

Part 1: Oil Activities

Overview

1. This Part contains rules relating to the corporation tax charge, including the supplementary charge, on profits from oil extraction and related activities. It rewrites Chapter 5 of Part 12 of, and Schedule 19C to ICTA, and sections 62 to 65 of FA 1991. Section 496A of, and Schedule 19B to, ICTA (exploration expenditure supplement) are not rewritten as the rules apply to expenditure incurred before 1 January 2006. They are therefore of limited future application.
2. Some of the source legislation relates to both income tax and corporation tax – the necessary rules for income tax are contained in the Schedule and will be inserted into ITTOIA after section 225.
3. Where there is a reference to provisions that are to be included in Bill 5, the draft clauses refer to “the Corporation Tax Act 2009”.
4. A number of petroleum revenue tax (PRT) definitions are used in the corporation tax and income tax rules, and some parts of the legislation depend on calculations made for PRT purposes. In particular the legislation uses the PRT term “participator” which means any person who has a share in the oil from an oil field in the UK sector. The legislation for PRT is not itself being rewritten.
5. The essence of the rules is that a “ring fence” is placed around the oil extraction trade. Profits from activities within the “ring fence” may not be reduced by reliefs or allowances, such as group relief, arising from activities outside the “ring fence”.
6. The establishment of a separate trade for the purposes of the ring fence is in section 16 of ITTOIA, for income tax purposes, and in section 492(1) of ICTA for corporation tax. Section 492(1) of ICTA will be rewritten in Bill 5 – see clause 40[j034801] of the draft Bill published in February 2008.
7. Bill 5 will also contain the rewritten definitions of “exploration and exploitation activities”, “exploration and exploitation rights” and “designated area” in section 830(2) to (4) of ICTA – see clause 1236[j999992] of the draft Bill published in February 2008. The equivalent income tax definitions are in section 874 of ITTOIA.
8. The extension of the UK to its territorial sea for the purposes of the scope of corporation tax, currently in section 830(1) of ICTA, will be rewritten in Bill 6. The equivalent income tax provision is in section 1013 of ITA.
9. Oil is used as a shorthand throughout these explanatory notes, but unless specifically mentioned the same rules and considerations apply to gas and other associated products.

10. The material is organised as follows:
- Chapter 1: Overview
 - Chapter 2: Basic Definitions
 - Chapter 3: Calculation and treatment of income and profits
 - Chapter 4: Expenditure Supplement
 - Chapter 5: Supplementary Charge

Chapter 1: Introduction

Clause 1: Overview of Part

11. This clause provides an overview of the legislation. It is new.

Chapter 2: Basic Definitions

Clause 2: Meaning of “associated companies”

12. This clause sets out the definition of “associated companies” for the purposes of the Part. It is based on section 502(3), (3A) and (4) of ICTA.

13. *Subsections (3) to (5)* modify the consortium relief rules (to be rewritten in Part 5 of Bill 6) solely for the purposes of this Part. The words “or indirectly” are not used in subsection (3), which modifies clause [j4800Brm] of Bill 6 by inserting subsection (4A) for these specific purposes. This is because the combination of “a company” in the inserted subsection (4A) and “any company” in the inserted subsection (4B) breaks the chain of ownership whenever a non-UK resident company appears in that chain. “Indirectly” is therefore not needed.

14. Section 413(6)(a) and (b) of ICTA are alternative definitions of a company being owned by a consortium. For the purposes of the oil tax provisions, section 413(6)(a) of ICTA applies. The effect of this is rewritten in *subsection (4)*, which inserts the definition found in section 413(6)(a) in place of the longer definition found in section 413(6)(b) and now rewritten in subsections (1) to (3) of clause [j4800Drm].

15. Clauses [j4800Arm], [j4800Brm] and [j4800Drm] are based on section 413 of ICTA. Draft clauses were published on 6 September 2007 – see clauses 55, 57 and 88 issued with paper CC/SC (07) 27. Clauses [j7416] and [j7416b] are based on section 416 of ICTA – draft clauses rewriting Part 11 of ICTA will be published at a later date.

Clause 3: Meaning of “oil extraction activities”

16. This clause sets out the definition of “oil extraction activities” for the purposes of this Part. It is based on section 502(1) and (2) of ICTA.

17. Certain definitions are taken from the PRT legislation in section 12 of the Oil Taxation Act 1975.

Clause 4: Meaning of “oil rights”

18. This clause sets out the meaning of “oil rights” for the purposes of this Part. It is based on section 502(1) of ICTA.

Clause 5: Meaning of “ring fence income”

19. This clause sets out the meaning of “ring fence income” for the purposes of this Part. It is based on section 502(1) of ICTA.

