Finance Act 2002

Changes to North Sea Tax

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Section 63 First-year allowances for expenditure wholly for a ring fence trade (and Sch. 21)

Summary

This section establishes, via Sch. 21, for a UK and United Kingdom Continental Shelf (UKCS) ring-fence trade, the availability of first-year allowances at a 100 per cent rate (or 24 per cent rate for long-life assets) in respect of capital expenditure incurred on plant and machinery, and at a 100 per cent rate in respect of capital expenditure incurred on mineral exploration and access. These enhanced-rate capital allowances will be tax deductible from profits in calculating both the normal corporation tax liability and the new ICTA 1988, s. 501A ten per cent supplementary corporation tax charge. The IR Budget Note 'Changes in the North Sea Tax Regime' (REV BN 17) states that the objective of these enhanced allowances is 'to promote investment in the North Sea'. There are a number of special restrictions specifically applicable to these provisions to prevent unintended claims for these more favourable categories of capital allowances. The new rates of allowance take effect for qualifying expenditure incurred on or after 17 April 2002.

Details

Section 63(1) gives effect to the provisions of Sch. 21, which s. 63(2) sets out as establishing the availability of first-year allowances in respect of capital expenditure incurred on plant and machinery, and mineral exploration and access in a ring fence trade comprising UK and UKCS oil extraction activities or acquisition, enjoyment or exploitation of UK and UKCS oil rights. Section 63(3) confirms that the new rates of allowance take effect for qualifying expenditure incurred on or after 17 April 2002.

Schedule 21, para. 1 and 2 introduce a new category of first year allowances for qualifying expenditure on plant and machinery for use wholly in a ring fence trade into CAA 2001, s. 39. Schedule 21, para. 3 sets out in a new CAA 2001, s. 45F, detailing the general qualifying conditions for this plant and machinery expenditure, clarifying that it must be incurred by a company on or after 17 April 2002 wholly for use in a ring fence trade within the meaning of ICTA 1988, s. 502 – in short, a trade comprising UK and UKCS oil-extraction activities or the acquisition, enjoyment or exploitation of UK and UKCS oil rights. The expenditure must not fall within the existing general exclusions covering a list of various categories of asset at CAA 2001, s. 46(2) (Sch. 21, para. 5).

Schedule 21, para. (4) introduces (in a new CAA 2001, s. 45G) certain specific restrictions which exclude certain items of plant and machinery from this new 100 per cent first year allowance category. There is no entitlement to first year allowances *if, within five years* of the date of incurring the expenditure or *at any point* during a company's (or a connected company's) ownership of the plant and machinery *if less than five years*, there is:

- never any use of those assets in the company's (or a connected company's) ring fence trade; or
- use at any time for a non-ring fence purpose by the company (or a connected company).

It is possible to interpret these new provisions in CAA 2001, s. 45F and S. 45G as applicable separately where two or more companies are joint-owners of part interests in an asset. This would imply that a company which incurs expenditure on a part share in an asset to use wholly for the purposes of its own ring fence trade may claim a first-year allowance even if a joint-owner uses the asset for a non-ring fence purpose. References to the asset in CAA 2001, s. 45G could also include a company's original part share of an asset even when that interest transfers and is then in the ownership of a connected company for this purpose.

Within three months of realising, there is a specific obligation on the claimant company to advise the Inland Revenue the amount of any change to capital allowance entitlement arising from new CAA 2001, s. 45G so that they can issue assessments or amended assessments as appropriate. Schedule 21, para. 7 sets out a technical amendment to include these obligations within the penalty regime of TMA 1970, s. 98 in respect of failure to provide information.

Schedule 21, para. 6 sets out the rates of first-year allowances applicable to plant and machinery falling within new CAA 2001, s. 45F, as follows :

- 24 per cent for long-life asset expenditure (broadly, assets with an economic life of 25 years or more).
- 100 per cent for non long-life asset expenditure (broadly, assets with an an economic life of less than 25 years).

