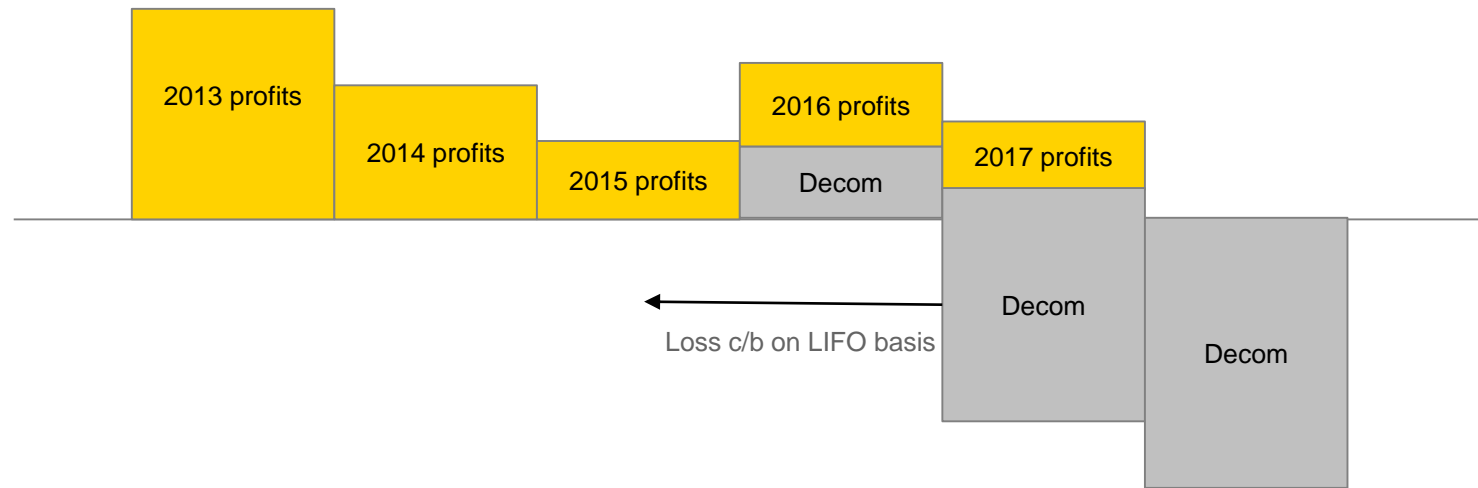


Transferable Tax History

SPE Petroleum Economics Conference, December 2018

Decommissioning relief: corporate tax



- ▶ Decommissioning expenditure can be claimed as a special allowance at a rate of 100%
- ▶ It offsets ring fence profits (eg 2016 above) or, to the extent it creates a loss, can be group relieved or carried back on a LIFO basis for an extended period (eg 2017/2018 above)
- ▶ If there are no (or insufficient) taxed profits available to absorb the loss, effective relief is unavailable (or restricted)

Late life assets: Background

- ▶ Decommissioning tax relief may be a blocker to transactions that would otherwise be value accretive for the UK.
- ▶ Where a seller is confident of obtaining effective tax relief on decommissioning, but a buyer is not, the post-tax value of the asset may be lower for the buyer than the seller (all other things being equal).
- ▶ This negative value arbitrage can be significant enough to prevent transactions from occurring.
- ▶ Retention of liability by seller overcomes value gap, but is not a solution for all transactions.