20. This term is then picked up in clause 6 as part of the definition of a company’s “ring fence profits”.

Clause 6: Meaning of “ring fence profits”

21. This clause sets out the meaning of “ring fence profits” for the purposes of this Part. It is based on section 502(1) and (1A) of ICTA.

22. Although the definition is not explicitly limited to corporation tax in the source legislation, the term is only used in the legislation in relation to corporation tax. Therefore, this term is not included in the rewritten rules for income tax.

Clause 7: Meaning of “ring fence trade”

23. This clause sets out the meaning of “ring fence trade” for the purposes of this Part. It is based on section 502(1) of ICTA.

Clause 8: Other definitions

24. This clause sets out further definitions necessary for this Part. It is based on sections 493(1A), 500(10) and 502(1) and (2) of ICTA.

Chapter 3: Calculation of profits

Overview

25. This Chapter contains the rules that determine how income/profits from a ring fence trade are calculated, to the extent that they differ from the calculation for any other type of trade. The starting point is that all normal trading income rules apply unless they are modified by a provision of this Chapter. The calculation may also be affected by the ring fence expenditure supplement rules set out in Chapter 4.

26. The general rules for the calculation of trading income for corporation tax purposes are rewritten in Bill 5 – see Part 3 of the draft Bill published in February 2008.

Clause 9: Disposal to be valued by reference to section 2(5A) of OTA 1975

27. This clause modifies the calculation of profits for corporation tax purposes where certain expenses are incurred in connection with the transportation of oil. It is based on section 493(A1) to (A3) of ICTA.

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28. The starting point is section 2(5A) of OTA 1975, which involves situations where the seller disposes of oil at arm's length and is required to meet certain transportation costs – *subsection (6)*.

29. Section 2(5A) OTA 1975 replaces:

- actual sales proceeds from a sale at arm's length under a contract which requires the seller to meet the transport costs,

with

- deemed proceeds based on a hypothetical sale at arm's length under which the seller does not have to meet the transport costs and has to transport the oil to the nearest landing point (or, in the case of onshore fields, to the place of extraction itself).

30. *Subsection (9)* adopts the price given by section 2(5A) of OTA 1975, for the seller only – it has no impact on the purchaser. Section 3(f) of OTA 1975 allows transport costs for transportation to that point. If a company does not claim transportation costs for corporation tax then for practical purposes the price at that point is the actual sale price minus the transport costs to that point.

31. In order to prevent double counting, *subsections (7) and (8)* require that the company does not otherwise get a deduction for the transportation cost or “transportation allowance” against either its ring fence or non ring fence profits, as that allowance is in effect netted off to reach the price in *subsection (9)*.

Clause 10: Valuation where market value taken into account under section 2 of OTA 1975

32. This clause specifies that where the market value of oil is included in the calculation of profits for PRT purposes by OTA 1975 in place of the actual sale price, the same price applies for corporation tax. It is based on section 493(1) of ICTA.

33. The market value applies to both the seller and the purchaser. Therefore the clause retains the term “person” rather than “company” as the other party may not necessarily be a company. The market value is derived by way of a comprehensive scheme put in place for PRT purposes – see in particular section 2 of and Schedule 3 to OTA 1975.

Clause 11: Valuation where disposal not sale at arm's length

34. This clause applies a market value price where oil is disposed of otherwise than at arm's length, but where the disposal is not covered by the PRT rules. It is based on section 493(3), (5) and (6) of ICTA.

35. A common application of this rule is where oil is extracted from an oil field that is not within the scope of PRT following the reforms in FA 1993, which took fields given development consent on or after 16 March 1993 out of the scope of PRT.

36. This clause also retains the term “person” because the transactions may not necessarily involve only companies.

Clause 12: Valuation where excess of nominated proceeds

37. This clause ensures that where the “nomination scheme” adds an amount to the disposal value of oil for PRT purposes, that amount is also added for corporation tax purposes. It is based on section 493(1A) of ICTA.

38. The “nomination scheme” is part of the mechanism to ensure that the full value of oil extracted from the UK sector is reflected in the profits calculated for PRT and for the ring fence trade. A full description of the scheme can be found in HMRC guidance at OTM 5199.

39. The addition to the price for corporation tax purposes is made even if the relevant oil field is not within the scope of PRT – see *subsection (1)(b)*.

40. *Subsection (3)* provides for a deduction in computing the profits of a non-ring fence trade. The wording has been changed to clarify its meaning as the source legislation in section 493(1A)(b) of ICTA is potentially unclear. See *Change 668* in Annex 1.

<p>Q1. We would welcome comments on the proposed change to the wording of section 493(1A)(b) of ICTA, rewritten in clause 12(3).</p>

Clause 13: Valuation where relevant appropriation but no disposal

41. This clause imposes a market value in a case where an oil producer does not sell the oil to another party but takes it into use in another of its businesses, such as refining. It is based on section 493(2) of ICTA.