Schedule 21, para. 8 and 9 introduce a new category of first year allowances for qualifying expenditure on mineral exploration and access in a ring fence trade (new CAA 2001, s. 416A and s. 416B). New CAA 2001, s. 416B sets out the general qualifying conditions for this mineral exploration and access expenditure (which, for this purpose, includes seismic data or similar mineral access results), clarifying that it must be incurred by a company on or after 17 April 2002 wholly for use in a ring fence trade again within the meaning of ICTA 1988, s. 502. The expenditure must not fall within the following exclusions :

- Acquisition of a mineral asset;
- Acquisition of an asset from a connected company.

In addition, to avoid giving unintended first-year allowances, for this purpose there is no deemed change to the time when a company incurs costs which would otherwise arise under CA 2001, s. 400(4) for pre-trading expenditure and under CA 2001, s. 434 for mineral exploration and access expenditure where commencement of trade is imminent.

Schedule 21, para. 10 sets out the entitlement to 100 per cent first-year allowances for the chargeable period in which the claimant company incurs qualifying mineral exploration and access expenditure (new CAA 2001, s. 416D). In this case, there is specific provision introduced, which allows the claim for first-year allowances to be for either part or all of the qualifying mineral and exploration access expenditure.

Under Sch. 21, para. 11, specific restrictions exclude certain expenditure on mineral exploration and access from this new 100 per cent first-year allowance category (new CAA 2001, s. 416E). This is a broadly framed, anti-avoidance provision which disallows first-year allowance claims in circumstances where there are arrangements present, relating to a transaction, wholly or mainly for a disqualifying purpose. New CAA 2001, s. 416E defines arrangements for this purpose widely and it is notable that such arrangements do not have to be legally enforceable to come within the scope of the restriction here. Arrangements have a disqualifying purpose if their whole or main object is to enable a person to claim a first-year allowance or a greater first-year allowance than would otherwise arise.

Schedule 21, para. 12 sets out a technical addition to CA 2001, s. 418(4) to ensure that the correctly intended balancing charge is assessable on a person in circumstances where the balancing event arises in the same chargeable period in which the claimant has incurred expenditure qualifying for first-year allowance. In the absence of this provision, a company could avoid appropriate clawback of first-year allowances from which it has benefited.

Schedule 21, para. 13 sets out further technical amendments to the existing CAA 2001, s. 419 to ensure that the correctly intended balancing charge or balancing allowance is assessable on a person in respect of expenditure they have incurred. These amendments achieve the desired balancing adjustment by defining UQE (unrelieved qualifying expenditure) in respect of the same chargeable period as that in which the person incurred qualifying expenditure for the following alternative scenarios:

- where that person incurred no first-year qualifying expenditure;
- where that person incurred first-year qualifying expenditure but received no qualifying disposal proceeds;
- where that person incurred both first-year qualifying expenditure and received a qualifying disposal receipt(s).

The resultant UQE forms part of the formula described and set out in CAA 2001, s. 417 and 418 to calculate the relevant balancing adjustment(s).

For commentary on ring fence trade generally, see CCH *British Tax Reporter* ¶173-920.

Section 91 Supplementary charge in respect of ring fence trades

Summary

With effect from 17 April 2002, s. 91 introduces a supplementary charge of 10 per cent corporation tax on adjusted profits from a UK and United Kingdom Continental Shelf (UKCS) ring fence trade – this is in addition to the normal corporation tax liability. In contrast to the adjusted profits which are the basis of charging normal corporation tax, there is no deduction allowed for any financing costs when calculating the ring fence trade profits subject to the 10 per cent supplementary charge. Section 91 incorporates a fairly wide definition of financing costs for this purpose.

Details

Section 91 adds new ICTA 1988, s. 501A 'Supplementary charge in respect of ring-fence trades'. Its subs. (1) is the basic provision introducing a ten per cent supplementary corporation tax charge on adjusted UK and UKCS ring-fence profits from oil extraction activities or the acquisition, enjoyment or exploitation of UK and UKCS oil rights as already defined in ICTA 1988, s. 492 and s. 502. Although s. 91(1) applies for all accounting periods beginning on or after 17 April 2002, s. 93(1) provides that accounting periods straddling 17 April 2002 are split at that point and treated as two separate accounting periods with all necessary apportionments made on the basis of the relative number of days. The practical effect of this combination is that the ten per cent supplementary charge applies with immediate effect from 17 April 2002, making apportionments of profits on a time basis, as necessary.

