HMRC - OT30021 - Farm Outs - Exploration

Consideration

For relatively unexplored acreage consideration will generally consist wholly, or mainly, of the Farmer in undertaking to bear future costs (e.g. drilling). This will be a specified work programme in respect of both the proportionate interest in the licence to be acquired and any interest retained by the Farmer out. The assignment is normally made, subject to government consent, before the work is undertaken and is called a Farm in. In contrast, an agreement under which the work obligation is to be completed before the assignment is generally referred to as an earn-in.

The Farmer in may also pay a cash reimbursement to the farmer out for sunk costs relating to the proportionate interest acquired, or grant a subordinated interest e.g. for a share in future net profits or production out of that licence interest.

The potential capital gains consequences of creating a Production or Profit Participation Agreement are covered by the general guidance in the Capital Gains Manual on Deferred Consideration at CG14850 +, and particularly at CG14874, ‘Deferred consideration: not instalments of a capital sum: income receipts’.

Agreements may include options to re-assign the licence interest, or to assign additional proportionate interests, in return for further consideration.

Differing opinions of prospectivity in licence areas or the wish to concentrate resources in one particular area (e.g. offshore rather than onshore) can also lead to licence swaps between companies during the exploration phase.

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