42. Where a market value is applied for PRT purposes by OTA 1975, that market value is used in the calculation of profits for corporation tax purposes – see *subsections (4) and (5)*. The market value also applies to the non-ring fence business.

Clause 14: Valuation where appropriation to refining etc

43. This clause imposes a market value in a case where an oil producer does not sell the oil to another party but takes it into use in another of its businesses, such as refining, and where the PRT rules do not apply. It is based on section 493(4), (5) and (6) of ICTA.

44. In such a case the same calculation of market value is made using the PRT rules as if the PRT rules had applied to the appropriation.

Clause 15: Restrictions on debits to be brought into account

45. This clause modifies the loan relationship rules in the case of a ring fence trade. It is based on section 494(2) and (2A) of ICTA.

46. The clause ensures that non-trading debits from a company's loan relationships cannot be set against the company's ring fence profits, unless the loan relationship represents money borrowed to finance oil extraction activities or to acquire oil rights.

47. *Subsection (5)* provides that where a non-trading debit is restricted in this way the legislation allows the company to have relief for the debit against other profits.

48. The terms "debtor relationship" and "creditor relationship" have not been used as they do not appear in the rewritten legislation for loan relationships.

Clause 16: Restrictions on credits to be brought into account

49. This clause ensures that exchange gains in respect of loan relationships are not treated as part of the ring fence profits where the exchange gains do not arise from money borrowed to finance ring fence activities. It is based on section 494(2), (2ZA) and (2A) of ICTA.

50. The clause operates in a similar way to clause 15. Where a credit is excluded from the computation of ring fence profits it is brought into account by *subsection (5)*.

Clause 17: Sale and lease-back

51. This clause ensures that where financing has been obtained by way of a sale and lease-back of assets, a deduction for the expenditure may not be made against ring fence profits unless certain conditions are met. It is based on section 494AA of ICTA.

52. *Subsections (6)* and *(7)* ensure that a deduction is only permitted against ring fence profits if the disposal proceeds are used in the ring fence trade.

53. Where the deduction is prevented from being given in full or in part against the ring fence profits, *subsection (8)* allows a deduction from other profits of the company for any amount that has not been allowed because of this clause.

Clause 18: Reduction of expenditure by reference to regional development grant

54. This clause restricts a deduction for expenditure incurred to the extent that the expenditure has been met by a regional development grant. It is based on section 495(1), (2) and (7) of ICTA.

55. The main restriction in respect of a grant is applied by section 534 of CAA 2001. This clause applies essentially the same restriction to the purchaser of an asset who buys the asset from a connected party, and where that connected party received a regional development grant on the original acquisition or construction of the asset.

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56. The clause applies to expenditure taken into account under Parts 2, 3 or 6 of CAA 2001. Section 84 of FA 2008 repeals Part 3 for corporation tax purposes with respect to expenditure incurred on or after 1 April 2011. The reference to Part 3 has therefore been retained.

Clause 19: Adjustment as a result of regional development grant

57. This clause supplements clause 18 and section 534 of CAA 2001 where the amount of expenditure involved is redetermined at a later date. It is based on section 495(3) to (7) of ICTA.

58. The most likely application of regional development grants in the oil context is for onshore assets such as initial treatment plants to stabilise the crude oil arriving by pipeline. The eligibility of such assets for PRT relief, or the proportion that is eligible, can take some time to agree. As a result, the PRT position (which determines the amount eligible for capital allowances) may not be finalised for some time.

59. Therefore, capital allowances could be given on the full amount in the “initial period”, disregarding the grant, as section 534(2) of CAA 2001 or its predecessors would not have applied at that stage. *Subsection (5)* ensures that the position can be adjusted in a later period if a change in circumstances occurs.

60. If the change increases the expenditure eligible for capital allowances, *subsection (7)* treats the company as having incurred additional expenditure.

61. If the change reduces the eligible expenditure *subsection (8)* treats the company as receiving a trading receipt.

62. In both cases the adjustment is treated as made in the relevant later period (referred to as the “adjustment period”).

63. Section 137 of FA 1982, referred to in the source legislation, has been rewritten in section 534 of CAA 2001.

64. The clause applies to expenditure taken into account under Parts 2, 3 or 6 of CAA 2001. Section 84 of FA 2008 repeals Part 3 for corporation tax purposes with respect to expenditure incurred on or after 1 April 2011. The reference to Part 3 has therefore been retained.

Clause 20: Tariff receipts etc

65. This clause brings certain tariff receipts into the calculation of ring fence profits if those receipts would not otherwise be included. It is based on section 496 of ICTA.

