Estimates of the Remaining Exchequer Cost of Decommissioning UK Upstream Oil and Gas Infrastructure (April 2023)

The Exchequer costs considered here arise 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 Oil Taxation Act 1975 allows participators in an oil and gas field liable to Petroleum Revenue Tax (PRT)[1] 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.

With respect to Offshore Corporation Tax – comprised of Ring Fence Corporation Tax (RFCT) and Supplementary Charge (SC) – 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.

Decommissioning costs are not deductible against profits subject to the Energy Profits Levy.

Exchequer liabilities from decommissioning

In August 2022, the NSTA's central estimate was that total industry costs between 2022 and 2067 for decommissioning all upstream UK oil and gas infrastructure would be £46 billion.[2] The Exchequer cost of tax relief from this expenditure currently projected by HMRC is £21.8 billion.[3] This is made up of £10.4 billion[4] from tax repayments and a reduction in Offshore Corporation Tax of £11.4 billion. Decommissioning expenditure reduces company profits and hence lowers the overall tax take.

The £10.4 billion estimate reported above appears in the *HM Revenue and Customs Annual Report and Accounts 2021–22* (18 July 2022). Extracts from that publication follow with **emphasis** added:

> **Exchequer liabilities arising from oil and gas infrastructure**
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> There are 2 taxes levied on companies exploring and producing oil and gas from the [UK and] UK Continental Shelf (UKCS): Petroleum Revenue Tax (PRT) and offshore Corporation Tax (CT), the latter comprising of 2 elements: Ring-fenced Corporation Tax and Supplementary Charge.
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> The legislation governing the losses from decommissioning costs (Oil Taxation Act 1975) allows participators in an oil and gas field liable to PRT to carry-back decommissioning losses

1. 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.
2. 2021 prices.
3. Nominal prices with discounting.
4. This is shown in HMRC's annual report and accounts as a provision. Within this total, repayments of PRT and CT are £2.1 billion and £8.3 billion, respectively.

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

The provision is estimated as the appropriately discounted sum of all forecast decommissioning repayments over the expected lifetime of the North Sea oil and gas fields. Repayment profiles are derived from the output produced by HMRC's North Sea Forecasting Model developed at the individual company and field level. There has been no significant change in the model since last year.

A provision of £10.4 billion has been reported in 2021-22 based on the estimated tax repayments of PRT £2.1 billion (£3.3 billion in 2020-21) and offshore CT £8.3 billion (£6.2 billion in 2020-21) by HMRC to companies over the period to 2065 due to losses from decommissioning expenditure.

The key determinants of the provision estimate are future decommissioning costs from the North Sea Transition Authority's (NSTA) Asset Stewardship Survey, economic determinants (including oil & gas prices, production and the US Dollar/Sterling exchange rate) from the Office for Budget Responsibility and the Department for Business, Energy and Industrial Strategy (BEIS) as well as the discount rates from HM Treasury.

There has been a £0.9 billion increase in the overall provision since last year. The main causes of the increase were higher decommissioning expenditure in nominal terms as well changes in discount rates, partly offset by the effect of higher forecast oil and gas prices in the short/ medium term which reduces the provision.

The provision utilised in-year is the tax repayments in 2021-22 due to decommissioning expenditure.

Uncertainty around the estimate of the provision

There is inherent uncertainty surrounding forecasting oil and gas revenues over 30+ years ahead.

The £10.4 billion provision is based on a view of assumptions as mentioned above. However, low and high estimates of the provision have been prepared based on different views:

a) the high estimate of £15.9 billion is based on a lower fossil fuel demand scenario (i.e. lower price assumptions and production)

b) the low estimate of £8.8 billion is based on a higher fossil fuel demand scenario.

The sensitivity of the £10.4 billion provision to individual inputs is as below.

The largest impact on the size of the provision, and biggest source of uncertainty in estimating it, is future decommissioning costs. Annually, the NSTA 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 NSTA gives a range for expected decommissioning costs for UKCS oil and gas infrastructure over the remaining life of the North Sea basin.

The [£10.4 billion] provision included in the Trust Statement is calculated using the NSTA's central estimate for remaining decommissioning costs [of £46 billion in 2021 prices which was] published in August 2022. Using the NSTA's lower and upper decommissioning cost estimates [£37 billion and £59 billion, respectively] would instead give provision estimates of £8.0 billion and £14.3 billion respectively.

A major economic determinant which drives the provision are oil and gas prices. The model has utilised certain BEIS projections and applied a growth rate to projected prices for later years. Compared to the baseline oil and gas price forecasts a ten percent increase (decrease) would decrease (increase) the provision by approximately £0.6 billion (£1.0 billion).

The provision is also impacted by discount rates 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 50 basis points will decrease the overall provision by £0.6 billion. The same decrease in discount rates would increase the provision by £0.7 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 £0.4 billion decrease in the provision. A 10-cent depreciation of the Dollar results in a £0.5 billion increase in the required provision.

Decommissioning Relief Deeds (DRDs)

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 on the UK Continental Shelf, companies have a statutory obligation to decommission their operations properly once oil and gas production has ceased. Any companies that have carried on a ring-fence trade, and the associates of those companies, are eligible to be party to a deed.

As at 30 March 2023, 105 deeds had been signed and were in force, up from 101 at the end of March 2022. These 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 March 2023, Offshore Energies UK estimated that £10 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, only one claim has been made, in 2015. Ten payments, totalling £244.3 million, relating to that claim had been made by the end of March 2022. The remaining amount of the claim is reflected in HM Treasury's 2021-22 accounts as a provision for £129 million. As at 30 March 2023, the remaining provision was £102.1 million, taking into account payments made subsequent 31 March 2022. The value of the provision represents the best estimate of the outstanding costs to settle. It relates to amounts estimated still 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 (now NSTA) that maximum economic recovery had been achieved for these assets. The provision is based on 50%[5] 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.

5. 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.