

**EXPLANATORY MEMORANDUM TO**  
**THE INVESTMENT ALLOWANCE AND CLUSTER AREA ALLOWANCE**  
**(RELEVANT INCOME: TARIFF RECEIPTS) REGULATIONS 2018**

[2018] No. [XXXX]

**1. Introduction**

- 1.1 This explanatory memorandum has been prepared by HM Revenue & Customs (“HMRC”) on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

**2. Purpose of the instrument**

- 2.1 The investment and cluster area allowances, set out in Part 8 of the Corporation Tax Act 2010, currently provide tax relief which is activated by income from the production of oil and gas within the UK Continental Shelf (UKCS). This instrument extends the scope of the investment and cluster area allowances to allow them to be activated by income earned from making an asset available for third party use, namely tariff receipts, as well as production income. This will encourage investment in key infrastructure, critical to the protection of existing production of oil and the development of new projects.

**3. Matters of special interest to House of Commons**

*Matters of special interest to the Select Committee on Statutory Instruments*

- 3.1 This instrument has effect in relation to income arising in accounting periods beginning on or after 16 September 2016. Authority for retrospective effect is provided by the powers in section 332F(5) and section 356JH(5) of the Corporation Tax Act 2010. This instrument is the first use of the powers in sections 332F(3)(b) and (4) and sections 356JH(3)(b) and (4) to prescribe that income other than production income is relevant income for the purposes of the investment and cluster area allowances.

*Other matters of interest to the House of Commons*

- 3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and Northern Ireland and is not a financial instrument that relates exclusively to England, Wales and Northern Ireland.

**4. Legislative Context**

- 4.1 The investment and cluster area allowances were inserted into Part 8 of the Corporation Tax Act 2010 by Finance Act 2015. Section 332F and section 356JH give the meaning of relevant income for the purposes of investment and cluster area allowances respectively. For both allowances relevant income means production income from oil extraction activities, or other income prescribed by regulations. These regulations specify which other types of income are relevant income. This is

the first use of the powers in section 332F(3)(b) and section 356JH(3)(b), which were inserted by Finance Act 2016.

- 4.2 Section 332F(4) and section 356JH(4) contains the powers to make changes to chapters 6A and 9 of Part 8 Corporation Tax Act 2010 in consequence of, or in connection with any provision contained in the regulations. These regulations use these powers to attribute relevant income as necessary.
- 4.3 Tariff receipts are defined in s291 and section 291A, Part 8, of Corporation Tax Act 2010.

## **5. Extent and Territorial Application**

- 5.1 The extent of this instrument is the United Kingdom
- 5.2 The territorial application of this instrument is the United Kingdom.

## **6. European Convention on Human Rights**

- 6.1 The Commissioners for Her Majesty's Revenue and Customs have made the following statement regarding Human Rights:

“In our view the provisions of the Investment Allowance and Cluster Area Allowance (Relevant Income: Tariff Receipts) Regulations 2018 are compatible with the Convention rights.”

## **7. Policy background**

### *What is being done and why*

- 7.1 The oil and gas industry has been operating in the UK and UK Continental Shelf since the late 1960s, and although it is a mature industry, it continues to make an important contribution to the UK economy. The sector supports over 300,000 jobs, contributes to the UK's energy security by providing around half of our primary energy needs, and has paid around £330bn in production taxes to date. There is still an estimated 20 billion barrels of recoverable oil remaining.
- 7.2 In December 2014 the Government published a strategy for the oil and gas fiscal regime in the document 'Driving Investment: a plan to reform the oil and gas fiscal regime'. This strategy set out the Government's commitment to maximise the economic recovery of the UK's hydrocarbon resources.
- 7.3 Within this context the Finance Act 2015 introduced the investment and cluster area allowances, which support the oil and gas sector by reducing the amount of ring fenced profits taxed by the supplementary charge (one of the direct taxes on oil and gas related activities). The allowances were extended in 2017 (SI 2017/292) to expand the scope of qualifying expenditure which could generate the allowances. Building on this, these regulations will expand the scope of relevant income which can activate the allowances to include tariff receipts and will encourage investment in key infrastructure which is critical to the protection of existing production and the development of new projects.
- 7.4 This instrument has effect in relation to accounting periods beginning or of after 16 September 2016. This is the date Royal Assent was given to the power, announced at Budget 16, to expand the scope of relevant income. The retrospective extension of

the allowances will allow companies to benefit from the extended allowances for tariff receipts earned whilst the regulations were being consulted on and finalised.