66. Tariff receipts arise where assets used in the ring fence trade are not used wholly for oil extraction by the owner but are used by other businesses in return for

payment of a fee or “tariff”. Typical examples include the use of pipelines and treatment plants.

67. Tax-exempt tariffing receipts arise where the oil field to which the assets are attached for PRT purposes is not within the charge to PRT and therefore the tariffs are not chargeable to PRT.

68. Definitions of “tariff receipt” and “tax-exempt tariffing receipts” have been included to aid users of the legislation.

Clause 21: Expenditure on and under abandonment guarantees

69. This clause provides relief against corporation tax where an oil field participator incurs expenditure in obtaining an abandonment guarantee. It is based on sections 62 and 63(8) of FA 1991.

70. The cost of decommissioning oil fields is eligible for relief under the capital allowances code. However, as the majority of oil fields are shared between two or more participators there is a risk that one or more of the participators may not meet their share of the cost when the time comes. As a result participators have taken out guarantees with financial institutions to cover their share. This clause provides relief for the cost of obtaining the guarantee.

Clause 22: Relief for reimbursement expenditure under abandonment guarantees

71. This clause provides relief for a participator against ring fence profits where some or all of a participator’s share of decommissioning costs is met by a guarantee and the participator subsequently reimburses the guarantor. It is based on section 63 of FA 1991.

72. Section 63(5) of FA 1991 uses the term “accounting period” and therefore appears to confine the section to corporation tax. A similar point arises in section 65(4) of FA 1991. However, sections 62 and 64 of FA 1991 and the remainder of sections 63 and 65 do not suggest that they should be limited to corporation tax. Therefore, they have been rewritten in full for income tax with necessary adaptation (such as “tax year” for “accounting period”) – see Schedule 1 which inserts sections 225M to 225T ICTA and *Change 669* in Annex 1.

<p>Q2. We would welcome comments on the proposed change to make it clear that sections 62 to 65 of FA 1991 apply for income tax as well as for corporation tax.</p>
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Clause 23: Payment under abandonment guarantee not immediately applied

73. This clause applies where a guarantor makes payments into a fund and the assets of the fund are subsequently used to cover decommissioning costs. It is based on section 62(4) of FA 1991.

74. In such a case the rules for relief under clause 21 or clause 22 apply to the expenditure when it is eventually met out of the assets of the fund.

Clause 24: Amounts excluded from section 22(1)

75. This clause restricts relief where amounts are repaid to a guarantor instead of being applied to meet decommissioning costs. It is based on section 63(2) of FA 1991.

76. Schedule 1 applies this provision to income tax. See the commentary on clause 22 and *Change 669* in Annex 1.

Clause 25: Introduction to sections 26 and 27

77. This clause sets out the circumstances in which clauses 26 and 27 apply, and provides some related definitions. It is based on section 64(1), (2) and (3) and section 65(1) of FA 1991.

78. This clause incorporates amendments made by section 104 of FA 2008 – the replacement of “qualifying participator” with “contributing participator” to match changes made to the PRT rules, and amendment of certain cross references to OTA 1975.

Clause 26: Relief for expenditure incurred by a participator in meeting defaulter’s abandonment expenditure

79. This clause provides for relief to a participator who meets the decommissioning expenditure that should have been met by another participator (the “defaulter”). It is based on section 64(4) and (5) of FA 1991.

80. This clause incorporates amendments made by section 104 of FA 2008 – the replacement of “qualifying participator” with “contributing participator” to match changes made to the PRT rules, and amendment of certain cross references to OTA 1975.

Clause 27: Reimbursement by defaulter in respect of certain abandonment expenditure

81. This clause applies where a defaulting participator reimburses another participator who has met the defaulter’s liability for decommissioning expenditure. It is based on section 65 of FA 1991.

82. Relief against ring fence profits is given to the defaulter, and the other participator is treated as receiving additional ring fence income.

83. This clause incorporates amendments made by section 104 of FA 2008 – the replacement of “qualifying participator” with “contributing participator” to match changes made to the PRT rules, and amendment of certain cross references to OTA 1975.

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84. The time limit in *subsection (5)* is subject to reduction from six years to four years by paragraph 27 of Schedule 39 to FA 2008, from a date to be determined by order.

85. Schedule 1 applies this provision to income tax. See the commentary on clause 22 and *Change 669* in Annex 1.

Clause 28: Deduction of PRT in calculating income for corporation tax purposes

86. This clause provides that a company may deduct PRT paid as an expense in calculating profits from the ring fence trade. It is based on section 500(1), (2), and (3) of ICTA.

