

CORPORATION TAX ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Part 8: Oil activities

Chapter 4: Calculation of profits

Overview

951. This Chapter contains the rules that determine how income/profits from a ring fence trade are calculated, to the extent that they differ from the calculation for any other type of trade. The starting point is that all normal trading income rules apply unless they are modified by a provision of this Chapter. The calculation may also be affected by the ring fence expenditure supplement rules set out in Chapter 5.
952. The general rules for the calculation of trading income for corporation tax purposes are in Part 3 of CTA 2009.

Section 280: Disposal to be valued by reference to section 2(5A) of OTA 1975

953. This section modifies the calculation of profits for corporation tax purposes where certain expenses are incurred in connection with the transportation of oil. It is based on section 493(A1) to (A3) of ICTA. There is no equivalent for income tax.
954. The starting point is section 2(5A) of OTA 1975, which involves situations where the seller disposes of oil at arm's length and is required to meet certain transportation costs – *subsection (6)*.
955. Section 2(5A) OTA 1975 replaces:
- actual sales proceeds from a sale at arm's length under a contract which requires the seller to meet the transport costs,
- with
- deemed proceeds based on a hypothetical sale at arm's length under which the seller does not have to meet the transport costs and has to transport the oil to the nearest landing point (or, in the case of onshore fields, to the place of extraction itself).
956. *Subsection (9)* adopts the price given by section 2(5A) of OTA 1975, for the seller only – it has no impact on the purchaser. Section 3(1)(f) of OTA 1975 allows transport costs for transportation to that point. If a company does not claim transportation costs for corporation tax then for practical purposes the price at that point is the actual sale price minus the transport costs to that point.
957. In order to prevent double counting, *subsections (7) and (8)* require that the company does not otherwise get a deduction for the transportation cost or “transportation allowance” against either its ring fence or non ring fence profits, as that allowance is in effect netted off to reach the price in *subsection (9)*.

Section 281: Valuation where market value taken into account under section 2 of OTA 1975

958. This section specifies that where the market value of oil is included in the calculation of profits for PRT purposes by OTA 1975 in place of the actual sale price, the same price applies for corporation tax. It is based on section 493(1) of ICTA.
959. The market value applies to both the seller and the purchaser. The section therefore retains the term “person” rather than “company” as the other party may not necessarily be a company. The market value is derived by way of a comprehensive scheme put in place for PRT purposes – see in particular section 2 of and Schedule 3 to OTA 1975.
960. The corresponding rule for income tax is section 225F of ITTOIA (inserted by Schedule 1 to TIOPA).

Section 282: Valuation where disposal not sale at arm’s length

961. This section applies a market value price where oil is disposed of otherwise than at arm’s length, but where the disposal is not covered by the PRT rules. It is based on section 493(3), (5) and (6) of ICTA.
962. A common application of this rule is where oil is extracted from an oil field that is not within the scope of PRT following the reforms in FA 1993, which took fields given development consent on or after 16 March 1993 out of the scope of PRT.
963. This section also retains the term “person” because the transactions may not necessarily involve only companies.
964. The corresponding rule for income tax is section 225G of ITTOIA (inserted by Schedule 1 to TIOPA).

Section 283: Valuation where excess of nominated proceeds

965. This section ensures that where the “nomination scheme” adds an amount to the disposal value of oil for PRT purposes, that amount is also added for corporation tax purposes. It is based on section 493(1A) of ICTA.
966. The corresponding rule for income tax is section 225H of ITTOIA (inserted by Schedule 1 to TIOPA).
967. The “nomination scheme” is part of the mechanism to ensure that the full value of oil extracted from the UK sector is reflected in the profits calculated for PRT and for the ring fence trade. A full description of the scheme can be found in HMRC guidance at OTM 5199.
968. The addition to the price for corporation tax purposes is made even if the relevant oil field is not within the scope of PRT – see *subsection (1)(b)*.
969. *Subsection (3)* provides for a deduction in computing the profits of a non-ring fence trade. The wording has been changed to clarify its meaning as the source legislation in section 493(1A)(b) of ICTA was unclear. See *Change 29* in Annex 1.

