may be in doubt. Within the context of CT it is possible for an Inspector to see from the accounts that there has been a receipt which has been treated as non-taxable. The sort of items that are in mind are insurance receipts, compensation payments, recoveries from partners of payments made earlier. Where there is doubt as to whether these items should be taken into account for PRT purposes it will not be apparent to the Inspector who deals with the expenditure claim that the taxpayer may have taken the benefit of the doubt and claimed the gross payment or left out an item from the return of receipts. This may be a perfectly proper course of action but the Inspector is not in a position to consider the technical merits of the decision that has been taken unless he or she is aware of the item concerned. Companies should be encouraged to provide details of such receipts spontaneously. However where they do not do so the PRT/Accounts reconciliation will disclose the existence of such receipts and provide the opportunity for the Inspector who deals with the claims to consider the technical merits of the company’s view.

As was considered above it is common for a field that is assessed up to date and in particular for one that is paying tax for claims to be made in advance of submission of related accounts and CT computations. The same will be true of a field which surrenders CFA. By contrast in the early years of development of a field (other than a donor of CFA) claims for expenditure relief under Schedules 5 and 6 may be made many years after the related accounts and CT computations have been submitted. Equally, where a taxpayer incurs exploration, appraisal or research expenditure but has no or limited PRT-liable field interests, claims for relief under Schedule 7 may not be made until many years have elapsed since the expenditure was incurred. In these circumstance there is no good reason why decisions should be taken on claims unless they can be seen to reconcile back to the accounts and computations that the OTO already hold. Similarly, in view of the long periods involved in the development of most fields claims for the early years should in future be submitted together with reconciliations as a matter of course and it will increasingly become the practice of OTO not to take decisions on such claims until they have been reconciled to the earlier accounts and CT computations.

It may be the case that within the OTO a different Inspector deals with the field and the CT computation. The Inspector dealing with the CT will take overall responsibility for PRT/Accounts reconciliations and if a claim is received for a back year the Inspector examining the claim will not take a decision on it without first consulting the Inspector responsible for the reconciliation. It would help this process if claims would identify the schedule within reconciliations where the expenditure unclaimed is recorded.

Top of page

OTO’s aim

OTO’s aim is to obtain a reconciliation of claims and returns to accounts and computations for every producer and for every year in which that producer is involved in the North Sea. For the future it will be the aim to receive the reconciliations together with the CT computations in line with the target dates set by pay and file. Indeed for a company masking PRT expenditure claims a reconciliation should henceforth be regarded as an integral part of the CT computation. It is recommended that there are in many cases a substantial number of back years for which reconciliations still need to be provided. In some cases it may be necessary to adopt a different standard of reconciliation for these earlier years in order to clear the backing. Wherever possible and in particular where it can be seen that little or no tax is at risk, OTO will adopt a pragmatic approach to the need to clear reconciliations for early years.

The primary course of the reconciliation is to provide a check on PRT not on CT so CT appeals should not be kept open solely because reconciliations are outstanding. However Inspectors have found the analysis in reconciliations helpful in examining CT computations and there have been instances of errors in CT computations being discovered in the course of performing the PRT/Accounts reconciliation.

Companies that have not submitted reconciliations should be encouraged to supply details of the dates by which they expect to supply reconciliations. If companies are reluctant to supply timetables or if having done so they fall behind schedule careful consideration should be given to what action is appropriate on OTO’s part taking into account all relevant facts. Depending on the circumstances it may be necessary to defer taking decisions on claims until reconciliations are received.

It is important that when companies are taken over or when a field interest is sold, the purchaser retains access to all the information needed to produce outstanding reconciliations and to analyse expenditure shown as unclaimed on reconciliations that have been received. If we are involved in any pre-transaction clearances the opportunity should be taken to draw attention to the need to retain access to old record.

Top of page

The accounts and CT computations

Before considering the reconciliation to the accounts it is convenient to consider the information that ideally should be provided in the CT computations. UK incorporated companies will submit audited accounts and in nearly all cases non UK incorporated companies will also provide audited accounts. In any case where a company declines to submit audited accounts OTO will need to consider with the company whether the accounts submitted are adequate for tax purposes, the company’s reasons for not submitting audited accounts, and possibly further measures by way of inspection of primary accounting records that may be needed on an ongoing basis. If extra resources are needed to examine claims and computations from companies that do not produce audited accounts this may lead to some delay in the taking of decisions.