87. Clauses 29 and 30 set out what happens when PRT is repaid and clause 31 deals with interest on PRT repayments.

Clause 29: Effect of repayment of PRT: general rule

88. This clause provides that when an amount of PRT is repaid the deduction under clause 28 is reduced by the amount repaid. It is based on section 500(4) of ICTA.

89. *Subsection (2)* provides that the repayment reduces or extinguishes the deduction for the original period for which the deduction was given, not the period when the repayment was received.

90. The time limit in *subsection (3)* is subject to reduction from six years to four years by paragraph 23 of Schedule 39 to FA 2008, from a date to be determined by order.

Clause 30: Effect of repayment of PRT: special rule

91. This clause supplements clause 29 in cases where the repayment derives from a carried back loss. It is based on section 500(5) to (10) of ICTA.

92. In such a case the PRT repayment is treated as received, and hence the reduced deduction for corporation tax is applied, for the period in which the loss arose.

93. The time limit in *subsection (3)* is subject to reduction from six years to four years by paragraph 23 of Schedule 39 to FA 2008, from a date to be determined by order.

Clause 31: Interest on repayment of PRT

94. This clause provides that interest paid to a participator on a repayment of PRT is disregarded in calculating profits for corporation tax purposes. It is based on section 501 of ICTA.

Clause 32: Management expenses

95. This clause prohibits a deduction for expenses of management of an investment business against profits from a ring fence trade. It is based on section 492(3A) of ICTA, inserted by section 112 of FA 2008.

Clause 33: Losses

96. This clause prevents losses that arise in trades outside the ring fence from being set off against ring fence profits. It is based on section 492(3) and (4) of ICTA.

97. Where a set-off is prevented in this way, *subsection (5)* allows the loss to be carried forward and set against future profits from “related activities”, that is activities which, taken together with the ring fence trade, would be regarded as a single trade but for the specific ring fence rule in section 492(1) of ICTA.

98. The equivalent income tax rule, originally in section 492(2) of ICTA, is in section 80 of ITA 2007.

99. The rules concerning relief for trade losses for corporation tax purposes will be rewritten in Bill 6 – draft clauses were published on 8 November 2007 with paper C/SC (07) 38.

100. See clause 6[j4506Arm] of that draft for rules about the extension of the loss carry-back period in a ring fence trade where allowances for abandonment expenditure under section 164 of CAA 2001 are involved; and clause 7[j4506Brm] of that draft, which extends the time limit for making a claim where allowances are made under section 165 (abandonment expenditure after the cessation of trade) or 416 (site restoration expenditure) of CAA 2001.

Clause 34: Group relief

101. This clause prevents group relief arising from losses, allowances or expenditure outside the ring fence trade from being set against profits from the ring fence trade. It is based on sections 492(8) and 494A(1), (2) and (3) of ICTA.

102. *Subsections(2) and (3)* provide that where a company cannot use certain amounts against its ring fence profits, those ring fence profits are disregarded in calculating how much the company can surrender as group relief.

103. The group relief rules will be rewritten in Bill 6. Draft clauses were published on 6 September 2007 with paper CC/SC (07) 27 – see clauses 3[j4801rm], and 9[j4812rm] of that draft.

104. The legislation dealing with charges on income will also be rewritten in Bill 6. Draft clauses were published on 17 April 2008 with paper CC/SC (08) 14 – see clause 1[j30001] of that draft.

Clause 35: Capital allowances

105. This clause ensures that capital allowances arising from “special leasing” cannot be deducted from a company’s ring fence profits. It is based on section 492(6) and (7) of ICTA.

106. The restriction does not apply to the extent that the leased asset is used in oil extraction activities by an associated company.

107. Special leasing is defined in section 19 of CAA 2001 as leasing that is not part of any other qualifying activity.

Chapter 4: Ring Fence Expenditure Supplement

Overview

108. This Chapter rewrites the rules in Schedule 19C of ICTA, which provide a supplement for certain expenditure incurred on or after 1 January 2006. These rules supercede the exploration expenditure supplement in Schedule 19B of ICTA, which applies to expenditure incurred before 1 January 2006. Schedule 19B is therefore of limited future application and is not rewritten. This also means that certain terms used in this Chapter such as “the carried forward qualifying Schedule 19B amount” do not need to be altered.

<p>Q3. We welcome comments on the proposal that Schedule 19B to ICTA should not be rewritten.</p>
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109. The supplement is in two parts – “pre-commencement”, the period before the ring fence trade was set up and commenced, and “post-commencement”. As a result, the two parts are dealt with in different ways. Pre-commencement supplement is dealt with in clauses 44 to 49 and post-commencement supplement is dealt with in clauses 50 to 58.

110. Schedule 19C of ICTA is written in a style similar to the rewrite Acts. Therefore this Chapter is little changed from the source legislation.