Section 284: Valuation where relevant appropriation but no disposal

970. This section imposes a market value in a case where an oil producer does not sell the oil to another party but takes it into use in another of its businesses, such as refining. It is based on section 493(2) of ICTA.
971. The corresponding rule for income tax is section 225I of ITTOIA (inserted by Schedule 1 to TIOPA).

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972. Where a market value is applied for PRT purposes by OTA 1975, that market value is used in the calculation of profits for corporation tax purposes – see *subsections (4) and (5)*. The market value also applies to the non-ring fence trade.

Section 285: Valuation where appropriation to refining etc

973. This section imposes a market value in a case where an oil producer does not sell the oil to another party but takes it into use in another of its businesses, such as refining, and where the PRT rules do not apply. It is based on section 493(4), (5) and (6) of ICTA.
974. The corresponding rule for income tax is section 225J of ITTOIA (inserted by Schedule 1 to TIOPA).
975. In such a case the same calculation of market value is made using the PRT rules as if the PRT rules had applied to the appropriation.

Section 286: Restriction on debits to be brought into account

976. This section modifies the loan relationship rules in the case of a ring fence trade. It is based on section 494(2) and (2A) of ICTA.
977. The section ensures that non-trading debits from a company's loan relationships cannot be set against the company's ring fence profits, unless the loan relationship represents money borrowed to finance oil extraction activities or to acquire oil rights. The loan relationship rules are in Parts 5 and 6 of CTA 2009.
978. *Subsection (5)* provides that where a non-trading debit is restricted in this way the legislation allows the company to have relief for the debit against other profits.

Section 287: Restriction on credits to be brought into account

979. This section ensures that exchange gains in respect of loan relationships are not treated as part of the ring fence profits where the exchange gains do not arise from money borrowed to finance ring fence activities. It is based on section 494(2), (2ZA) and (2A) of ICTA.
980. The section operates in a similar way to section 286. Where a credit is excluded from the computation of ring fence profits it is brought into account by *subsection (5)*.

Section 288: Sale and lease-back

981. This section ensures that where financing has been obtained by way of a sale and lease-back of assets, a deduction for the expenditure may not be made against ring fence profits unless certain conditions are met. It is based on section 494AA of ICTA.
982. *Subsections (6) and (7)* ensure that a deduction is only permitted against ring fence profits if the disposal proceeds are used in the ring fence trade.
983. Where the deduction is prevented from being given in full or in part against the ring fence profits, *subsection (8)* allows a deduction from other profits of the company for any amount that has not been allowed because of this section.
984. This section has no income tax equivalent.

Section 289: Reduction of expenditure by reference to regional development grant

985. This section restricts a deduction for expenditure incurred to the extent that the expenditure has been met by a regional development grant. It is based on section 495(1), (2) and (7) of ICTA.
986. The corresponding rule for income tax is section 225K of ITTOIA (inserted by Schedule 1 to TIOPA).

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987. The main restriction in respect of a grant is applied by section 534 of CAA. This section applies essentially the same restriction to the purchaser of an asset who buys the asset from a connected party, and where that connected party received a regional development grant on the original acquisition or construction of the asset.
988. The source legislation applies to expenditure taken into account under Parts 2, 3 or 6 of CAA. Section 84 of FA 2008 repeals Part 3 of CAA for corporation tax purposes with respect to expenditure incurred on or after 1 April 2011. The section therefore applies to Parts 2 and 6 of CAA and the reference to Part 3 of CAA has been retained for the interim period by way of a transitional provision in Schedule 2.

Section 290: Adjustment as a result of regional development grant

989. This section supplements section 289 and section 534 of CAA where the amount of expenditure involved is re-determined at a later date. It is based on section 495(3) to (7) of ICTA.
990. The corresponding rule for income tax is section 225L of ITTOIA (inserted by Schedule 1 to TIOPA).
991. The most likely application of regional development grants in the oil context is for onshore assets such as initial treatment plants to stabilise the crude oil arriving by pipeline. The eligibility of such assets for PRT relief, or the proportion that is eligible, can take some time to agree. As a result, the PRT position (which determines the amount eligible for capital allowances) may not be finalised for some time.
992. Accordingly, capital allowances could be given on the full amount in the “initial period”, disregarding the grant, as section 534(2) of CAA or its predecessors would not have applied at that stage. *Subsection (5)* ensures that the position can be adjusted in a later period if a change in circumstances occurs.
993. Section 137 of FA 1982, referred to in the source legislation, was rewritten in section 534 of CAA.
994. The source legislation applies to expenditure taken into account under Parts 2, 3 or 6 of CAA. Section 84 of FA 2008 repeals Part 3 of CAA for corporation tax purposes with respect to expenditure incurred on or after 1 April 2011. The section therefore applies to Parts 2 and 6 of CAA and the reference to Part 3 of CAA has been retained for the interim period by way of a transitional provision in Schedule 2.

