

Ever-changing: fiscal policy in the North Sea

Exploring the impact of taxation in Oil and Gas production

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Welcome and Introductions



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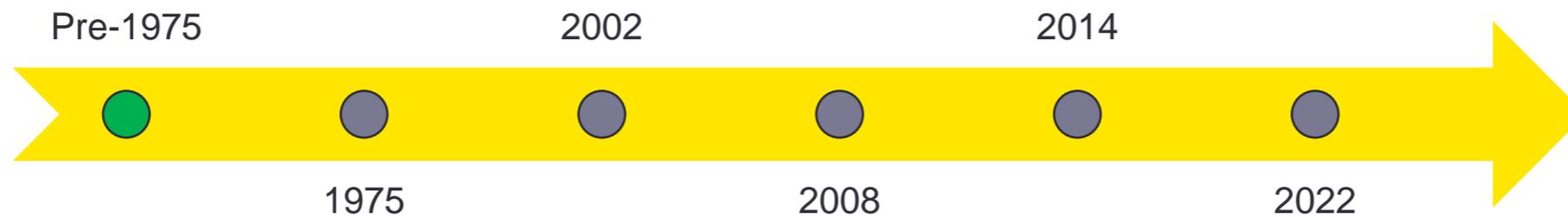
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How did we get here?



Brief history of oil and gas production - non-tax legislation

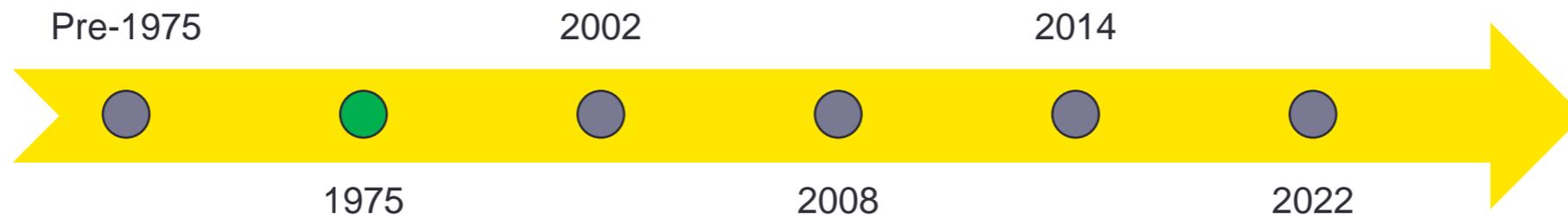
- ▶ **1910s:** Onshore production encouraged. During this time, the right to control exploration and production in the UK was conferred upon the Crown.
- ▶ **1958:** UN Conference on the Law of the Sea – 200 miles from shore established.
- ▶ **1964:** Continental Shelf Act – vested rights over the UKCS in the Crown. Division of UKCS into quadrants and blocks. Consolidation of licensing arrangements.
- ▶ **1964 – 1971:** Four rounds of offshore licensing. By 1973, significant number of discoveries had been made on the UKCS.



Brief history of oil and gas production - 1975

1975

- ▶ British National Oil company formed.
- ▶ First official production of oil at the Argyll field.
- ▶ Introduction of Oil Taxation Act 1975



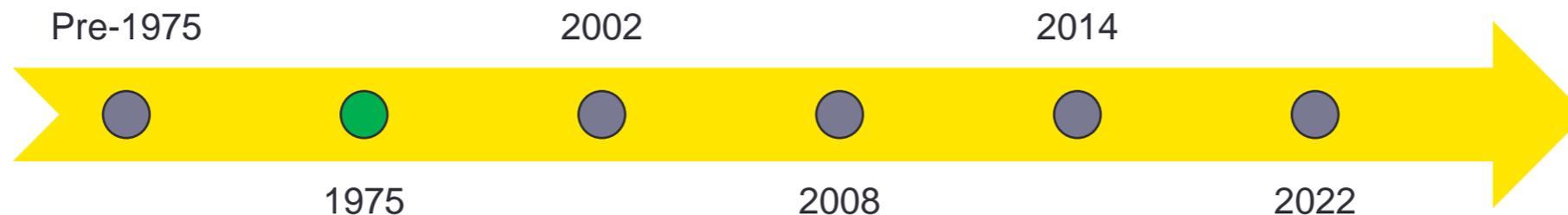
Brief history of oil and gas production – initial tax legislation