Late life assets - example

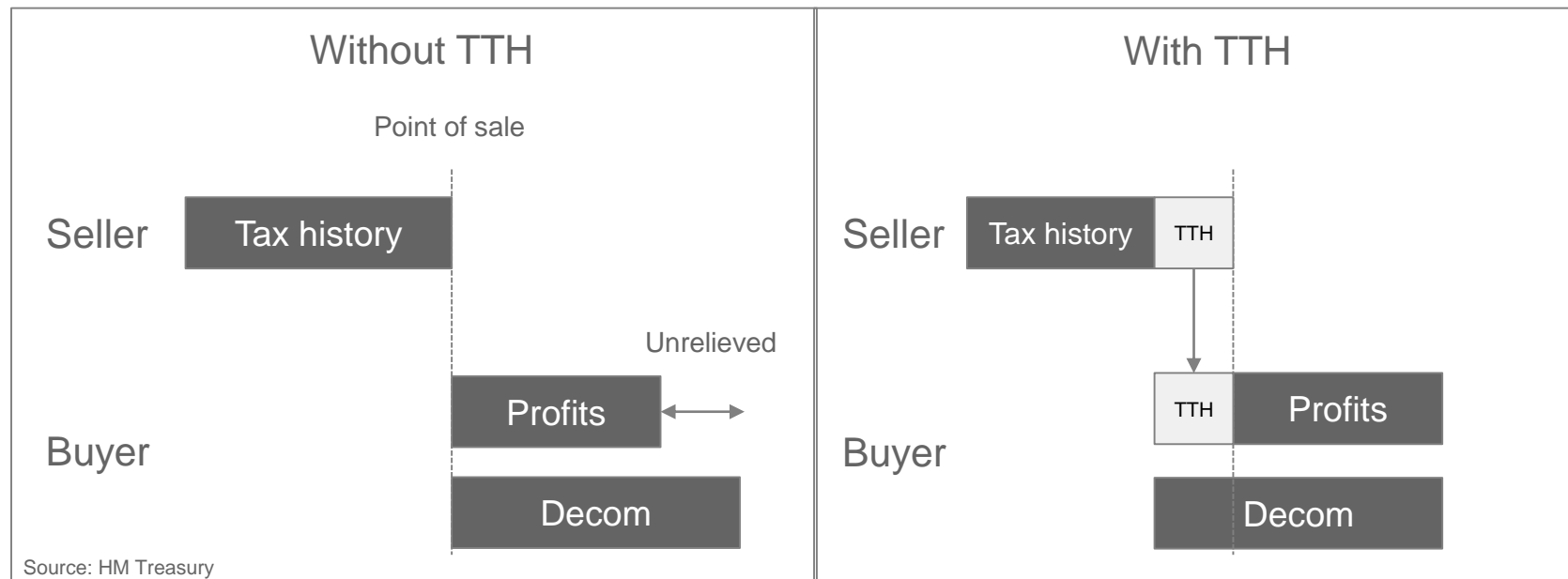
Seller view	Pre-2015	2016	2017	2018	2019	2020	2021	2022	2023
Profits (ignoring decom)	500	300	300	150	100				
Decom						(50)	(150)	(350)	(200)
Tax (paid)/repaid	(250)	(120)	(120)	(60)	(40)	20	60	140	80
Pre-tax NPV(10) at 1 Jan 17			44						
Post-tax NPV(10) at 1 Jan 17			27						

Buyer view	Pre-2015	2016	2017	2018	2019	2020	2021	2022	2023
Profits (ignoring decom)			300	150	100				
Decom						(50)	(150)	(350)	(200)
Tax (paid)/repaid			(120)	(60)	(40)	20	60	140	
Pre-tax NPV(10) at 1 Jan 17			44						
Post-tax NPV(10) at 1 Jan 17			(14)						

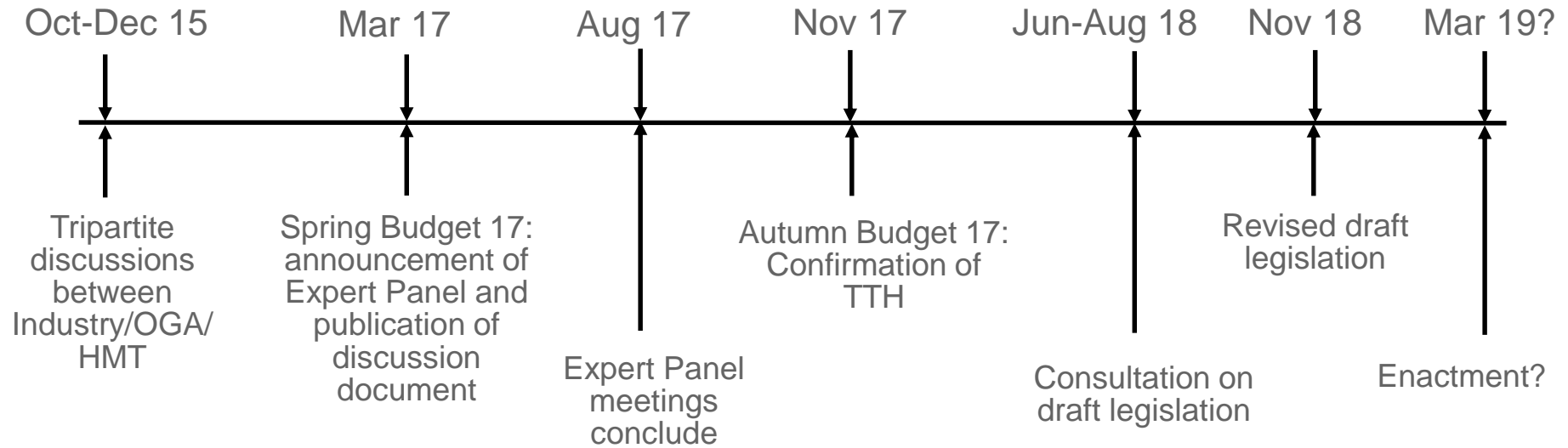
Transfer of tax history: a solution?

