**Estimates of the Remaining Exchequer Cost of Decommissioning UK Upstream Oil and Gas Infrastructure (August 2019)**

The Exchequer cost arises from refunds of previously tax paid (when losses as a result of decommissioning expenditure are "carried back" against past profits) and lower levels of tax on current or future profits (which are reduced by current, carried forward or future decommissioning costs).

The latest estimates are given in *Statistics of Government revenues from UK Oil and Gas production* (HMRC, 19 July 2019) (**emphasis** added):

> Decommissioning of UK oil and gas infrastructure
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> > The Oil Taxation Act 1975 allows participators in an oil and gas field liable to PRT [Petroleum Revenue Tax] to carry-back losses almost indefinitely against profits it has previously made from the field, or which previous participators in the field had made. This may result in the repayment of tax.
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> > With respect to Offshore Corporation Tax (comprised of RFCT [Ring Fence Corporation Tax] and SC [Supplementary Charge]) the Corporation Tax Act 2010 allows for a company's decommissioning loss to be carried back against its own historical profits dating back to April 2002. Again, this may result in a repayment of tax.
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> **Exchequer liabilities from decommissioning**
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> > **The OGA has estimated that the total industry costs between 2019–20 and 2064–65 for decommissioning all UKCS oil and gas infrastructure are £51 billion[1]. The projected Exchequer cost of tax relief from this expenditure is £16.8[2] billion. This is made up of £8.3[3] billion from tax repayments and a reduction in the Offshore Corporation Tax of £8.5 billion. Decommissioning expenditure reduces company profits and hence lowers the overall tax take.**

Further information is provided in *HM Revenue and Customs Annual Report and Accounts 2018–19* (18 July 2019) (**emphasis** added):

> **Petroleum Revenue Tax**
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> Petroleum Revenue Tax (PRT) is a 'field-based' tax charged on the profits arising from individual oil and gas fields that were approved for development before 16 March 1993. The rate of PRT was permanently set at 0% effective from 1 January 2016 but it has not been abolished so that losses (such as losses arising from decommissioning PRT-liable fields) can be carried back against past PRT payments.

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1. 2018 prices.
2. Nominal prices with discounting.
3. This is shown in HMRC's annual report and accounts as a provision. Repayments of PRT and CT are £2.9 billion and £5.5 billion respectively, after rounding.

**Exchequer liabilities arising from oil and gas infrastructure**

There are two taxes levied on companies exploring and producing oil and gas from the UK Continental Shelf (UKCS): Petroleum Revenue Tax (PRT) and offshore Corporation Tax (CT), the latter being comprised of two elements: Ring-fence Corporation Tax and Supplementary Charge.

The legislation governing the losses from decommissioning costs (the Oil Taxation Act 1975) allows participators in an oil and gas field liable to PRT to carry-back decommissioning losses almost indefinitely against profits it has previously made from the field, or which previous participators in the field have made. This may result in the repayment of PRT. With respect to offshore CT, the Corporation Tax Act 2010 allows for a company's decommissioning loss to be carried back against its own historical profits dating back to April 2002. Again, this may result in a repayment of offshore CT.

**Provision for oil and gas field decommissioning**

A provision of £8.3 billion has been identified in the 2018–19 Trust Statement based on the estimated tax repayments of PRT £2.9 billion (2017–18: £6.7 billion) and offshore CT £5.4 billion (2017–18: £6.2 billion) by HMRC to companies incurring losses from decommissioning expenditure over the period 2019–20 to 2066–67. This is discounted to the present value using HM Treasury guidance.

The key determinants of the provision estimate are future decommissioning costs from the Oil and Gas Authority's (OGA) Asset Stewardship Survey, economic determinants (including oil & gas prices and production) from the Office for Budget Responsibility's (OBR) Spring Statement 2019 economic and fiscal outlook as well as the discount rate and the US Dollar/Sterling exchange rate.

There has been no significant change in the model used to calculate the provision since last year. The main driver of the overall reduction in the provision has been lower decommissioning costs. This is consistent with the target of reducing overall UKCS decommissioning costs referenced in the OGA Decommissioning Strategy.

The provision utilised in-year is the tax repayments in 2018–19 due to decommissioning expenditure.

**Uncertainty around the estimate of the provision**

The largest impact on the size of the provision, and biggest source of uncertainty in estimating it, is future decommissioning costs. Annually, the OGA estimates the total costs of remaining oil and gas decommissioning for the UKCS, including newly sanctioned projects, and changes to the portfolio of potential, as yet unsanctioned projects.

Recognising the uncertainty around this, the OGA gives a range for expected decommissioning costs for UKCS oil and gas infrastructure over the remaining life of the North Sea basin.