Oil Taxation Act (“OTA 1975”)

OTA 1975 introduced two key new concepts to UK corporate tax:

- ▶ Petroleum Revenue Tax (“PRT”) as a new tax:
 - ▶ Central to the introduction of PRT was the intent to recover additional tax from the production of UK oil*. Initially set at 75% but deductible when calculating corporate tax.
 - ▶ PRT profits (or losses) were to be calculated on a field-by-field basis reflecting income less expenditure and not accounting gains and losses.
 - ▶ Intended to allow a project to rapidly recover its cost and a reasonable return before being subject to PRT.
- ▶ The introduction of a “ring fence” around corporate tax profits from UK oil production
 - ▶ Main intention was to ensure “non-ring fence” losses could not be used to shelter profits derived from UK oil production.

*oil means oil and gas for the purpose of these slides



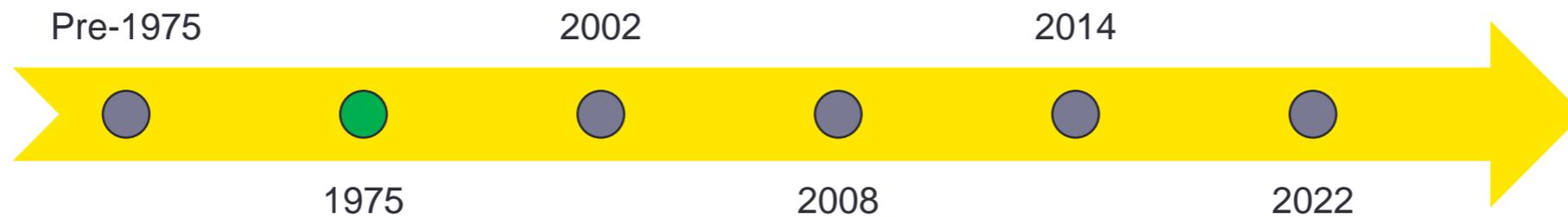
Brief history of oil and gas production – what are “ring-fence” profits

- ▶ A company carries on a “ring-fence” trade if they undertake either:
 - ▶ Oil extraction activities or,
 - ▶ The acquisition, enjoyment or exploitation of oil rights.

- ▶ Oil extraction activities includes:
 - ▶ Searching for oil.
 - ▶ Extracting oil under rights of the company itself or an associate.
 - ▶ Transporting oil under rights of the company itself or an associate.
 - ▶ Initially treating or storing oil under rights of the company itself or an associate.

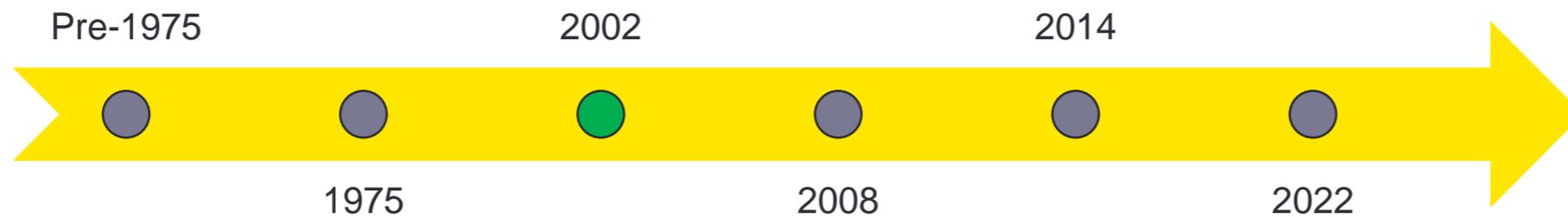
- ▶ Cut off of the ring-fence at midstream stage depending if the activities are performed by the same company or group.