The “tax value gap” is caused by i) the risk of forecast net future cashflow on the asset (undiscounted) being negative, and ii) buyer’s inability to obtain tax relief for the negative net outflow.

Solution: allow seller’s tax history to be transferred to the buyer



Late life assets: background



Key design principles

1. RFCT and SC history to be transferred on a LIFO basis

The seller's RFCT history is to be transferred on a LIFO basis starting 2 years before the year in which completion occurs (ie for deals completing in 2019, and assuming calendar years, seller's history from 2016 and earlier is transferred). Corresponding SC history is also transferred.

2. Elective basis

Seller and buyer are able to elect how much "transfer" is required to facilitate the deal, subject to an overall cap to prevent abuse. Making use of TTH is not mandatory for every deal.

3. Deals on or after 1 November 2018

TTH will be possible for deals where the OGA gives consent for the transfer on or after 1 November 2018. Since legislation will not actually be enacted until 2019, this has a degree of retrospective effect.

HMT protection to consider

1. Is buyer motivated to acquire an “excessive” amount of capacity?

Buyer may not need the full amount of TTH to shelter a post-acquisition net loss on the acquired asset. If it can match losses on its legacy assets with the “transferred” capacity, it would be motivated to obtain more capacity than is needed to facilitate the deal. This is negated by restricting “activation” of the TTH to the actual post-acquisition net decommissioning loss on the acquired asset. As a result, “profit tracking” by Buyer is required.

2. Is seller motivated to transfer an “excessive” amount of capacity?

If the seller has:

- i) a significant amount of excess historic capacity;
- ii) tranches of profits taxed at different effective rates (taking account of tax rate changes, decommissioning cap, impact of IA); and
- iii) the relief arising on the most recent history would be “low-taxed” by reference to other tranches of capacity,

the seller could be motivated to transfer amounts of low-taxed capacity in excess of the amount required to facilitate the deal. This is intended to be negated by an overall cap on the history transferred, by reference to the buyer’s share of the decommissioning cost as estimated for the purposes of the DSA. Anti-avoidance provisions are also included.

TTH: worked example

Assume deal completes on 1 January 2019, and election is made to transfer 600 of history. For simplicity, assume RFCT profits = SC profits.

Seller tax position	2015	2016	2017	2018	2019	2020	2021	2022	2023
Taxable profits	500	400	300	300					
Tax paid	250	160	120	120					
Transferred history	(200)	(400)							

Buyer tax position	2015	2016	2017	2018	2019	2020	2021	2022	2023
Profits (ignoring decom)					300	400	200		
Transferred profits	200	400							
Tax paid	100	160			120	160	80		
Decom								(700)	(500)
Activated TTH								-	300
Tax refund on decom								280	200

Key issues addressed in revised legislation

▶ Certainty for buyer

- ▶ HMRC had unilateral right to reject TTH election “for the protection of the revenue”, any time within 12 months after completion
- ▶ HMRC could unilaterally alter the cap, by substituting its own assumptions into the DSA estimate
- ▶ HMRC had freedom to determine how attribution of buyer’s post-acquisition profits to the TTH field is performed
- ▶ Revised legislation enables greater certainty for buyer that TTH can be assumed

▶ Timing of access to TTH

- ▶ Intention is after permanent cessation of production, but draft legislation suggested permanent abandonment of all wells – that could be much later

▶ Intra-group transfers

- ▶ Limited ability to transfer TTH intra-group immediately prior to or after third party share sale – to facilitate hive-down transactions

▶ Onward sales

- ▶ Mechanism for transferring TTH acquired to a new buyer refined

Summary

- ▶ TTH available for asset transfers under contemplation **today**
- ▶ Legislation expected to be enacted Q1 2019, but should now be in reasonably final form
- ▶ HMT and industry both want this measure to contribute to MER – if you think it could be relevant to a deal under consideration, come and ask!

Contact details



Bob Cardno | Director | International Tax Services | Energy

Ernst & Young LLP
Blenheim House, Fountainhall Road, Aberdeen AB15 4DT,
United Kingdom
Office: +44 1224 653248
rcardno@uk.ey.com

Disclaimer

- ▶ The information in this pack is intended to provide only a general outline of the subjects covered. It should not be regarded as comprehensive or sufficient for making decisions, nor should it be used in place of professional advice.
- ▶ Accordingly, EY accepts no responsibility for loss arising from any action taken or not taken by anyone using this pack.
- ▶ The information in this pack will have been supplemented by matters arising from any oral presentation by us, and should be considered in the light of this additional information.
- ▶ If you require any further information or explanations, or specific advice, please contact us and we will be happy to discuss matters further.

Questions?



EY | Assurance | Tax | Transactions | Advisory

Ernst & Young LLP

© 2017 Ernst & Young LLP. Published in the UK.
All Rights Reserved.

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

ey.com