HMRC - OT20300 - Take Or Pay Gas Sales Contracts

To secure an adequate supply of natural gas in the early years of exploiting North Sea reserves, a purchaser will often have entered into a long term sales contract and agreed to pay the producer for a specified minimum quantity of gas even if that gas was not taken. Although the details of contracts vary, a typical one may specify that the purchaser is required to pay the seller for a certain quantity of gas each year, whether or not the purchaser can take delivery of that quantity in the year. If it cannot take delivery, the purchaser may be allowed credit in future years for any payments in respect of gas not taken. There may be circumstances where payments are refundable.

For accountancy purposes, it is usual for payments by the purchaser for gas not delivered at an accounting date to be dealt with as deferred credits in the balance sheet of the seller. They are regarded as payments in advance for gas to be delivered, and are released to the profit and loss account when the purchaser is entitled to receive credit for them. In effect, the profit element is brought into account when the gas is delivered.

In accordance with general tax law, the earliest chargeable period in which trading profits can be recognised for tax purposes is that in which the item sold to the customer has been substantially rendered to him. Take or pay contracts are considered to be contracts for the sale and delivery of gas. The purchaser is paying for gas and its delivery. It therefore follows that until the gas has been delivered, the service the customer is paying for has not been rendered. It is when the gas is delivered that the profit arises. It does not arise when payment is made.

The above paragraph is based on legal advice.

Once a company has adopted International Accounting Standards (IAS), the payment for the right to take amounts of gas in the future may be accounted for as revenue (see OT02025).

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