HMRC - OT20203 - Overview Of The Main Types Of Costs Incurred In Oil Exploration And Production - Exploration

This covers broadly the period from the obtaining of the licence to the time when a decision is made to develop, or not to develop, a field. The expenditure will mostly be concerned with evaluating the licence area, the drilling of exploration and appraisal wells, and the decision whether to go ahead, or to wait, or to give up the interest.

Expenditure during this period will be mostly capital rather than revenue as there is the bringing into existence of a capital asset (an advantage that is available for the trade). See Atherton v British Insulated and Helsby Cables Ltd 10TC155, reaffirmed and extended by the House of Lords in Granada Motorway Services Ltd v Tucker 53TC92. The Granada case confirmed that in principle expenditure on getting rid of a disadvantage may be capital expenditure in the same way as expenditure on acquiring an advantage. The case also confirmed that in principle, both tangible and intangible costs could be capital expenditure. For one example of the application of the law as to the nature and extent of possible capital expenditure in the oil industry see the comments of Mr Justice Vinelott in RTZ Oil and Gas Ltd v Elliss 61TC132.

Internal costs directed to asset creation and asset enhancement etc will, in principle, be as much of a capital character as costs paid away to third parties.

Relief, if at all, for this expenditure will be under the capital allowance legislation, with the great majority of expenditure probably qualifying as RDA, MEA and P&M. There will however, be some small revenue expenditure e.g. the annual payment of licence rental. The allowability and timing will depend on whether or not the company is trading.

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