The starting point for the computations should be an analysis of the movement on the fixed asset accounts between the opening and closing balances of the year of both tangible and intangible assets. The movement should be broken down on a field by field basis and also within each field by reference to capital allowance categories. Non field expenditure, in particular exploration, should be analysed by block or by license wherever possible highlighting in particular areas which are close to development. It should also be the aim to analyse operating expenditure on a field by field basis as well as between internal categories and the allocation of any head office costs, parent company costs or research and development into the company and/or into fields should also be shown.

Receipts such as compensation and insurance receipts should be identified. They may not appear in the profit and loss account but may be treated as adjustments to fixed assets accounts that is as credits to those accounts. These items need to be identified so that the gross expenditure on the fixed asset account can be reconciled with expenditure claims. When such items are identified in the computations by Inspectors dealing with CT they should report them to the Inspector dealing with the particular field or other affected area of claim for consideration. Miscellaneous receipts should be reported in a similar fashion (e.g. receipts arising out of exploration or research).

Top of page

The reconciliation

The reconciliation should take account of incomings to identify all receipts and reconcile them to the PRT1. In particular S493 adjustments should be recorded between the CT accounts and the PRT returns and tariff receipts and chargeable disposal receipts also need to be identified.

The format of the reconciliation is a matter for the particular company but it should provide all the information set out below. Companies should be encouraged to supply only a reconciliation of the accounts to claims and refrain from providing the intermediate stages that the company needs to go through such as reconciliations to trial balances and billings. Operators will however be expected to provide reconciliations between Schedule 5 claims and billings to all other participators in fields for which they are operator. OTO will consider operators performance in this area in any review of the suitability of a particular operator to act as responsible person.

A reconciliation which amalgamates several years may be acceptable in clearing arrears where little or no tax is at stake. This may be in situations where it is accepted that there is little likelihood of there being any tax payable in respect of the field, in situations where expiry of time limits is not likely to be a factor because the periods terminate before the first claim period for any affected field ends, and in circumstances where the expenditure is clearly seen to be in a period where the field is pre-pay back. It will still be necessary to have a more detailed year by year analysis and consideration of accruals around the period at which a field approaches pay back. Because Sch 7 claims are always intended to be tax effective it will be necessary to reconcile them on an annual basis.

The reconciliation should be designed to tie the expenditure in the accounts which has already been analysed on a field by field basis back to identified expenditure claims under Schedule 5 and Schedule 6. There should also be a full reconciliation of exploration expenditure and any research and development as analysed in the accounts and computations back to the Schedule 7 claims. The analysis of claims should identify the claim numbers agreed with the OTO and if that information is not available the date of the claim.

The reconciliation should identify unclaimable expenditure in particular terms such as interest, depreciation, onshore exploration and buildings. Expenditure on exempt gas fields also needs to be separately identified. This is necessary so that it can be seen that none of this expenditure has unwittingly franked claims that have been made. Inspectors should look for negative amounts in this expenditure analysis as these may indicate receipts which have been ignored for PRT purposes.

If the reconciliation reveals over claims they should be explicitly identified when the reconciliation is presented to OTO. (See also Examination of the Reconciliations below).

There will be a residue of expenditure which is in principle claimable for PRT purposes but has not yet been claimed. This will relate to fields under development, and similar prospects and also unutilised exploration expenditure where the taxpayer has no need of Schedule 7 claims. It is important that this expenditure is analysed to the extent that is possible when the reconciliation is prepared. This will enable future claims to be checked against this analysis and avoid a further reconciliation. It will be useful if an ongoing memorandum of unclaimed amounts is submitted each year with the reconciliation for the latest year showing the unclaimed amounts of earlier years updated by claims made since the previous reconciliation.

OTO does not recognise as a general principle that there may be a setting off of over claims against “under claims”. Companies are not obliged to claim expenditure and OTO cannot be involved in considering whether an “under claim” arose as a result of deliberate policy or as a result of error. In considering culpability in relation to over claims OTO will not as a matter of principle accept the offsetting of over claims with “under claims” but a flexible approach will be taken in setting particular cases and regard will always be had to all of the circumstances and the merits of the particular case before forming a view on culpability.

