

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HM Treasury and HM Revenue and Customs</b>	<b>Title:</b> <b>Impact Assessment of Extending 100% First Year Capital Allowances (FYA) within ring fence trades</b>	
<b>Stage:</b> Implementation	<b>Version:</b> 1	<b>Date:</b> Budget 2008
<b>Related Publications:</b> : Securing a Sustainable Future: A Consultation on the North Sea Fiscal Regime		

### Available to view or download at:

[http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/consult\\_liveindex.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/consult_liveindex.cfm)

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### What is the problem under consideration? Why is government intervention necessary?

Most capital expenditure within the North Sea ring-fence, whether in putting plant and machinery in place, or in dismantling it at the end of the life of an oil field, currently qualifies for 100% First Year Allowances (FYAs). This allows these costs to be written off for tax purposes in the period in which the expenditure is incurred. However, there are some areas where different rules apply and currently, expenditure on long-life assets and mid-life decommissioning do not qualify for 100% FYAs.

### What are the policy objectives and the intended effects?

By extending 100% FYAs to all decommissioning and long-life asset expenditure it is aimed to: Improve the simplicity, cohesiveness and consistency of the North Sea fiscal regime and help move the whole regime closer to a resource rent cash flow tax system.

Remove a potential tax distortion on the timing of decommissioning and allow industry to undertake decommissioning at the optimum economic point. This may also act to reduce the overall maintenance costs by allowing the removal of redundant platforms etc. rather than having to keep them in a safe state for future removal.

### What policy options have been considered? Please justify any preferred option.

- 1) Do nothing
- 2) 100% capital allowances for mid-life decommissioning and long-life assets. This is the preferred option as it acts to remove the distortion on the timing of decommissioning and ensures a more simple and consistent treatment of capital expenditure.

### When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The impact of the proposed policy measures is likely to be included in any review of the measures implemented following the HM Treasury December 2007 Consultation on North Sea Taxation.

### **Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.***

Signed by the responsible Minister:

Angela Eagle .....Date: 24 February 2008

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups'
	<b>One-off</b> (Transition) <b>Yrs</b>	
	£ -	
	<b>Average Annual Cost</b> (excluding one-off)	
£ -	<b>Total Cost (PV)</b>	£
<p>Other <b>key non-monetised costs</b> by 'main affected groups' Affected North Sea companies will have to amend their existing systems to allow for additional accelerated capital allowance claims, which in the absence of any future changes will apply until such time as affected oil &amp; gas fields cease production.</p>		

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups'
	<b>One-off</b> <b>Yrs</b>	
	£ -	
	<b>Average Annual Benefit</b> (excluding one-off)	
£ -	<b>Total Benefit (PV)</b>	£
<p>Other <b>key non-monetised benefits</b> by 'main affected groups' Accelerated capital allowance claims will enable affected North Sea companies to secure a tax relief timing advantage and possibly give them scope to rationalise their overall capital allowance computations.</p>		

**Key Assumptions/Sensitivities/Risks** These measures aim to accelerate the timing of capital allowance claims for asset expenditure not already within the existing 100% first year allowance arrangement and as such will not involve anything new or novel.

Price Base Year	Time Period Years	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £
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What is the geographic coverage of the policy/option?	UK Continental Shelf			
On what date will the policy be implemented?	Royal Assent 2008			
Which organisation(s) will enforce the policy?	HMRC			
What is the total annual cost of enforcement for these organisations?	£			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	N/A			
What is the value of the proposed offsetting measure per year?	£ 0			
What is the value of changes in greenhouse gas emissions?	£ 0			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)		
Increase of	£ negligible	Decrease of	£ negligible	<b>Net Impact</b>	£ negligible

Key:      Annual costs and benefits: Constant Prices      (Net) Present Value

## Evidence Base (for summary sheets)

### Rationale for intervention

The UK Government remains committed to promoting a healthy and prosperous UK oil and gas industry and has a stated objective to maximise the economic recovery of the UK's oil and gas reserves. Whilst the underlying geology and future oil and gas prices are the dominant drivers of investment, and hence ultimate recovery, Government has a crucial role to play in ensuring that the fiscal regime helps deliver the best possible future for oil and gas production from the UK Continental Shelf (UKCS). A careful balance must be struck between promoting investment and production, whilst ensuring a fair return for the UK taxpayer from our national resources.

Following the 2005 Pre-Budget report the Government has engaged with the oil and gas industry and other interested stakeholders to discuss wider structural concerns over areas of the North Sea fiscal regime which were viewed as running counter to the above policy objectives. Following those discussions Government is undertaking a package of reforms to the North Sea fiscal regime to help encourage investment, reduce the impact of the fiscal regime on investment decisions, help facilitate asset trade, increase certainty and stability, remove anomalies and simplify the fiscal regime and reduce the administrative burden it imposes. This measure forms part of that package.

### Policy Objective

These proposals aim to:

- Improve the simplicity, cohesiveness and consistency of the North Sea fiscal regime and help move the whole regime closer to a resource rent cash flow tax system.
- Remove a potential tax distortion on the timing of decommissioning and allow industry to undertake decommissioning at the optimum economic point. This may also act to reduce overall maintenance costs by allowing the removal of redundant assets rather than having to keep them in a safe state for future removal.

### Policy proposals

The oil industry is very capital intensive and large amounts of money is spent on infrastructure such as pipelines, platforms etc. Most expenditure, whether on putting the plant and machinery in place, or in dismantling at the end of the life of the oil field, currently qualifies for 100% First Year Allowances (FYA), allowing the costs to be written off for tax purposes in the accounting period in which the expenditure is incurred.