- 7.5 The provision in regulation 2 applies to investment allowance, and specifies that in order to be treated as relevant income, the tariff receipt must be attributable to a qualifying oil field in which the company is a licensee.
- 7.6 The provision in regulation 3 applies to cluster area allowance, and specifies that in order to be treated as relevant income, the tariff receipt must be attributable to a cluster area in which the company is a licensee.
- 7.7 The provisions in regulation 4 amend Corporation Tax Act 10 s332F and s356JH and specify that where the relevant income is only partly attributable to a qualifying oil field or cluster area, that income must be attributed to the oil field and cluster area on a just and reasonable basis. This is to prevent excessive income being attributed to any one area, and subsequent excessive activation of allowances.
- 7.8 The provision in regulation 5 removes from the scope of relevant income any tariff receipts that arise in connection with arrangements which have as their main purpose, or one of the main purposes, gaining a tax advantage.

#### *Consolidation*

- 7.9 This is the first instrument made under these powers so consolidation is not relevant at this time.

### **8. Consultation outcome**

- 8.1 At the time the investment and cluster area allowances were introduced, consideration was given to including tariff receipts as relevant income. However, it was decided that there were too many unresolved issues, both tax and commercial, surrounding this complex area and that it was something that would be looked at in the future.
- 8.2 In Autumn 2015 HM Treasury and the Oil and Gas Authority (the industry regulator) ran a series of themed workstream meetings with industry, and one of the findings from the workstream was that underinvestment in infrastructure had been a contributing factor in production inefficiency, and lack of inclusion of tariff receipts as relevant income was a constraint. Government concluded that allowing tariff receipts as relevant income to activate the allowances would improve the incentive for owners to maintain investment in infrastructure.
- 8.3 At Budget 2016 government announced that it would take representations on how best to address some of the complexities around different commercial arrangements between owners and users of infrastructure, including issues of allocation and transparency. Finance Act 2016 introduced a power to enable this expansion to be delivered through regulation.
- 8.4 Over summer 2016 government consulted with industry on the commercial arrangements, culminating in a paper in Autumn 2016 clarifying the government position. The consultations uncovered a potential ambiguity surrounding the definition of tariff receipts in current primary legislation. Finance Act 2018 resolved this ambiguity by updating the primary legislation, and thereby paved the way for these regulations.

## **9. Guidance**

- 9.1 Draft guidance will be shared with industry for comment. Finalised guidance on these changes will be published in the online Oil and Gas Tax Manual.<sup>1</sup>

## **10. Impact**

- 10.1 There is no impact on charities or voluntary bodies. The extension of the investment and cluster area allowances will affect only oil and gas companies earning tariff receipts (around 60) and is expected to have a positive impact on oil and gas companies' post-tax profits within the UK.
- 10.2 There is no impact on the public sector.
- 10.3 A Tax Information and Impact Note covering this instrument was published on xxx July 2018 alongside draft legislation explaining changes to the investment and cluster area allowances and is available on the gov.uk website.

## **11. Regulating small business**

- 11.1 The legislation does not apply to activities that are undertaken by small businesses.

## **12. Monitoring & review**

- 12.1 The changes introduced by this instrument will be consistently monitored and reviewed by HMRC within the context of the oil and gas tax regime.

## **13. Contact**

- 13.1 Nicola Garrod at HM Revenue & Customs, Telephone: 03000 589251 or email: nicola.garrod@hmrc.gsi.gov.uk can answer any queries regarding the instrument.

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<sup>1</sup> <https://www.gov.uk/hmrc-internal-manuals/oil-taxation-manual>