Clause 36: Introduction

111. This clause sets out an overview of the Chapter. It is based on paragraph 1 of Schedule 19C to ICTA.

112. The clause incorporates the reference in the source legislation to section 393B of ICTA, inserted by paragraph 9 of Schedule 35 to FA 2008. Section 393B of ICTA was inserted by section 111 of FA 2008 and will be rewritten in Bill 6.

Clause 37: Qualifying companies

113. This clause sets out the definition of a qualifying company for the purposes of this Chapter. It is based on paragraph 2 of Schedule 19C to ICTA.

Clause 38: Accounting periods

114. This clause sets up defined terms for accounting periods that lie either side of, or straddle, 1 January 2006. It is based on paragraph 3 of Schedule 19C to ICTA.

Clause 39: The relevant percentage

115. This clause sets out the relevant percentage for the supplement and provides a power for the Treasury to vary the percentage by order. It is based on paragraph 4 of Schedule 19C to ICTA.

Clause 40: Limit on number of accounting periods for which supplement may be claimed

116. This clause limits to six the number of accounting periods for which supplement may be claimed. It is based on paragraph 5 of Schedule 19C to ICTA.

117. By virtue of *subsection (3)* a claim for an accounting period under Schedule 19B to ICTA counts as part of the overall total of six accounting periods.

Clause 41: Qualifying pre-commencement expenditure

118. This clause defines “qualifying pre-commencement expenditure” for the purposes of the Chapter. It is based on paragraph 6 of Schedule 19C to ICTA.

Clause 42: Unrelieved group ring fence profits for accounting periods

119. This clause defines the term “unrelieved group ring fence profits” for an accounting period. It is based on paragraph 7 of Schedule 19C to ICTA.

120. The broad scheme of the supplement is to increase the amount of certain expenditure and losses that cannot be relieved immediately to reflect the time value of the delay in obtaining effective tax relief. However, where there are unrelieved profits from a ring fence trade elsewhere in the same group, some or all of the losses could have been used against those other ring fence profits in the same accounting period. Where this is the case supplement is restricted by clause 47 or clause 57 as appropriate. The pool of expenditure eligible for supplement in a given period is reduced by the amount of any unrelieved group ring fence profits.

121. This term applies for both pre-commencement and post-commencement supplement.

Clause 43: Taxable ring fence profits of an accounting period.

122. This clause defines the term “taxable ring fence profits” for the purposes of the Chapter. It is based on paragraph 8 of Schedule 19C to ICTA.

123. This term is used in clause 42 to determine the amount of unrelieved group ring fence profits.

Clause 44: Supplement in respect of a pre-commencement accounting period

124. This clause sets out when a company may qualify for pre-commencement supplement, and how the supplement is given effect. It is based on paragraph 9 of Schedule 19C to ICTA.

125. Supplement is given as a percentage of the “reference amount”, which is defined in clause 48. “Pre-commencement period” is defined in clause 38.

126. The term “reduced proportionally”, used in *subsection (4)*, is to be defined separately in Bill 6 to cover the entire Bill.

Clause 45: The mixed pool of qualifying pre-commencement expenditure and supplement previously allowed.

127. This clause sets out how the pool of expenditure that qualifies for pre-commencement supplement is determined. It is based on paragraph 10 of Schedule 19C to ICTA.

128. The pool can include amounts carried forward from the exploration expenditure supplement in Schedule 19B to ICTA.

Clause 46: Reduction in respect of disposal receipts under CAA 2001

129. This clause restricts the amount of expenditure eligible for supplement where there is a relevant disposal receipt taken into account under CAA 2001. It is based on paragraph 11 of Schedule 19C to ICTA.

Clause 47: Reduction in respect of unrelieved group ring fence profits

130. This clause restricts the amount eligible for supplement where some or all of the expenditure could have been surrendered as group relief. It is based on paragraph 12 of Schedule 19C to ICTA.

131. The term “unrelieved group ring fence profits” is defined in clause 42.

Clause 48: The reference amount for a pre-commencement period

132. This clause defines the “reference amount” for the purposes of clause 44. It is based on paragraph 13 of Schedule 19C to ICTA.

133. The reference amount is the amount on which supplement can be claimed, that is the eligible expenditure reduced under either or both of clauses 46 and 47 as appropriate.

Clause 49: Claims for pre-commencement supplement

134. This clause sets out how a claim to pre-commencement supplement must be made and applies the time limit in paragraph 74 of Schedule 18 to FA 1998 to the claim. It is based on paragraph 14 of Schedule 19C to ICTA.

Clause 50: Supplement in respect of a post-commencement period

135. This clause sets out when a company may qualify for post-commencement supplement, and how the claim is given effect. It is based on paragraph 15 of Schedule 19C to ICTA.