- ▶ These activities must be undertaken in the UK or on the UKCS, i.e. this does not apply to overseas E&P.



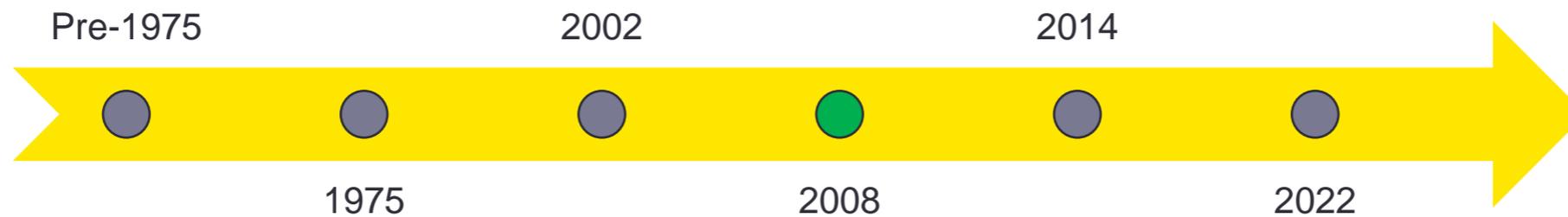
Brief history of oil and gas production – introduction of the Supplementary Charge

- ▶ Finance Act 2002 introduced a further tax for companies with a ring-fence trade.
- ▶ Initially the Supplementary Charge was set at 10% but it has been as high as 32% in the mid-2010s.
- ▶ The Supplementary Charge is levied on the same profits base as ring-fence corporation tax but without a deduction for finance expenses.
- ▶ A restriction related to decommissioning arose in the mid-2010s when the Supplementary Charge rate rose above 20%.



Brief history of oil and gas production – ring fence corporation tax main rate diverges

- ▶ Until 2008, the main rate of ring fence corporation tax mirrored the “non-ring fence rate” notwithstanding PRT and the Supplementary Charge.
- ▶ In 2008, the non-ring fence rate was reduced to 28% and subsequently changed several times after this. The ring-fence rate has remained at 30% since then.
- ▶ Between 2007 and 2015, Brent crude experienced all time high prices which coincided with the Supplementary Charge being increased.
- ▶ The effective tax rate suffered by companies with a ring-fence trade has however, in practice, been much higher than those without. Conversely, there are certain capital allowances and loss uplifts available for companies with a ring-fence trade not otherwise available.



Driving investment: a plan to reform the oil and gas fiscal regime

Box 4.A: Objectives and principles of the fiscal regime

Objectives

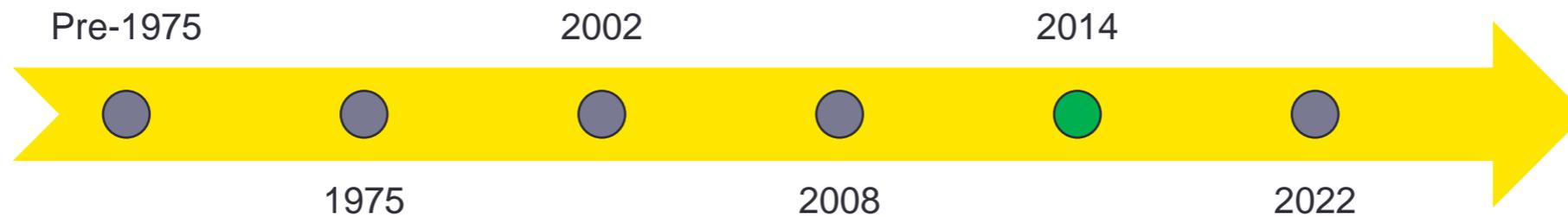
The government designs the fiscal regime to support its twin objectives of maximising the economic recovery of hydrocarbon resources whilst ensuring a fair return on those resources for the nation.

