



Oil and gas fiscal regime: reinvestment relief for pre-trading companies

Who is likely to be affected?

Companies involved in oil and gas exploration and appraisal (E&A) activity in the UK or UK Continental Shelf (UKCS) which have not commenced a ring fence trade.

General description of the measure

The measure will introduce an exemption to prevent a chargeable gain being subject to a corporation tax (CT) charge where an asset is disposed of in the course of oil and gas E&A activities and the proceeds are then used for the same purposes. To be eligible for the exemption the company must operate such activities wholly outside the ring fence.

Policy objective

This measure encourages investment in the UK and UKCS by allowing companies undertaking E&A activity, who have not started trading within the ring fence, to reinvest their profits back into the industry without a CT charge arising.

The measure will improve the alignment of CT treatment for companies undertaking E&A activity which have not started trading within the ring fence with those who have started trading within the ring fence, as those trading inside the ring fence already have an exemption from CT when they dispose of assets in the course of E&A activity and then reinvest the proceeds into new assets.

Background to the measure

The Government announced this measure in Autumn Statement 2013.

Detailed proposal

Operative date

This measure will have effect on and after the date that Finance Bill 2014 receives Royal Assent.

Current law

Under sections 198A to 198I Taxation of Chargeable Gains Act 1992 (TCGA 1992), a person who is carrying on a ring fence trade, and who makes a disposal and acquisition which is a ring fence reinvestment, can claim reinvestment relief, with the effect that any gain arising from the disposal is not a chargeable gain.

Proposed revisions

Legislation will be introduced in Finance Bill 2014 to amend TCGA 1992 to create an equivalent relief so that a person who makes a disposal and acquisition in the course of oil and gas E&A activities, and is operating wholly outside the ring fence trade, can claim reinvestment relief, with the effect that any gain arising from the disposal is not a chargeable gain.

Summary of impacts

Exchequer impact (£m)	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
	-	nil	nil	nil	nil	nil
	This measure is not expected to have an Exchequer impact.					
Economic impact	This measure is not expected to have any significant economic impacts, but forms part of a wider package to encourage exploration.					
Impact on individuals and households	Any resulting increase in production would contribute to the security of the UK's energy supply.					
Equalities impacts	This measure is considered to have no differential impact on any equality groups.					
Impact on business including civil society organisations	<p>Only a small number of UK businesses will be affected by the measure. The proposals are designed to support exploration companies. This measure is expected to have a negligible impact on these businesses.</p> <p>This measure will have no impact on civil society organisations.</p>					
Operational impact (£m) (HMRC or other)	The additional costs for HM Revenue & Customs in implementing this change are expected to be negligible.					
Other impacts	<p><u>Sustainable development, wider environment and health</u>: the oil and gas industry is heavily regulated to ensure its activities do not lead to pollution or disturbance to habitat or wildlife, and to ensure the health and wellbeing of its workers.</p> <p><u>Small and micro business assessment</u>: it is not anticipated that many small or micro businesses will be affected by this measure. This change applies only to oil and gas companies operating in the UK or UKCS. The administrative impact on small companies is expected to be negligible.</p>					

Monitoring and evaluation

The measure will be kept under review through regular communication with affected taxpayer groups.

Further advice

If you have any questions about this change, please contact Natalie Reeder on 03000 586574 (email: natalie.reeder@hmrc.gsi.gov.uk).

1 Oil and gas exploration and appraisal: pre-trading reinvestment

- (1) In Chapter 2 of Part 6 of TCGA 1992 (oil and mineral industries), after section 198I insert –

