EXPLANATORY MEMORANDUM TO

THE INVESTMENT ALLOWANCE AND CLUSTER AREA ALLOWANCE (RELEVANT INCOME: TARIFF RECEIPTS) REGULATIONS 2019

2019 No. 63

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 can be used depending on the level of income from the production of oil and gas within the UK Continental Shelf. This instrument extends the scope of the investment and cluster area allowances by including income earned from tariffs as well as oil and gas production in the income that is taken into account in determining whether the allowances can be used. Tariff receipts can be earned by making an asset available for third party use, for example a company might let another company use its pipeline to transport its oil and be paid for that.

3. Matters of special interest to Parliament

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 and the change will increase the ability of those affected to obtain tax relief using investment and cluster area allowances and so is wholly relieving. 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.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument includes Scotland and Northern Ireland.

3.3 The powers under which this instrument is made cover the entire United Kingdom (see section 1183 of the Corporation Tax Act 2010) and the territorial application of this instrument is not limited either by the Act or by the instrument.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 Robert Jenrick, the Exchequer Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Investment Allowance and Cluster Area Allowance (Relevant Income: Tariff Receipts) Regulations 2019 are compatible with the Convention rights."

6. Legislative Context

6.1 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 and this is the income that is taken into account in determining whether the allowances can be used. 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

6.2 Sections 332F(4) and section 356JH(4) contain the powers to make changes to chapters 6A and 9 of Part 8 of the Corporation Tax Act 2010 where consequential changes are required following the use of the power to specify relevant income. These regulations use these powers to ensure that income is appropriately attributed for the purposes of making investment and cluster area allowances useable and introduce an anti-avoidance provision.

6.3 Tariff receipts are defined in s291 and section 291A, Part 8, of the Corporation Tax Act 2010.

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 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 oil and gas 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 profits taxed by the supplementary charge (one of the taxes on oil and gas related activities). The allowances were extended in 2017 (SI 2017/292) to expand the scope of the types of expenditure which could generate the allowances. Building on this, these regulations will expand the scope of types of income that can make those allowances useable to include tariff receipts

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 2016, to expand the scope of income that could make investment and cluster area allowances useable. 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.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union

9. Consolidation

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

10. Consultation outcome

10.1 At the time the investment and cluster area allowances were introduced, consideration was given to including tariff receipts as income that could make investment and cluster area allowances useable. 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.

10.2 In autumn 2015 HM Treasury and the Oil and Gas Authority (the industry regulator) consulted with industry, and one of the findings was that underinvestment in infrastructure (e.g. pipelines etc.) had been a contributing factor in production inefficiency. Not being able to include tariff receipts as income that could make allowances useable was a constraint on such investment. Government concluded that expanding the scope to include tariff receipts would improve the incentive for owners to maintain investment in infrastructure.

10.3 At Budget 2016 government announced that it would consult to understand the types of commercial arrangements that existed and Finance Act 2016 introduced a power to enable the expansion of the scope of income that could make investment and cluster area allowances useable to be delivered through regulation.

10.4 The consultation with industry and representative bodies uncovered a potential ambiguity surrounding the definition of tariff receipts in that not all such receipts would be taxed within the oil and gas tax regime. Finance Act 2018 resolved this ambiguity updating the legislation, and paving the way for these regulations.

11. Guidance

11.1 Draft guidance will be shared with industry for comment over the next few months. Finalised guidance on these changes will be published in the online Oil and Gas Tax Manual.[1]

[1] https://www.gov.uk/hmrc-internal-manuals/oil-taxation-manual

12. Impact

12.1 The extension of the investment and cluster area allowances will affect only oil and gas companies earning tariff receipts (around 60).

12.2 There is no impact on charities or voluntary bodies.

12.3 There is no impact on the public sector.

12.4 A Tax Information and Impact Note covering this instrument was published on 23 July 2018 alongside draft legislation explaining changes to the investment and cluster area allowances and is available on the gov.uk website[2] and it remains an accurate summary of the impacts that apply to this instrument.

13. Regulating small business

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

14. Monitoring & review

14.1 The changes introduced by this instrument will be kept under review through regular communication with those affected and through the monitoring of tax receipts from activity in the oil and gas sector.

14.2 The Regulations do not include a statutory review clause because they relate to provisions imposing, abolishing or varying tax (see section 28(3) of the Small Business, Enterprise and Employment Act 2015).

15. Contact

15.1 Hugh Dorey at HM Revenue & Customs Telephone: 03000 585838 or email: hugh.dorey@hmrc.gsi.gov.uk can be contacted with any queries regarding the instrument.

15.2 Martyn Rounding, Deputy Director for Corporation Tax Structure, at HM Revenue & Customs can confirm that this Explanatory Memorandum meets the required standard.

15.3 Robert Jenrick, the Exchequer Secretary to the Treasury can confirm that this Explanatory Memorandum meets the required standard.

[2] https://www.gov.uk/government/consultations/draft-legislation-oil-and-gas-taxation-investment-and-cluster-area-allowances