The specific proposals are to:

- Extend the availability of immediate 100% relief to all expenditure incurred in decommissioning redundant installations and equipment during the life of a field. Currently, immediate 100% relief is not available in respect of decommissioning (the term "abandonment" is also commonly used) expenditure that is not incurred for the purposes of, or in connection with, the closing down of an oil field, and wholly or substantially, to comply with an abandonment programme under S163 (2) (a) and (3) CAA 2001.
- Allow all expenditure on plant and machinery, for use wholly in a ring fence trade, to qualify for FYA of 100%. Currently, expenditure on long-life assets (assets with a useful economic life of at least 25 years) used in a ring fence trade only qualifies for immediate 24% relief (S52 Capital Allowances Act (CAA) 2001) and, in respect of the remaining expenditure, an annual allowance of 6% (S102 CAA 2001), on a reducing balance basis.

### 100% FYAs for mid-life decommissioning

Different areas of the North Sea are licensed to companies to enable them to produce oil and gas. Sometimes one company will be the sole licensee for a field, for other fields there will be a number of licensee companies. When the field comes to the end of its economic life, the licensees are obliged to decommission the infrastructure – pipelines, platforms etc, to return the area, broadly to its natural state. Assets are decommissioned under an ‘abandonment programme’ agreed with BERR (the Department for Business, Enterprise and Regulatory Reform). The programme will be drawn up in respect of specific assets – so there may be one programme for the oil platform and another for the pipeline – rather than being for ‘the field’ as such.

The companies have to meet all their decommissioning costs, but these are relievable for tax purposes. Most of the expenditure is capital in nature and qualifies for 100% First Year Allowances (FYA), enabling the cost of decommissioning to be written off in the year in which it is incurred.

Currently, however, immediate 100% relief is not available in respect of decommissioning (the term “abandonment” is also commonly used) expenditure that is not incurred for the purposes of, or in connection with, the closing down of an oil field, and wholly or substantially, to comply with an abandonment programme under S163 (2) (a) and (3) CAA 2001.

Typically, the costs that will not qualify for immediate 100% relief are mid-life decommissioning costs, which by their very nature will not normally satisfy the conditions in S163 CAA 2001. In the circumstances we are considering, some infrastructure is being decommissioned, but the field is continuing to produce, so the expenditure is not related to the closing down of the field.

### **100% FYAs for long-life asset expenditure**

Currently, expenditure on long-life assets (assets with a useful economic life of at least 25 years) used in a ring fence trade qualifies for immediate 24% relief (S52 Capital Allowances Act (CAA) 2001) and, in respect of the remaining expenditure, an annual allowance of 6% (S102 CAA 2001), on a reducing balance basis.

However, because of the hostile environment in the North Sea, there are in fact few assets where it is reasonable to expect a useful economic life of at least 25 years from new. This proposal is therefore a simplification measure to disapply the long-life asset regime, for expenditure on plant and machinery used wholly in a ring fence trade, with the result that all such expenditure will qualify for FYA of 100%.

### **Costs and Benefits**

It is expected that accelerated capital allowance claims will enable affected North Sea companies to secure a tax relief timing advantage and possibly give them scope to rationalise their overall capital allowance computations. There may be costs in so far as affected North Sea companies will have to amend their existing systems to allow for additional accelerated capital allowance claims, which in the absence of any future changes will apply until such time as affected oil & gas fields cease production.

The Government expects the net impact of these measures on the admin burden on business to be negligible.

### **Consultation**

In the 2005 Pre-Budget report the then Chancellor announced that the Government would open discussions with the oil and gas industry to examine wider structural concerns over areas of the North Sea fiscal regime. These discussions would cover any areas of the fiscal regime which either Government or industry felt could potentially undermine ongoing stability, and impact on the Government's objective to maximise the economic recovery of the UK's oil and gas reserves.

The initial round of discussions lasted from January 2006 though to September 2006 and provided a forum within which UKCS stakeholders could discuss any aspect of the fiscal regime with officials from HM Treasury, HM Revenue and Customs and BERR. A large number of stakeholders took advantage of

this opportunity and meetings were held with a wide range of delegates from oil and gas companies, representative bodies, academics, the supply chain and other stakeholders.

At Budget 2007 Government published "The North Sea Fiscal Regime: a discussion paper". This discussion paper summarised the discussions that had occurred up to September 2006, and set out the conclusions that had been drawn from those. It also announced that discussions would continue, with the paper forming the basis for further, more focussed discussions through to the end of September 2007.

The issue outlined above was raised during the two rounds of discussions. The Government's proposal to remedy it were then set out in "Securing a sustainable future: a consultation on the North Sea Fiscal Regime" that was released in December 2007. Draft legislation for this measure was published alongside the consultation document to allow interested parties to comment on the exact detail of the proposed measures. The consultation period lasted through to the end of January 2008.

### **Competition Assessment**

These measures will help to level the playing field between companies who decommission mid-life and those who decommission at cessation of production. It will also break down the division between assets that for tax purposes are treated as long life and those that are not.

### **Small Firms' Impact Test**

The extension of one hundred percent first year allowances will afford benefits to all companies involved in North Sea oil and gas extraction ranging from large integrated operations operating across a range of oil and gas fields on the UKCS through to small and medium-sized businesses with interests in only one field or in onshore developments.

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No