“198J Oil and gas exploration and appraisal: pre-trading reinvestment

- (1) This section applies if a company which is an E&A company makes a disposal of, or of the company’s interest in, relevant E&A assets and that disposal is –
- (a) a disposal of, or of an interest in, a UK licence which relates to an undeveloped area, or
 - (b) a disposal of an asset used in an area covered by a licence under Part 1 of the Petroleum Act 1998 or the Petroleum (Production) Act (Northern Ireland) 1964 which authorises the company to undertake E&A activities.
- (2) If –
- (a) the consideration which the company obtains for the disposal is applied by it, within the permitted reinvestment period, on E&A expenditure at a time when the company is an E&A company, and
 - (b) the company makes a claim under this subsection in relation to the disposal,
- any gain accruing to the company on the disposal is not a chargeable gain.
- (3) If part only of the amount or value of the consideration for the disposal is applied as described in subsection (2)(a) –
- (a) subsection (2) does not apply, but
 - (b) subsection (4) applies if all the amount or value of the consideration is so applied except for a part which is less than the amount of the gain (whether all chargeable gain or not) accruing on the disposal.
- (4) If the company makes a claim under this subsection in relation to the disposal, the company is to be treated for the purposes of this Act as if the amount of the gain accruing on the disposal were reduced to the amount of the said part (and, if not all chargeable gain, with a proportionate reduction in the amount of the chargeable gain).
- (5) The incurring of expenditure is within “the permitted reinvestment period” if the expenditure is incurred in the period beginning 12 months before and ending 3 years after the disposal, or at such earlier or later time as the Commissioners for Her Majesty’s Revenue and Customs may by notice allow.

- (6) Subsections (6), (7), (10) and (11) of section 152 apply for the purposes of this section as they apply for the purposes of section 152, except that –
- (a) in subsection (6) the reference to a trade is to be read as a reference to E&A activities, and
 - (b) in subsection (7) the references to the trade are to be read as references to the E&A activities.
- (7) In this section –
- “E&A activities” means oil and gas exploration and appraisal in the United Kingdom or an area designated by Order in Council under section 1(7) of the Continental Shelf Act 1964;
- “E&A company” means a company which carries on E&A activities and does not carry on a ring fence trade (within the meaning of section 277 of CTA 2010);
- “E&A expenditure” means expenditure on E&A activities which is treated as such under generally accepted accounting practice;
- “relevant E&A assets” means assets which –
- (a) are used, and used only, for the purposes of E&A activities carried on by the company throughout the period of ownership, and
 - (b) are within the classes of assets listed in section 155 (with references to “the trade” in that section being read as references to the E&A activities);
- “UK licence” means a licence within the meaning of Part 1 of the Oil Taxation Act 1975;
- and a reference to a UK licence which relates to an undeveloped area has the same meaning as in section 194 (see section 196).

198K Provisional application of section 198J

- (1) This section applies where a company which is an E&A company for a consideration disposes of, or of an interest in, any assets and declares, in the company’s return for the chargeable period in which the disposal takes place –
 - (a) that the whole or any specified part of the consideration will be applied, within the permitted reinvestment period, on E&A expenditure, and
 - (b) that the company intends to make a claim under section 198J(2) or (4) in relation to the disposal.
- (2) Until the declaration ceases to have effect, section 198J applies as if the expenditure had been incurred and the person had made a claim under that section.
- (3) The declaration ceases to have effect as follows –
 - (a) if and to the extent that it is withdrawn before the relevant day, or is superseded before that day by a valid claim under section 198J, on the day on which it is so withdrawn or superseded, and
 - (b) if and to the extent that it is not so withdrawn or superseded, on the relevant day.
- (4) On the declaration ceasing to have effect in whole or in part, all necessary adjustments –

- (a) are to be made by making or amending assessments or by repayment or discharge of tax, and
 - (b) are to be so made despite any limitation on the time within which assessments or amendments may be made.
- (5) In this section “the relevant day” means the fourth anniversary of the last day of the accounting period in which the disposal took place.
- (6) For the purposes of this section –
- (a) sections (6), (10) and (11) of section 152 apply as they apply for the purposes of that section, except that in subsection (6) the reference to a trade is to be read as a reference to E&A activities, and
 - (b) terms used in this section which are defined in section 198J have the meaning given by that section.

198L Expenditure by member of same group

- (1) Section 198J applies where –
- (a) the disposal is by a company which, at the time of the disposal, is a member of a group of companies (within the meaning of section 170),
 - (b) the E&A expenditure is by another company which, at the time the expenditure is incurred, is a member of the same group,
 - (c) that other company is an E&A company, and
 - (d) the claim under that section is made by both companies, as if both companies were the same person.
- (2) “E&A company” and “E&A expenditure” have the meaning given by section 198J.”
- (2) The amendment made by this section has effect in relation to disposals made on or after the day on which this Act is passed.

EXPLANATORY NOTE

OIL AND GAS EXPLORATION AND APPRAISAL: PRE-TRADING REINVESTMENT

SUMMARY

1. Clause [X] makes provision for relief from corporation tax on chargeable gains where a company disposes of certain assets that were used by it for the purpose of oil and gas exploration and appraisal (E&A) activities. The relief applies where the proceeds are then reinvested in E&A activities.