New ICTA 1988, s. 501A(2) and (3) clarify that the adjusted ring fence profits subject to the ten per cent supplementary charge are the company's post 16 April 2002 ring fence profits as noted above which the Oil Taxation Office would otherwise determine as the profits of the company's ring fence trade, but excluding any financing costs. The exclusion of a company's financing costs post 16 April 2002 covers any such amounts included in both profits of its ring fence trade and in any loss relief surrendered to it under ICTA 1988, s. 492(8). The IR Budget Note 'Changes in the North Sea Tax Regime' (REV BN 17) states that the exclusion of financing costs as tax deductible in determining this ten per cent supplementary charge is 'to prevent companies manipulating their levels of borrowing between ring fence and non-ring fence activities to minimise the impact of the supplementary charge'.

New ICTA 1988, s. 501A(4), (5) and (6) clarify the scope of financing costs, defined as costs of debt finance, which do not qualify as deductible for the purposes of the ten per cent supplementary charge. The following are items which fall within the definition of non-deductible costs of debt finance for this purpose:

- costs which are loan relationship debits under FA 1996, Pt. 4, ch. 2;
- exchange differences in respect of debt finance under FA 1993, Pt. 2, ch. 2;
- trading results on interest rate and currency contracts under FA 1994, Pt. 4, ch. 2;

- finance costs implicit in finance leases. For this purpose, new ICTA 1988, s. 501A(8),(9) and (10) define a finance lease in terms of when a particular leasing arrangement in question does or may appear as a finance lease or loan disclosure in accounts drawn up under the *Companies Act* 1985 or similar 1986 legislation in Northern Ireland under generally accepted accounting practice. A deeming provision treats the lessee and any connected persons as companies incorporated in the UK for this purpose.
- New ICTA, s. 501A(7) clarifies the position on taxation of any repayments or refunds in respect of financing costs implicit under a finance lease. There is mirror treatment here in that there is no ten per cent supplementary tax due on such repayments if there was no relief for the original financing cost because it was originally excluded under new ICTA 1988, s. 501A(5).
- A final, potentially wide-ranging 'catch-all' category of 'any other costs arising from what would be considered in accordance with generally accepted accounting practice to be a financing transaction'.

For commentary on ring fence trade generally, see CCH *British Tax Reporter* ¶173-920.

Section 92 Assessment, recovery and postponement of supplementary charge

Summary

Section 92 introduces administrative provisions to cover assessment, recovery and postponement of tax in respect of the new ten per cent supplementary charge due on profits from a ring fence trade under new ICTA 1988, s. 501A with effect from 17 April 2002. It includes clarification that the ten per cent supplementary charge has no impact on the calculation or utilisation of surplus ACT balances nor any impact on calculations to determine whether a company is large for the purposes of making quarterly instalments of corporation tax.

Details

Section 92(1) adds s. 501B 'Assessment, recovery and postponement of supplementary charge' to ICTA 1988. New ICTA 1988, s. 501B(1) and (2) gives the Inland Revenue the rights to apply existing legislation in the administration of the ten per cent supplementary charge due on profits from a ring fence trade under ICTA 1988, s. 501A with effect from 17 April 2002. These new rights apply with regard to the following general areas already applicable to normal corporation tax:

- returns of information and provision of supporting materials;
- assessment, collection and receipt of tax;
- appeals;
- administration, penalties, interest and insolvency.

The exception to the above is that the ten per cent supplementary corporation tax and the related 'adjusted ring fence profits' on which that charge arises are not relevant and have no impact on the calculation or utilisation of any surplus ACT balance which remains unrelieved from prior years following the previous abolition of ACT. Hence, no references to corporation tax or profits chargeable to corporation tax in FA 1998 , s. 32 have any effect in respect of the new ten per cent supplementary charge nor its calculation or utilisation (New ICTA 1988, s. 501B(3)).

Section 92(2) is a technical amendment to TMA 1970 extending the scope of Treasury powers to make provision by regulation for accelerating due dates for payment of corporation tax to include the ten per cent supplementary charge in its ambit.
Section 92(3) and (4) are further technical amendments to include the ten per cent supplementary charge in various corporation tax self-assessment provisions of FA 1998, Sch. 18, which covers corporation tax returns, assessments and related matters.