Where the company is not the operator for a field it will probably have unrecognisable differences because of differences in exchange rate policies and accruals. The resolution of such problems will be dealt with on a case by case basis. Inspectors will need to consider carefully explanations put forward and exercise judgement in reaching agreement with companies. Similarly the reconciliation may include amounts described as unclaimed amounts. These may constitute over claims. And accounts expenditure may need to be increased in the course of the reconciliation by various adjustments to make the figures reconcile. Inspectors will need to consider such adjustments critically. It would help the process of reconciliation and the examination of claims if companies would, when making claims, always specifically identify and give the reasons for negative items of expenditure included within claims.

It will be necessary to analyse the turnover in the accounts between arm’s length and non arm’s length sales in order to agree adjustments under S493. If this analysis is provided before final agreement of valuation issues has taken place it is possible that they may be changes in the designation of sales from arm’s length to non arm’s length. It may be necessary therefore to check that the analysis is agreed. Errors in this area are likely to operate against the taxpayer’s interest.

In certain circumstances, the OTO will agree to examine ‘informal’ claims, particularly those relating to Schedule 7 expenditure. This procedure enables a company to submit details of allowable expenditure without, in the case of Schedule 7 claims, specifying the field of claim or period for allowance until a formal claim is submitted. The procedure operates on the basis that the same care is required for an informal as for a formal claim, and that the latter must specify the exact items being claimed from any formal ‘pool’. The reconciliation should be to the informal claim, which will normally be based on accounting periods. Where subsequent formal claims have been made they will already be reconciled to the informal claim.

Top of page

Examination of the Reconciliations

The fact that reconciliations have been received in OTO should be taken into account by each Inspector with PRT responsibilities for the taxpayer and for each field in which the company is a participator in examining claims.

It is expected that the first reconciliations that are received from any company will need the most careful examination. Inspectors will need to satisfy themselves that the reconciliation has been competently performed and that all matters that need to be considered have been considered. It will be necessary for the Inspector to inform himself as to the detailed way in which the reconciliation has been completed and presented. Provided the method of doing the reconciliation remains consistent it is to be anticipated that future reconciliations will be agreed more readily. The greatest value in reconciliations will therefore have been achieved by the time the reconciliation is completed. By that time companies will probably have made any further claims that they feel they ought to have made and they will have notified OTO individually of over claims as they have been identified.

Paragraph 9 Schedule 2 OTA 1975 provides that where any return statement, declaration or accounts as are mentioned in Paragraph 8 Schedule 2 were made or submitted by any person neither fraudulently nor negligently and it comes to his notice those were incorrect then, unless the error is remedied without unreasonable delay, the return statement, declaration or account shall be treated as having been negligently made or submitted by the first mentioned person. It is important therefore that as companies discover errors or over claims in the course of performing the reconciliations they bring them to OTO’s attention immediately without waiting for completion of the reconciliation. This will ensure that in cases where the original error was not one arising from negligence that Para 9 does not operate to treat it as such.

Top of page

Results

It is accepted that a totally balanced reconciliation will often prove difficult to achieve. Whatever method a company uses most exercises will finish with an unexplained difference. As far as seems reasonable, having regard to the amount of the difference both in absolute terms and in relation to total expenditure, the company should endeavour to establish the reason or likely reason for the difference. In the final analysis it is a matter for judgement at what point and level an unexplained difference should be accepted. Clearly a difference representing excess PRT claimed expenditure over CT expenditure gives OTO more cause for concern than the reverse situation. It is in fact more likely on the evidence of completed reconciliations seen that the company will uncover PRT claimable but unclaimed expenditure as a result of the exercise. Additional expenditure claims submitted in these circumstances will be subjected to careful examination. Where for time limit reasons such an additional claim is submitted before submission and examination of the reconciliation concerned, examination of the PRT claim may need to be deferred until the reconciliation is submitted and examined.

When further claims are made as a result of a reconciliation it is not enough for a company to identify the existence of unclaimed amounts. There may have been good reason for not claiming the expenditure. Thus claims arising from a reconciliation must identify the nature of the expenditure and demonstrate that it is allowable in the particular field or under Schedule 7.

Previous page

Next page