136. The calculation of post-commencement supplement is set out in clauses 51 to 58. Under *subsection (2)* the supplement is treated as a loss carried forward to be set against future profits from the ring fence trade.

Clause 51: Amount of post-commencement supplement for a post-commencement period.

137. This clause sets out how to calculate the amount of the post-commencement supplement. It is based on paragraph 16 of Schedule 19C to ICTA.

138. The supplement is a percentage of the “reference amount”. The percentage is specified in clause 39 and “reference amount” for post-commencement supplement is defined in clause 58.

139. The term “reduced proportionally”, used in *subsection (2)*, is to be defined separately in Bill 6 to cover the entire Bill.

Clause 52: Ring fence losses

140. This clause sets out how much of a trading loss from the ring fence trade is eligible for inclusion in the calculation of post-commencement supplement. It is based on paragraph 17 of Schedule 19C to ICTA.

141. *Subsection (3)* provides that losses are not eligible for supplement if they could have been claimed against profits from an earlier accounting period.

142. The clause incorporates the reference in the source legislation to section 393B of ICTA, inserted by paragraph 9 of Schedule 35 to FA 2008. Section 393B of ICTA was inserted by section 111 of FA 2008 and will be rewritten in Bill 6.

Clause 53: Special rule for straddling periods

143. This clause sets out the rules that apply where a company’s accounting period straddles 1 January 2006. It is based on paragraph 18 of Schedule 19C to ICTA.

Clause 54: The pool of ring fence losses and the pool of non-qualifying Schedule 19B losses

144. This clause sets out how to determine the company’s pool of expenditure (the “ring fence pool”) for the purposes of post-commencement supplement. It is based on paragraph 19 of Schedule 19C to ICTA.

145. The ring fence pool includes qualifying amounts carried forward from the pool determined under Schedule 19B to ICTA. The clause also defines a non-qualifying

pool which contains non-qualifying amounts carried forward under Schedule 19B to ICTA.

Clause 55: The ring fence pool

146. This clause sets out how and when additions to and reductions of the ring fence pool are made. It is based on paragraph 20 of Schedule 19C to ICTA.

Clause 56: Reductions in respect of utilised ring fence losses

147. This clause sets out how reductions in the two pools are to be made when a ring fence loss is utilised against profits. It is based on paragraph 21 of Schedule 19C to ICTA.

148. The general rule is that when losses carried forward are set against profits in a later period, the non-qualifying pool is reduced first and the ring fence pool is then reduced by any balance of the loss after the non-qualifying pool has been reduced to nil.

Clause 57: Reductions in respect of unrelieved group ring fence profits

149. This clause sets out how the expenditure eligible for supplement is to be reduced where there is an amount of unrelieved group ring fence profits. It is based on paragraph 22 of Schedule 19C to ICTA.

150. The term “unrelieved group ring fence profits” is defined in clause 42.

Clause 58: The reference amount for a post-commencement period

151. This clause sets out how to determine the reference amount, the amount on which supplement is calculated, for the purposes of post-commencement supplement. It is based on paragraph 23 of Schedule 19C to ICTA.

Chapter 5: Supplementary Charge in Respect of Ring Fence Trades

Clause 59: Supplementary charge in respect of ring fence trades

152. This clause imposes an additional charge to tax of 20% on an adjusted measure of profits from the ring fence trade. It is based on section 501A(1), (2) and (3) of ICTA.

153. The adjustment to profits for this purpose is that financing costs, defined in clause 60, are left out of account.

Clause 60: Meaning of “financing costs” etc

154. This clause defines the term “financing costs” for the purposes of the supplementary charge. It is based on section 501A(4) to (11) of ICTA.

Clause 61: Assessment, recovery and postponement of supplementary charge

155. This clause sets out the arrangements for the administration of the supplementary charge. It is based on section 501B of ICTA.

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156. The general rule is that the supplementary charge is treated for all administrative purposes as corporation tax, unless specific rules apply. In particular, this ensures that the relevant rules in TMA 1970 and in Schedule 18 to FA 1998 can apply.

Part 2: Oil Activities: Income Tax

Clause 62: Amendments of ITTOIA 2005

157. This clause introduces the Schedule of amendments which inserts the equivalent income tax provisions, where relevant, into ITTOIA 2005. It is new.

Schedule 1: Oil Activities: Income Tax Amendments

158. This Schedule inserts income tax provisions into ITTOIA 2005. The proposed location in ITTOIA is immediately after section 225 in Part 2, as these provisions are essentially a special case of the trading income rules.

