

CAPITAL ALLOWANCES ACT 2001

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Glossary

Part 2: Plant and machinery allowances

Chapter 13: Provisions affecting mining and oil industries

Overview

- 587. This Chapter brings together rules which apply only to the mining and oil industries.
- 588. [Section 159](#) states the meaning of “mineral extraction trade”.
- 589. [Section 160](#) treats expenditure incurred for mineral exploration and access in connection with a mineral extraction trade as incurred for the purposes of the trade.
- 590. [Section 161](#) deals with relief for pre-trading expenditure on mineral exploration and access.
- 591. [Section 162](#) sets up a separate qualifying activity for a ring fence trade.
- 592. [Section 163](#) defines “abandonment expenditure” for the purposes of the next two sections.
- 593. [Section 164](#) gives special relief for abandonment expenditure in ring fence trades.
- 594. [Section 165](#) provides relief for abandonment expenditure in the three years following the cessation of trade.
- 595. [Section 166](#) is an anti-avoidance provision applying if an interest in an oil field is transferred.
- 596. [Sections 167 to 171](#) deal with production sharing contracts. [Section 167](#) sets out the general conditions which apply. [Section 168](#) treats expenditure incurred on plant or machinery by a contractor under a production sharing contract as being incurred on plant or machinery. [Section 169](#) provides a similar rule for expenditure incurred by “participators” in production sharing contracts. [Section 170](#) deals with the acquisition of an interest in a production sharing contract by a participator. [Section 171](#) deals with disposal values on the cessation of ownership under subsection (2) of any of the previous three sections.

Background

- 597. [Sections 160](#) and [161](#) work together to give relief for pre-trading expenditure on mineral exploration and access. If the expenditure is connected with an existing trade, section 160 will apply. If it is not connected to an existing trade then section 161 will apply.

598. On 7 August 2000 the Inland Revenue announced that the government had agreed to bring forward new legislation to give relief for the re-use of oil rigs, pipelines and other North Sea Oil installations. This is expected to form part of Finance Act 2001 and to become incorporated into this Chapter.

Section 159: Meaning of “mineral extraction trade” etc.

599. This section is based on the defined terms in section 83(1) of CAA 1990. They define “mineral extraction trade” and “mineral exploration and access” by reference to the definitions in Part 5. See section 394(2) for the meaning of “mineral extraction trade” and section 396 for “mineral exploration and access”.

Section 160: Expenditure treated as incurred for purposes of mineral extraction trade

600. This section is based on section 83(6) of CAA 1990. It provides for expenditure on the provision of plant or machinery for mineral exploration and access which is connected with a mineral extraction trade to be treated as for the purposes of the trade.
601. This relaxes the ordinary rule in *section 11* that expenditure has to be for the purposes of the qualifying activity.

Section 161: Pre-trading expenditure on mineral exploration and access

602. This section is based on section 63 of CAA 1990. It allows pre-trading expenditure on plant or machinery used for mineral exploration and access to be brought into the pool at cost when the trade commences.
603. There is a minor change in *subsection (4)(a)*. In section 63(1)(a) of CAA 1990 there is no explicit requirement that the expenditure has to be *capital* expenditure on the provision of plant or machinery. See *Change 25* in Annex 1.
604. This section is referred to in section 13(7). This is because this section overrides the general rule for plant and machinery which is used before it is brought into use for a qualifying activity. The general rule in section 13(3) and (4) would operate to bring the plant or machinery into the pool at the lower of cost or market value.
605. R&D allowances (see Part 6) are available for some types of pre-trading expenditure on mineral exploration and access. Oil and gas exploration and appraisal is treated as “research and development” by section 437(2)(b).

Section 162: Ring fence trade a separate qualifying activity

606. This section is based on section 492(1) of ICTA and section 62A(2) of CAA 1990. It creates a separate qualifying activity for ring fenced trades.

Section 163: Meaning of “abandonment expenditure”

607. This section is based on section 62A(1). It introduces and defines the term “abandonment expenditure” for the purposes of sections 164 and 165.
608. Subsection (5) refers to definitions in the Oil Taxation Act 1975 and the Petroleum Act 1998. These are set out below.

Section 12 of OTA 1975 provides:

““oil field” shall be construed in accordance with Schedule 1 to this Act.

Schedule 1 to OTA 1975 provides:

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“ for the purposes of this Part of this Act an oil field is any area which the appropriate authority may determine to be an oil field, being an area of which every part is, or is part of, a licensed area.

Section 29(1) of the Petroleum Act 1998 provides:

“ an “abandonment programme” is... a programme setting out the measures proposed to be taken in connection with the abandonment of an offshore installation or submarine pipeline.

Section 44 of the Petroleum Act 1998 provides:

“(1) In this Part of this Act, “offshore installation” means any installation which is or has been maintained, or is intended to be established, for the carrying on of any activity to which subsection (2) applies.