Section 291: Tariff receipts etc

995. This section brings certain tariff receipts into the calculation of ring fence profits if those receipts would not otherwise be included. It is based on section 496 of ICTA.
996. The corresponding rule for income tax is section 225M of ITTOIA (inserted by Schedule 1 to TIOPA).
997. Tariff receipts arise where assets used in the ring fence trade are not used wholly for oil extraction by the owner but are used by other businesses in return for payment of a fee or “tariff”. Typical examples include the use of pipelines and treatment plants.
998. Tax-exempt tariffing receipts arise where the oil field to which the assets are attached for PRT purposes is not within the charge to PRT and therefore the tariffs are not chargeable to PRT.
999. Definitions of “tariff receipt” and “tax-exempt tariffing receipt” have been included to aid users of the legislation.

Section 292: Expenditure on and under abandonment guarantees

- 1000. This section provides relief against corporation tax where an oil field participator incurs expenditure in obtaining an abandonment guarantee. It is based on sections 62 and 63(8) of FA 1991.
- 1001. The corresponding rule for income tax is section 225N of ITTOIA (inserted by Schedule 1 to TIOPA).
- 1002. The cost of decommissioning oil fields is eligible for relief under the capital allowances code. But as the majority of oil fields are shared between two or more participators there is a risk that one or more of the participators may not meet their share of the cost when the time comes. As a result participators have taken out guarantees with financial institutions to cover their share. This section provides relief for the cost of obtaining the guarantee.

Section 293: Relief for reimbursement expenditure under abandonment guarantees

- 1003. This section provides relief for a participator against ring fence profits where some or all of a participator's share of decommissioning costs is met by a guarantee and the participator subsequently reimburses the guarantor. It is based on section 63 of FA 1991.
- 1004. The corresponding rule for income tax is section 225O of ITTOIA (inserted by Schedule 1 to TIOPA).

Section 294: Payment under abandonment guarantee not immediately applied

- 1005. This section applies where a guarantor makes payments into a fund and the assets of the fund are subsequently used to cover decommissioning costs. It is based on section 62(4) of FA 1991.
- 1006. The corresponding rule for income tax is section 225P of ITTOIA (inserted by Schedule 1 to TIOPA).
- 1007. In such a case the rules for relief under section 292 or 293 apply to the expenditure when it is eventually met out of the assets of the fund.

Section 295: Amounts excluded from section 293(1)

- 1008. This section restricts relief where amounts are repaid to a guarantor instead of being applied to meet decommissioning costs. It is based on section 63(2) of FA 1991.
- 1009. The corresponding rule for income tax is section 225Q of ITTOIA (inserted by Schedule 1 to TIOPA).

Section 296: Introduction to sections 297 and 298

- 1010. This section sets out the circumstances in which sections 297 and 298 apply, and provides some related definitions. It is based on sections 64(1), (2) and (3) and 65(1) of FA 1991.
- 1011. The corresponding rule for income tax is section 225R of ITTOIA (inserted by Schedule 1 to TIOPA).

Section 297: Relief for expenditure incurred by a participator in meeting defaulter's abandonment expenditure

- 1012. This section provides for relief to a participator who meets the decommissioning expenditure that should have been met by another participator (the "defaulter"). It is based on section 64(4) and (5) of FA 1991.

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1013. The corresponding rule for income tax is section 225S of ITTOIA (inserted by Schedule 1 to TIOPA).

Section 298: Reimbursement by defaulter in respect of certain abandonment expenditure

1014. This section applies where a defaulting participator reimburses another participator who has met the defaulter's liability for decommissioning expenditure. It is based on section 65 of FA 1991.
1015. The corresponding rule for income tax is section 225T of ITTOIA (inserted by Schedule 1 to TIOPA).
1016. Relief against ring fence profits is given to the defaulter, and the other participator is treated as receiving additional ring fence income.
1017. The time limit in *subsection (5)* was amended from six years to four years by paragraph 27 of Schedule 39 to FA 2008. This change takes effect by Order from 1 April 2010 (see article 2(2) of the Finance Act 2008, Schedule 39 (Appointed Day, Transitional Provisions and Savings) Order 2009 (SI 2009/403)).