159. Some parts of the source legislation apply only for corporation tax – for example, the ring fence expenditure supplement - and are therefore not reproduced for income tax. There is, therefore, no income tax equivalent of clauses 2, 6, 9, 15 to 17, and 28 to 61. Section 492(2) of ICTA (restriction of relief for trading losses) is rewritten in section 80 of ITA 2007.

160. Sections 225N to 225T of ITTOIA, which are inserted by the Schedule, rewrite sections 62 to 65 of FA 1991 for income tax purposes. It is not clear whether or not the whole of the source legislation applies for income tax as well as for corporation tax. The rewritten material applies the whole of the source legislation to income tax. See *Change 669* in Annex 1.

Change 668: Oil taxation: deduction for excess of nominated proceeds. Clause 12

This change clarifies the meaning of section 493(1A)(b) of ICTA.

For income tax and corporation tax purposes a separate “ring fence trade” is deemed to exist by virtue of section 16 of ITTOIA (for income tax) or section 492(1) of ICTA (for corporation tax). The activities making up the ring fence trade are set out in section 16(2) of ITTOIA and section 492(1)(a) to (c) of ICTA.

Section 493 of ICTA contains rules which ensure that the correct value of oil or gas is brought into account in computing the profits of the ring fence trade. Section 493(1A) of ICTA deals with what is termed “an excess of nominated proceeds”. This is a concept that is part of the Petroleum Revenue Tax (PRT) regime. It allows a company to “nominate” a crude oil sales contract (within the crude oil forward market) as being a contract through which crude oil will actually be delivered, rather than only being a financial (or “paper”) transaction. The “excess” may arise if crude oil is delivered through a contract that has not been so nominated, and HMRC’s value exceeds the actual contract price of the oil (the excess is calculated by multiplying the volume delivered by the price/value difference).

Where this is the case, the same “excess” is also treated as a deduction by virtue of section 493(1A)(b) of ICTA. However, the wording of section 493(1A)(b) is unclear in referring to “any trade to which section 492(1) [of ICTA] does not apply”. It is not clear whether this refers to the activities listed in section 492(1)(a) to (c), or to the deemed “separate trade” referred to in the full out words of section 492(1), or to both. The use of the word “any” in “any trade” suggests a wide application. The explanatory notes published with the legislation that introduced this provision (section 151 of FA 2006) state that the intention is to give a deduction in computing profits of the non-ring fence trade, whereas the wording of section 493(1A)(b) might suggest that it only applies in the case of a separate trade that is deemed to exist by section 492(1).

Clause 12 therefore clarifies the legislation by expanding the reference to refer to both the concept of the deemed separate trade, and the activities listed in section 492(1) of ICTA, thereby making it clear that the deduction can be given against the profits of any non-ring fence trade, not solely a deemed trade created by section 492(1).

This change could be favourable to some taxpayers and adverse to others in principle. But it is expected to have no practical effect as it is in line with current practice.

Change 669: Oil taxation: abandonment guarantees and expenditure under sections 63 and 65 of FA 1991. Schedule 1.

This change clarifies that sections 63 and 65 of FA 1991 apply for income tax as well as for corporation tax.

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Sections 62 to 65 of FA 1991 contain a scheme for relieving certain costs involved with the abandonment of oil installations. Section 62 provides relief for the costs of obtaining an abandonment guarantee and is not limited to corporation tax. Section 64 provides relief where an oil field participator meets expenditure that should have been met by another participator, but where that participator has defaulted in their obligation. Again, this is not limited to corporation tax.

Section 63 of FA 1991 deals with a situation where a guarantee has been set up and the guarantor meets certain expenditure, but the participator is then required to reimburse some or all of those costs to the guarantor. Section 63(5) uses the term “accounting period” which suggests that it applies only to corporation tax. However there appears to be no indication in the remainder of section 63 that it should only apply to corporation tax. A similar point arises in connection with the wording of section 65(4) and (5).

Section 63(4) of FA 1991 provides relief for an oil field participator against their income from the oil ring fence trade for certain expenditure incurred under the terms of an abandonment guarantee. If that provision does not apply for income tax purposes then that relief might not be available to a participator that is liable to income tax. Section 65(3) of FA 1991 provides relief when a defaulter reimburses expenditure met by another participator, whilst section 65(4) provides for a charge to tax on the participator who is reimbursed. In this case, both the relief and the charge might not apply if the provision does not apply for income tax purposes.

Schedule 1 contains the rewritten material for income tax, and it includes full rewrites of sections 63 and 65 of FA 1991, suitably adapted for income tax to refer to a tax year rather than an accounting period – see the inserted sections 225O, 225Q, 225R and 225T of ITTOIA.

This change could be favourable to some taxpayers and adverse to others in principle. But it is expected to have no practical effect as it is in line with current practice.