Golden Brown?

The New Brown Field Allowance for Oil and Gas Companies

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The Chancellor of the Exchequer announced a new tax measure aimed at supporting billions of pounds of new investment in older oil and gas fields in the North Sea, increasing tax revenues from the industry.

A tax allowance for certain mature fields, known as brown fields, will shield a portion of income from the Supplementary Charge, encouraging companies to invest in getting the very most out of existing fields and infrastructure in the UK Continental Shelf.

The profits of oil and gas companies in the UK are subject to corporation tax (currently 30%) and a supplemental charge (currently 32%). Certain older fields are also subject to Petroleum Revenue Tax (PRT) at 50%, which was replaced with the supplemental charge for fields that were given development consent on or after 16 March 1993. Any company currently subject to PRT is allowed to deduct such PRT paid from its profits when calculating its income for corporation tax purposes.

Overall, the amount of tax on the oil and gas sector is high, and in particular the sector has not benefited from the reduction in the general rate of corporation tax to 24%. The industry has been lobbying for general and targeted measures to ease the tax burden in appropriate cases. The Chancellor had been under pressure from the oil and gas industry to provide incentives after the increase in the supplemental charge to 32% in 2011 (to help fund a sharp decline in the amount of fuel duty). That announcement, which had not previously been trailed by the Chancellor, had provided a nasty surprise to the industry.

This year's Budget, which contained no nasty surprises for the oil and gas sector (although readers may recall numerous other omnishambles contained therein) announced several measures intended to increase investment in the oil and gas sector in fields that were considered, because of the high tax rates, not to be commercially viable. This included an increase in the small field allowance and an allowance for new large deep water fields (aimed at fields west of Shetland). These measures were provided for in the Finance Act 2012, which received Royal Assent on 17 July 2012.

The announcement in respect of brown fields is the first detailed announcement in relation to these proposed new measures.

The effect of the allowance is to reduce the amount of profits subject to tax for the supplemental charge and PRT. It will not affect the amount of profits subject to corporation tax. In relation to income subject to the supplemental charge, it will reduce the profits subject to tax up to a maximum of £250m (a potential relief of £80m), and for PRT up to a maximum of £500m (a potential relief of £160m). The increased relief for companies subject to PRT recognises the fact that these older fields remain subject to a higher tax rate of 50%.

The exact amount of the allowance available will depend upon the field in question, taking into account its size and cost. In summary, the allowance is available to incremental projects which:

- increase expected production from offshore oil or gas fields (as described in a revised consent for development which is authorised by the Department of Energy & Climate Change on or after 7 September 2012 following the submission of an approved field development addendum by the operator); and
- have verified expected capital costs per tonne of incremental reserves in excess of £60.

The maximum level of allowance will be £50/tonne and will only be available to projects with verified expected capital costs of £80/tonne or above. The manner in which the relief has been introduced suggests that that the Chancellor is unlikely to be persuaded lower the supplemental charge below 32%, which the oil and gas industry had been lobbying for, but rather introduce targeted measures to offer relief in relation to certain fields.

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The government has estimated that these combined measures will reduce the government's tax take by £155 million over the next two years with the majority of this (£95 million) being recouped by increased tax take in 2014-2017, as a result of increased production as a result of these measures.

The underlying philosophy of introducing brown field allowances is to use a tax cut to stimulate production. Other than the consistently reducing rate of corporation tax, the government appears to have been loathe to apply this philosophy to other taxes. The additional rate of income tax will decrease from 50% to 45% next April, but there appears to be no intention to reduce it further. The rate of national insurance remains high for both employers and employees. The rate of VAT only appears to increase. The top rate of SDLT is now 15% (up from 1% in 2000).

In the view of the authors, a benefit for the wider economy as well as the oil and gas sectors would be an increase in the rate of capital allowances. Certain plant or machinery capital allowances have been cut from 25% to 18% and the £100,000 first-year annual investment allowance has been reduced to £25,000. Such increases would incentivise cash-rich businesses to invest in capital equipment, generating substantial benefits for the wider economy. But such an increase would also reverse the stated intention of the government, so is perhaps unlikely to be realised in this Parliament.

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