Section 299: Deduction of PRT in calculating income for corporation tax purposes

1018. This section provides that a company may deduct PRT paid as an expense in calculating profits from the ring fence trade. It is based on section 500(1), (2), and (3) of ICTA.
1019. [Sections 300](#) and [301](#) set out what happens when PRT is repaid and section 302 deals with interest on PRT repayments.

Section 300: Effect of repayment of PRT: general rule

1020. This section provides that when an amount of PRT is repaid the deduction under section 299 is reduced by the amount repaid. It is based on section 500(4) of ICTA.
1021. *Subsection (2)* provides that the repayment reduces or extinguishes the deduction for the original period for which the deduction was given, not the period when the repayment was received.
1022. The time limit in *subsection (3)* was amended from six years to four years by paragraph 23 of Schedule 39 to FA 2008. This change takes effect by Order from 1 April 2010 (see article 2(2) of the Finance Act 2008, Schedule 39 (Appointed Day, Transitional Provisions and Savings) Order 2009 (SI 2009/403)).

Section 301: Effect of repayment of PRT: special rule

1023. This section supplements section 300 in cases where the repayment derives from a carried back loss. It is based on section 500(5) to (10) of ICTA.
1024. In such a case the PRT repayment is treated as received, and hence the reduced deduction for corporation tax is applied, for the period in which the loss arose.
1025. The time limit in *subsection (6)* was amended from six years to four years by paragraph 23 of Schedule 39 to FA 2008. This change takes effect by Order from 1 April 2010 (see article 2(2) of SI 2009/403).

Section 302: Interest on repayment of PRT or APRT

1026. This section provides that interest paid to a participator on a repayment of PRT or advance PRT is disregarded in calculating profits for corporation tax purposes. It is based on section 501 of ICTA and paragraph 10 of Schedule 19 to FA 1982.

Section 303: Management expenses

1027. This section prohibits a deduction for expenses of management of an investment business against profits from a ring fence trade. It is based on section 492(3A) of ICTA.

Section 304: Losses

1028. This section prevents losses that arise in trades outside the ring fence from being set off against ring fence profits. It is based on section 492(3) and (4) of ICTA.
1029. Where a set-off is prevented in this way, *subsection (5)* allows the loss to be carried forward and set against future profits from “related activities”, that is activities which, taken together with the ring fence trade, would be regarded as a single trade but for the specific ring fence rule in section 279.
1030. The equivalent income tax rule, originally in section 492(2) of ICTA, is in section 80 of ITA.
1031. See section 40 for rules about the extension of the loss carry-back period in a ring fence trade where allowances for abandonment expenditure under section 164 of CAA are involved; and section 43, which extends the time limit for making a claim where allowances are made under section 165 (general decommissioning expenditure after ceasing ring fence trade) or 416 (site restoration expenditure) of CAA.

Section 305: Group relief

1032. This section prevents group relief arising from losses, allowances or expenditure outside the ring fence trade from being set against profits from the ring fence trade. It is based on sections 492(8) and 494A(1), (2) and (3) of ICTA.
1033. *Subsections (2) and (3)* provide that where a company cannot use certain amounts against its ring fence profits, those ring fence profits are disregarded in calculating how much the company can surrender as group relief.

Section 306: Capital allowances

1034. This section ensures that capital allowances arising from “special leasing” cannot be deducted from a company’s ring fence profits. It is based on section 492(6) and (7) of ICTA.
1035. The restriction does not apply to the extent that the leased asset is used in oil extraction activities by an associated company.
1036. Section 492(5) of ICTA is not rewritten as it is considered to be unnecessary. It prohibits the deduction of capital allowances given under section 258 of CAA against general profits. However, the deduction under section 258 of CAA can only be given against income from special leasing and not against other profits. Special leasing is defined in section 19 of CAA as leasing that is not part of any other qualifying activity. It is therefore not necessary to have a rule to protect ring fence income from this type of deduction.