- Maximising economic recovery means ensuring that all resources are recovered where the benefits of recovery outweigh the costs, in such a way as to maximise value in current terms for the UK as a whole.
- A fair return implies that a share of the profits, or 'rent', should be retained for the nation, whilst ensuring returns on the private investment needed to exploit these resources is sufficient to make extraction activity commercially attractive.

Principles

To achieve these objectives over the future of the basin, the government will apply the following principles:

- To be consistent with the objective of maximising economic recovery as new projects become ever more marginal, the overall tax burden will need to fall as the basin matures.
- When making judgements about fiscal policy, the government will consider the wider economic benefits of oil & gas production, in addition to revenues.
- The government's judgement of what constitutes a 'fair return' will account for the competitiveness of commercial opportunities in the UK and UKCS and take account of both prices and costs.



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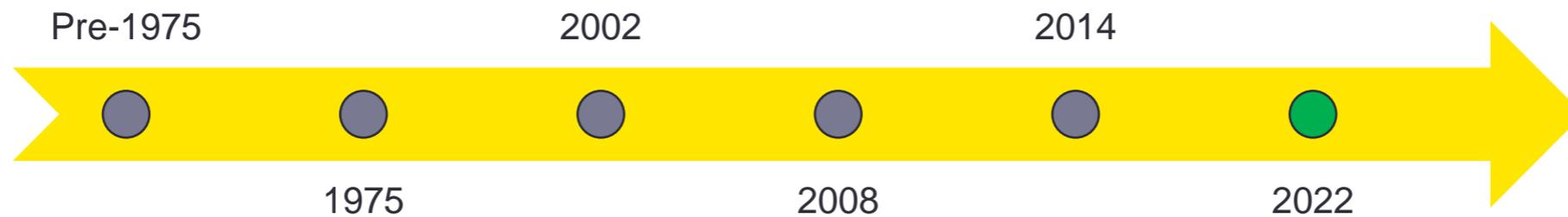
Where are we now?



Current fiscal landscape – energy (oil and gas) profits levy (“Energy Profits Levy” or “EPL”)

Circumstances leading to the introduction of the EPL:

- ▶ Post COVID-19 there was a focus on recovering the large public spend on furlough and business support payments.
- ▶ Simultaneously, E&P companies announced unusually high profits as a result of high oil prices, at the same time as energy bills increased significantly.
- ▶ The then incumbent Government introduced EPL as a temporary measure to tax the “exceptional” profits being earned by E&P companies – i.e., a windfall tax.



Current fiscal landscape – mechanics of initial EPL rules

- ▶ The profits base starts at the same position as the Supplementary Charge, restricted, no deduction of finance cost but it further denies a deduction for decommissioning costs.
- ▶ Non-EPL losses can not be offset against EPL profits. This was a key policy decision due to the level of ring-fence losses accrued after the 2014/15 oil price crash.
- ▶ Government wanted cash tax to be paid rather than companies to forgo losses brought-forward.
- ▶ An investment allowance was made available to give additional relief against EPL profits in respect of ongoing capital investment

May 2022 – EPL introduced at a rate of 25% with a sunset clause of December 2025.

Current fiscal landscape – EPL extension

- ▶ Despite the EPL being introduced as a “temporary” measure in May 2022 at a rate of 25% and with a sunset clause of 31 December 2025, it was subsequently extended

May 2022 – EPL introduced at a rate of 25% with a sunset clause of December 2025.