**The £8.3 billion provision included in the Trust Statement is calculated using the OGA's central estimate for decommissioning costs of £51.3 billion. Using the OGA's lower (£40 billion) and upper (£67 billion) decommissioning cost estimates would instead give provision estimates of £7 billion and £10.9 billion respectively.**

The main economic determinant which drives the provision are oil and gas prices. The model uses projections from the OBR where available and then applies a growth rate to project prices for later years. Upper and lower price projections have been estimated based on the distinct range of oil and gas prices as produced in the Department for Business, Energy and Industrial Strategy's Fossil Fuel Price Assumptions. Applying a higher price scenario reduces the provision by around £2 billion whilst lower prices require an increase in the provision of around £1 billion.

The provision is also impacted by interest rate and foreign exchange rates as follows:

a) An increase in the discount rate will reduce the present value of the provision. An overall increase in the discount rates of 100 basis points (i.e. 1%) will decrease the overall provision by £1 billion.

b) As oil prices are denominated in US Dollars, the overall provision is impacted by changes in the US Dollar/Sterling exchange rate. A 10 cent appreciation in the US Dollar gives rise to higher Sterling oil prices resulting in a £1 billion decrease in the provision. A 10 cent depreciation of the Dollar results in a less than £1 billion increase in the required provision.

**Provisions and contingent liabilities**

HMRC recognises a provision in the Trust Statement where it considers that it is probable that it will need to repay taxes already received in the current and previous financial years, in accordance with accounting standards. …

- Oil and gas field decommissioning costs, where companies decommissioning oil and gas infrastructure in the North Sea are entitled to recover tax previously paid in relation to profits from those oil and gas fields. As at 31 March 2019, HMRC estimates that it will have to repay £8.3 billion of tax in relation to oil and gas field decommissioning (2017–18: £12.9 billion). This is the estimated amount that HMRC will repay to oil and gas companies and is based on an estimate of the decommissioning costs that they will incur in future periods. In 2018–19, companies recovered £0.5 billion of Petroleum Revenue Tax (PRT) from HMRC in relation to decommissioning losses.

**Decommissioning Relief Deeds**

At Budget 2013, the government announced it would begin signing decommissioning relief deeds. These deeds represented a new contractual approach to provide oil and gas companies with certainty on the level of tax relief they will receive on future decommissioning costs. As part of the terms of becoming a participator in a licence in the UK or UK Continental Shelf, companies have a statutory obligation to decommission their operations properly once oil and gas production has ceased. Between October 2013 and the end of March 2019, the government entered into 92 decommissioning relief deeds with oil and gas companies to guarantee the basis on which tax relief for decommissioning is available. The deeds have been signed by the government and eligible companies. Any company that has carried on a ring-fence trade, and the associates of those companies, are eligible to be party to a deed.

The deeds indemnify the companies for changes in tax legislation or the default of joint-venture partners in respect of their decommissioning activities, allowing them to claim relief from HM Treasury potentially otherwise available to the field from HMRC through the tax system. The deed provides companies with greater certainty in respect of decommissioning tax relief and allows them to adopt post-tax securitisation arrangements for the future costs of decommissioning. The deeds thus support the government's objective of maximising economic production of oil and gas reserves in the UK Continental Shelf. They are designed to free up capital that otherwise would have been held in reserve against possible changes in tax rules. In December 2018, Oil & Gas UK estimated that £6 billion of capital had been unlocked for reinvestment as a result of the deeds.

HM Treasury has not disclosed the potential financial value of the Decommissioning Relief Deeds because it is unquantifiable, given the absence of comparable data to use in any calculation. The crystallisation of any liability is dependent on the financial health of the companies (and their joint-venture partners) that are party to the deeds. The government has not made any changes to the tax regime that would generate a liability to be paid under any decommissioning relief agreements.

HM Treasury recognises a provision when a claim is notified and the amount can be measured reliably. Since inception of the deeds, one claim has been made. The remaining amount of the claim is reflected in HM Treasury's Annual Report and Accounts 2018–19 as a provision for £357 million in respect of decommissioning expenditure incurred as a result of a company defaulting on their decommissioning obligations. The value of the provision represents the best estimate of the outstanding costs to settle the claim. The majority of this provision is expected to be realised over the next five years: £95 million within one year of 31 March 2019, £241 million between one year and five years and £21 million more than five years after 31 March 2019. The provision of £357 million relates to amounts estimated to be payable to MCX Dunlin and MCX Osprey in respect of decommissioning expenditure in relation to the Dunlin cluster of fields, created as a result of Fairfield Energy defaulting on their decommissioning obligations. The decision to decommission the Dunlin cluster was a commercial decision made by Fairfield Energy, MCX Dunlin and MCX Osprey after reaching agreement with the Oil and Gas Authority that maximum economic recovery had been achieved for these assets. The provision is based on 50%[4] of the estimated remaining decommissioning costs which would otherwise have been paid by the defaulting party, plus an estimate of any PRT relief that would be due on those costs, discounted for the time value of money.

4. The rates of RFCT and SC relief under the DRD in an imposition are, respectively, 30% and 20% of the decommissioning costs, regardless of the tax paid by the claimant or the defaulter.