(2) This subsection applies to any activity mentioned in subsection (3) which is carried on from, by means of or on an installation which is maintained in the water, or on the foreshore or other land intermittently covered with water, and is not connected with dry land by a permanent structure providing access at all times and for all purposes.

(3) The activities referred to in subsection (2) are—

- (a) the exploitation, or the exploration with a view to exploitation, of mineral resources in or under the shore or bed of relevant waters;
- (b) the storage of gas in or under the shore or bed of relevant waters or the recovery of gas so stored;
- (c) the conveyance of things by means of a pipe, or system of pipes, constructed or placed on, in or under the shore or bed of relevant waters; and
- (d) the provision of accommodation for persons who work on or from an installation which is or has been maintained, or is intended to be established, for the carrying on of an activity falling within paragraph (a), (b) or (c) or this paragraph.

(4) In this Part of this Act, “relevant waters” means—

- (a) tidal waters and parts of the sea in or adjacent to the United Kingdom up to the seaward limits of the territorial sea;
- (b) waters in an area designated under section 1(7) of the Continental Shelf Act 1964; and
- (c) such inland waters as may for the time being be specified for the purposes of this paragraph by Order in Council;

but Her Majesty may by Order in Council provide that, in such cases and subject to such exceptions and modifications as may be prescribed by the Order, this Part of this Act shall have effect as if—

- (i) any reference in this Part of this Act to relevant waters included a reference to waters in any area specified under section 10(8); and
- (ii) in relation to an installation which is or has been maintained, or is intended to be established, in relevant waters, any reference in subsection (3) to relevant waters included a reference to waters in a foreign sector of the continental shelf which are adjacent to such waters.

(5) For the purposes of this section—

“inland waters” means waters within the United Kingdom other than tidal waters and parts of the sea;

“installation” includes—

- (a) any floating structure or device maintained on a station by whatever means; and

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(b) in such cases and subject to such exceptions as may be prescribed by Order in Council, any apparatus or works which are by virtue of section 26 to be treated as associated with a pipe or system of pipes for the purposes of Part III of this Act,

but, subject to paragraph (b), does not include any part of a pipeline within the meaning of that section;

“modifications” includes additions, omissions and alterations.

- (6) The fact that an installation has been maintained for the carrying on of an activity falling within subsection (3) shall be disregarded for the purposes of this section if, since it was so maintained, the installation—
- (a) has been outside relevant waters or, where it was so maintained in a part of a foreign sector of the continental shelf adjacent to those waters, the area consisting of those waters and that part; or
 - (b) has been maintained for the carrying on of an activity not falling within that subsection.
- (7) Any statutory instrument containing an Order under subsection (4) shall be subject to annulment in pursuance of a resolution of either House of Parliament.

Section 45 of the Petroleum Act 1998 provides:

“ “Submarine pipeline” means a pipeline within the meaning of section 26 which is in, under or over waters in the territorial sea adjacent to the United Kingdom; or an area designated under section 1(7) of the Continental Shelf Act 1964.

Section 26 of the Petroleum Act 1998 provides:

- “(1) Except where the context otherwise requires, in this Part of this Act “pipeline” means a pipe or system of pipes (excluding a drain or sewer) for the conveyance of any thing, together with any apparatus and works associated with such a pipe or system.
- (2) For the purposes of this Part of this Act the apparatus and works associated with such a pipe or system are—
- (a) any apparatus for inducing or facilitating the flow of any thing through, or through a part of, the pipe or system;
 - (b) any apparatus for treating or cooling any thing which is to flow through, or through part of, the pipe or system;
 - (c) valves, valve chambers and similar works which are annexed to, or incorporated in the course of, the pipe or system;
 - (d) apparatus for supplying energy for the operation of any apparatus or works mentioned in paragraphs (a) to (c);
 - (e) apparatus for the transmission of information for the operation of the pipe or system;
 - (f) apparatus for the cathodic protection of the pipe or system; and
 - (g) any structure used or to be used solely for the support of a part of the pipe or system.
- (3) The Secretary of State may by order provide that a part of a pipeline specified in the order shall be treated for the purposes of this Part of this Act, except this subsection, as a pipeline.

Section 164: Abandonment expenditure incurred before cessation of ring fence trade

609. This section is based on section 62A of CAA 1990. It provides rules for a special allowance for abandonment expenditure.

610. To qualify for the allowance, an election must be made (which is irrevocable).
611. The special allowance is given in the chargeable period of abandonment, effectively as a 100% capital allowance.
612. *Section 165*, provides a similar relief for expenditure in the three years following cessation of the ring fence trade.