For accounting periods beginning on or after 17 April 2002, s. 92(5), (6), (7) and (9) together establish that, *unless determined by reference to a company's total corporation tax liability*, it is necessary to exclude any consideration of the ten per cent supplementary charge from determining whether a company is large for the purposes of deciding whether it is liable to make quarterly instalments of corporation tax under the *Corporation Tax (Instalment Payment) Regulations* 1998 (SI 1998/3175).

Section 92(8) of this clause is a somewhat general statement reserving regulatory rights to revoke or amend for any chargeable period(s) any provisions included in regulations which new ICTA 1988, s. 501B has altered.

For commentary on ring fence trade generally, see CCH *British Tax Reporter* ¶173-920.

Section 93 Supplementary charge : transitional provisions

Summary

Section 93 introduces transitional provisions to cover the introduction of the ten per cent supplementary charge in accounting periods which straddle 17 April 2002 and its impact on quarterly instalment payments of corporation tax for large companies. For corporation tax instalment purposes, the rules effectively treat the new ICTA 1988, s. 501A liability for the period commencing 17 April 2002 as separate from the normal corporation tax liability for the straddling accounting period.

Details

Section 93(1) provides that accounting periods straddling 17 April 2002 are split at that point and treated as two separate accounting periods with all necessary apportionments made on the basis of the relative number of days. The practical effect of the introduction of the charge for accounting periods beginning on or after 17 April 2002 and s. 93(1) is that the ten per cent supplementary charge applies with immediate effect from 17 April 2002. This requires making apportionments of profits on a time basis as necessary and allows the Inland Revenue to administer assessment, recovery and postponement of this supplementary tax due from 17 April 2002 accordingly.

Section 93(2), (3), (4) and (6) provide rules on how to determine corporation tax instalment payments for a company's accounting period which straddles 17 April 2002. The rules effectively treat the new ICTA 1988, s. 501A liability as arising in respect of a deemed accounting period commencing 17 April 2002. Under these transitional provisions, the new ICTA 1988, s. 501A liability for the period commencing 17 April 2002 is also separate from the normal corporation tax liability for the straddling accounting period.

To take a simple example of a large company (for corporation tax instalment purposes) with accounting periods of calendar years and a fixed estimate of the estimated corporation tax liability for the year ended 31 December 2002, this would require instalment payments as follows:

- for the normal 30 per cent corporation tax liability, the four basic quarterly instalments to pay 25 per cent each time of the estimated liability are due on 14 July 2002, 14 October 2002, 14 January 2003 and 14 April 2003.
- for the ten per cent supplementary corporation tax liability under new ICTA 1988, s. 501A, the deemed accounting period is 17 April 2002 to 31 December 2002 (259 days). There are three instalments due for this short deemed accounting period under the *Corporation Tax (Instalment Payments) Regulations* 1998 (SI 1998/3175). These are due as to c. 35.42 per cent of the estimated liability on 30 October 2002, c. 35.42 per cent of the estimated liability on 30 January 2003 and c. 29.16 per cent of the estimated liability on 14 April 2002.

Section 93(5) clarifies that a company can only be large and liable to make instalment payments for the ten per cent supplementary corporation tax liability for its deemed accounting period commencing 17 April 2002 if it is a large company for instalment purposes in respect of the accounting period straddling 17 April 2002. In this regard, the calculation as to whether a company is large for instalment purposes in the straddling period shall not take account of any ten per cent supplementary liability arising under new ICTA, s. 501A.

In future years subsequent to the straddling period, the determination of corporation tax instalment payments will treat the normal and supplementary liabilities as one for this purpose and not separately as is the case for the accounting period straddling 17 April 2002. However, s. 92(5), (6), (7) and (9) (see commentary above) together establish that*, unless determined by reference to a company's total corporation tax liability*, it is necessary to exclude any consideration of the ten per cent supplementary charge from determining whether a company is large for the purposes of deciding whether it is liable to make quarterly instalments of corporation tax under the *Corporation Tax (Instalment Payment) Regulations* 1998 (SI 1998/3175).

For commentary on ring fence trade generally, see CCH *British Tax Reporter* ¶173-920.