EXPLANATORY MEMORANDUM TO

THE CORPORATION TAX (VARIATION OF THE RELEVANT PERCENTAGE) ORDER 2011

2011 No. 2885

1. 1. 1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ('HMRC') on behalf of the Treasury and is laid before the House of Commons by Command of Her Majesty.

1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument increases the relevant percentage for ring fence expenditure supplement (explained in paragraph 4.1). Its purpose is to help ensure that the field allowance works effectively and equitably to support investment in marginal oil and gas fields.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The ring fence expenditure supplement is available to companies involved in exploring for oil or gas or in the development phase in the United Kingdom or on the United Kingdom Continental Shelf that do not yet have sufficient taxable income against which to set their costs and capital allowances. The supplement is added to the amount of losses carried forward from one accounting period to another for up to six accounting periods (not necessarily consecutively) to maintain the time value of exploration, appraisal and development costs.

4.2 The ring fence expenditure supplement is provided for in Chapter 5 of Part 8 of the Corporation Tax Act 2010. The amount of the supplement for any period in respect of which a claim is made is the relevant percentage for that period of the reference amount for that period. The reference amount is computed by reference to an amount of previously allowed supplement and losses. The current rate of supplement is 6% per annum.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom including the United Kingdom Continental Shelf.

6. European Convention on Human Rights

6.1 The Economic Secretary, Chloe Smith, has made the following statement regarding Human Rights:

> In my view the provisions of The Corporation Tax (Variation of the Relevant Percentage) Order 2011 are compatible with the Convention rights.

7. Policy background

7.1 The United Kingdom tax code effectively puts a ring fence around profits from oil and gas production to ensure they are not reduced by non-ring fence activity. Ring fenced profits are subject to corporation tax and to an additional tax called the supplementary charge. The rate of supplementary charge was increased in 2011 from 20% to 32%, as part of a Fair Fuel Stabiliser that would be funded by higher taxation of the profits of oil and gas companies when oil prices are high.

7.2 When the relevant criteria are met, a field allowance reduces the adjusted ring fence profits to which the supplementary charge applies. The field allowance is provided for in Chapter 7 of Part 8 of the Corporation Tax Act 2010. The policy aim of the field allowance is to provide an incentive to increase the economic production of oil and gas by encouraging the development of small and technically challenging oil and gas fields.

7.3 In the course of discussions with industry following Budget 2011, the Government ascertained that the ability of a company to benefit fully from the field allowance is dependent on whether a company has sufficient current taxable income against which to offset expenditure. If in a particular period it does not, the value to it of that expenditure will diminish as time passes. This issue is addressed to some extent by the ring fence expenditure supplement. The increase in the rate of supplement to 10% will help ensure existing field allowances work more effectively and equitably to support investment in marginal fields. It also brings the rate of supplement into line with the discount rate typically used by the sector.

8. Consultation outcome

8.1 No formal consultation has been undertaken although officials have held meetings with interested parties.

9. Guidance

9.1 HMRC will publish guidance on this Order shortly.

10. Impact

10.1 The impact on businesses investing in projects in the United Kingdom or on the United Kingdom continental shelf which currently have insufficient taxable income against which to offset their expenditure and which claim the supplement will be to increase their post-tax profits. No impact on other businesses or charities or voluntary bodies is foreseen.

10.2 No impact on the public sector is foreseen.

10.3 A Tax Information and Impact Note will be published on the HMRC website at http//www.hmrc.gov.uk/thelibrary/tiins.htm.

11. Regulating small business

11.1 The Order applies to small business. The impact on small businesses investing in projects in the United Kingdom or on the United Kingdom continental shelf which currently have insufficient taxable income against which to offset their expenditure and which claim the supplement will be to increase their post-tax profits. There will be no impact on other small businesses.

12. Monitoring & review

12.1 The policy will be kept under review through regular communication with the business sector affected by the measure.

13. Contact

13.1 Hugh Hedges at HMRC Tel: 020 7438 6576 or email: hugh.hedges@hmrc.gsi.gov.uk can answer any queries regarding the instrument.