Section 165: Abandonment expenditure within 3 years of ceasing ring fence trade

613. This section is based on section 62B of CAA 1990. It deals with abandonment expenditure after the cessation of the ring fence trade.
614. If the ring fence trade has ceased, then the relief provided by section 164 will not be available.
615. There is no election needed but the expenditure must be incurred within three years of the cessation of the ring fence trade. Section 5 determines when capital expenditure is incurred.
616. If the expenditure qualifies then there is no special allowance as such but the additional expenditure is added to the pool for the last period of trading. That will increase the balancing allowance or reduce the balancing charge so the net result is the same.

Section 166: Transfers of interests in oil fields: anti-avoidance

617. This section is based on section 64 of CAA 1990. It provides a rule that prevents the new owner of plant or machinery attributable to an interest in an oil field bringing in as qualifying expenditure more than the cost to the previous owner.

Section 167: Oil production sharing contracts

618. This section and sections 168 to 171 are based on section 64A of CAA 1990. They deal with oil production sharing contracts. In summary:
- a production sharing contract is a contract between an oil enterprise (normally a company) and a government for production of oil to be shared between the company and the government;
 - the contractor develops the field under the contract and incurs expenditure on plant and machinery to generate the production;
 - the contract provides that the plant and machinery is transferred to the government;
 - the contract may be exclusive or there may be other companies involved (“participators”);
 - the contracts may be transferred; and
 - the ordinary plant and machinery rules do not entitle the companies concerned to allowances because they do not own the plant or machinery. Furthermore the transfer itself is a disposal event.
619. This section explains what is meant by a production sharing contract. *Sections 167 to 171* give entitlement to allowances and prevent the transfer being a disposal event.

Section 168: Expenditure on plant or machinery incurred by contractor

620. This section sets out the basic rule for expenditure incurred on plant or machinery by a contractor under a production sharing contract. It allows the expenditure to qualify for plant and machinery allowances by deeming the plant or machinery to be owned by the contractor.

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621. Without this provision contractors would not be entitled to claim capital allowances because the ownership condition in section 11(4)(b) would not be satisfied after the transfer to the government and the transfer itself would be a disposal event.
622. *Subsection (1)* sets out the conditions that need to be satisfied.
623. *Subsection (2)* treats the contractor as owning the plant or machinery until the events identified in paragraph (a) or (b) take place. Section 171 deals with disposal events in those circumstances.

Section 169: Expenditure on plant or machinery incurred by participator

624. This section extends the basic rule in section 168 to include “participators” in production sharing contracts. It allows participators’ expenditure to qualify for plant and machinery allowances by deeming the plant or machinery to be owned by the participator.
625. Without this provision the expenditure would not qualify because the ownership condition in section 11(4)(b) would not be satisfied, and the transfer to the government would be a disposal event.
626. *Subsection (1)* sets out the conditions that need to be satisfied.
627. *Subsection (2)* applies a parallel rule for ownership and cessation of ownership as is provided for contractors in section 168(2). Similarly section 171 deals with disposal events.

Section 170: Participator’s expenditure attributable to plant or machinery

628. This section covers the position of participators who acquire an interest in a production sharing contract from a contractor or participator. If:
- part of the expenditure on acquiring the interest is attributable to plant or machinery; and
 - that plant or machinery is treated as owned by a contractor or participator under sections 168 or 169,
- then this section will allow plant and machinery to qualify for allowances for the participator acquiring the interest.
629. *Subsection (2)* deals with the deemed ownership and says when that comes to an end in a similar way to sections 168(2) and 169(2). Disposal events are given by section 171.
630. *Subsection (3)* creates a disposal event for the person who previously held that interest in the contract, and provides for a disposal value equal to the participators’ expenditure. The participator here is the participator in *subsection (1)(a)*. The attributable expenditure is apportioned – see *subsection (6)*.
631. *Subsection (4)* is needed because the participator in this section does not actually incur expenditure on plant or machinery. Instead an interest in a contract has been acquired. This subsection therefore deems the participator to have incurred expenditure and to own it as result of incurring that expenditure. The participator can then claim allowances. In sections 168 and 169 the contractor or participator has actually incurred expenditure on plant or machinery which they own, although it has to be transferred under the contract.
632. *Subsection (5)* deals with the amount of the expenditure that will qualify under this section.
633. *Subsection (6)* provides for a just and reasonable apportionment of the acquisition expenditure to find the amount of expenditure attributable under *subsection (3)*.

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Section 171: Disposal values on cessation of ownership

634. This section gives disposal values on cessation of deemed ownership. It applies when the plant or machinery is transferred to the government at the end of the production sharing contract. The disposal events it relates to are in sections 168(2)(a) and (b), 169(2)(a) and (b) and 170(2)(a) and (b). If the contractor or participator receives capital compensation then the disposal value is the amount of that compensation. Otherwise it is nil.