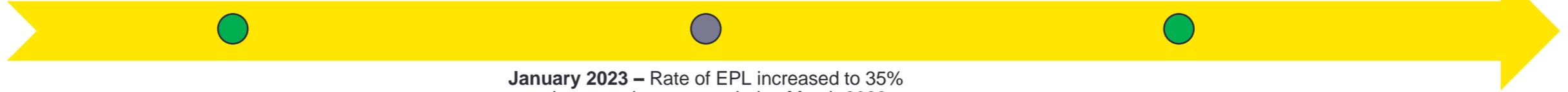


January 2023 – Rate of EPL increased to 35% and sunset clause extended to March 2028

Current fiscal landscape – Spring Budget 2024, and Labour proposals

May 2022 – EPL introduced at a rate of 25% with a sunset clause of December 2025.

Spring Budget 2024 – sunset clause extended to March 2029



January 2023 – Rate of EPL increased to 35% and sunset clause extended to March 2028

Immediately after taking power, the Labour government announced plans to increase the EPL rate to 38%, extend the sunset to March 2030, remove investment allowances and potentially capital allowances.

OEUK published a response: increasing the headline rate to 78%, extending for a year and removing all allowances associated with EPL compared to the current regime would lead to:

- ▶ A reduction in viable capital investment on the UKCS from £14.1 billion to £2.3 billion in the period 2025 to 2029.
- ▶ A reduction in the total economic value of the sector of £13 billion in the period 2025 to 2029.
- ▶ The loss of economic value directly impacts the UK supply chain companies and risks losing the capability and assets to other regions.
- ▶ Approximately 35,000 jobs are at risk over the period due to projects not going ahead.
- ▶ The sector's total tax yield peaks in 2026 before declining compared to the current scenario, which continues to increase HMT receipts over the period.
- ▶ 63% of additional production that could be sanctioned under the current regime would be uneconomic. The UK would be more reliant on other countries to meet the UK energy demand at a cost to the UK economy and net-zero.
- ▶ The proposed regime cannot be likened to Norway which allows companies a maximum £78 of relief for £100 expenditure. Under this proposal, total relief would be £46.25.



Current fiscal landscape - Autumn Budget 2024

- ▶ 2024 Autumn Budget - capital allowances remained intact however investment allowances heavily restricted.
- ▶ Lots of operators publicly expressing their concerns at the viability of continuing to trade under these conditions.

May 2022 – EPL introduced at a rate of 25% with a sunset clause of December 2025.

Spring Budget 2024 – sunset clause extended to March 2029

January 2023 – Rate of EPL increased to 35%

Autumn Budget 2024 – sunset clause extended to March 2030 and rate increased to 38%.

Commercial impact of the Energy Profits Levy

ENERGY VOICE The first word. Oil & Gas Energy Transition Markets Insights Podcast

OIL & GAS / NORTH SEA

Waldorf: Windfall taxes, decom uncertainties made TAQA, Dana asset deal 'impossible'

Reuters World Business Markets Sustainability Legal Breakingviews Technology Investigations

North Sea oil and gas producers say UK windfall tax is a 'wrecking ball'

By Arunima Kumar and Ron Bousso

August 1, 2024 12:57 PM GMT+1 · Updated 6 months ago

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Alba

Oil firm blames windfall tax for North Sea pull-out



APACHE

Apache said changes to windfall tax make production in the North Sea "uneconomic"

Commercial impact of the Energy Profits Levy

ENERGY VOICE
The first word.

Oil & Gas Energy Transition Markets Insights Podcast

OIL & GAS / NORTH SEA

Serica to buy North Sea assets as UK ‘can’t get any worse’

North Sea independent Serica plans drilling campaigns for Bruce, Keith and Rhum as boss doubles down on UK M&A ambitions.

27/01/2025, 7:00 am

He commented: “My view is, the fiscal regime in the North Sea can’t really get any worse than it is right now and so if you think whatever comes after the EPL is going to be better than the EPL, then the value of people’s assets is going to go up over time rather than down.”

3

Where are we heading?



Future outlook

-
- ▶ Consultation on replacement of EPL:
 - ▶ True price shocks only?
 - ▶ Applied to revenues, or to profits?
 - ▶ Rate?
 - ▶ Oil prices vs gas prices?

 - ▶ Future of North Sea energy sector

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