DETAILS OF THE CLAUSE

2. Subsection (1) inserts new sections 198J-198L after section 198I of Chapter 2 of Part 6 of Taxation of Chargeable Gains Act 1992 (TCGA).

3. Subsection (2) provides that the provisions inserted by paragraph (1) are to have effect in relation to disposals made on or after Royal Assent to Finance Act 2014.

New section 198J

4. Subsection (1) specifies the assets whose disposal may benefit from the relief. To qualify for the relief, the company making the disposal must be an “E&A company” disposing of “relevant E&A assets”, as those terms are defined in subsection (7). Additionally, the assets disposed of must either be used by the company in an area in which it is licensed to carry out E&A activities (also defined in subsection (7)), or be a licence (or licence interest) relating to an undeveloped area.

5. An “E&A company” is a company engaged in E&A activities outside the oil and gas ring fence (see s277 Corporation Tax Act 2010). The definition of “E&A activities” refers to UK or UK continental shelf “oil and gas exploration and appraisal”, that term being defined at section 1134 Corporation Tax Act 2010. “Relevant E&A assets” are defined in subsection (7) as assets used solely by the company for E&A activities that are within a class of assets listed in section 155 TCGA 1992.

6. Subsection (2) sets out that the relief will be available only if the disposal proceeds are reinvested on “E&A expenditure” (defined in subsection (7) as expenditure on E&A activities treated as such under generally accepted accounting practice) whilst the company is an E&A company, within the “permitted reinvestment period” as defined in subsection (5); and sets out that the effect of making a claim for relief is that the gain on the disposal will not be chargeable.

7. Subsections (3) and (4) provide that partial relief is available where only part of the proceeds of the disposal has been reinvested as required by subsection (1).
8. Subsection (5) defines “the permitted reinvestment period”.
9. Subsection (6) specifies that certain existing provisions under roll-over relief for capital gains, modified as necessary, are to be used for the purpose of apportioning consideration, and so calculating the disposal proceeds that may benefit from the relief, where the assets disposed of have not been used only for E&A activities.
10. Subsection (7) defines key terms used in new sections 198J-198L.

New section 198K

11. Subsections (1) and (2) allow the relief at 198J(2) and (4) to be applied provisionally.
12. Subsections (3) and (5) specify the conditions in which any provisional relief ceases to apply, and subsection (4) specifies the tax adjustments to be made in that event.
13. Subsection (6) replicates as necessary new 198J(6) (apportioning consideration and calculating disposal proceeds where asset disposed of was not used only for E&A activities) for the purposes of provisional application of the relief, and adopts the definitions in new s198J(7).

Section 198L

14. New section 198L allows the disposal and expenditure to be made by different E&A companies within the same capital gains group.

BACKGROUND NOTE

15. Companies are subject to corporation tax (CT) on chargeable gains that arise when they dispose of assets. When the proceeds of a disposal of an asset used for the purposes of a trade are invested in new assets, which are also used only for the purpose of the trade, within certain time limits, sections 152 and 154 TCGA 1992 provide that the chargeable gain is not charged to tax immediately but instead is deducted from the allowable cost of the new assets or, in certain circumstances, is deferred until the sale of the replacement business assets (roll-over relief).
16. For companies with ring fence oil and gas trades, reinvestment relief was introduced as one of a number of measures in Finance Act 2009. Reinvestment relief provides that, in circumstances where disposal proceeds are reinvested in new oil trade assets, and the disposal and acquisition qualify for roll-over relief, chargeable gains will not arise (rather than, as under roll-over relief, being deferred until the sale of the replacement assets).
17. Companies carrying on oil and gas exploration and appraisal activity who have not commenced trading are not eligible for existing reinvestment relief due to the trading requirement for roll-over relief. The new exemption will allow these companies to make

disposals and reinvestments without a chargeable gain arising. This will provide an equivalent to the exemption given by existing reinvestment relief for companies carrying on exploration and appraisal activities who have commenced a trade.

18. If you have any questions about this change, or comments on the legislation, please contact Natalie Reeder on 03000 586574 (email: natalie.reeder@hmrc.gsi.gov.uk).