

EXECUTIVE COUNCIL

PUBLIC

Title: Oil Taxation – Issuing a consultation document

Paper Number: 09/18

Date: 21 February 2018

Responsible Director: Financial Secretary

Report Author: Head of Tax

Portfolio Holders: MLA Roger Spink and MLA Roger Edwards

Reason for paper: This paper is submitted to Executive Council:
For policy update/information

Publication: Yes with redactions as highlighted in grey

Under Executive Council Standing Order 23(2), Executive Council must have regard to the categories of exempt information in Schedule 3 to the Committees (Public Access) Ordinance when determining if information should be withheld

*The categories which are potentially relevant to this paper are:
Clause 4: Economic Interests.*

Previous papers: 152/17 Sea Lion Update

List of Documents: Outline of consultation document (Appendix 1) to be published as part of the consultation process.
Draft press release (Appendix 2)

1. Recommendations

Honourable Members are recommended to:

- a) Approve the issue of a consultation document in late February outlined in the proposed changes set out in section 3.2, to the Falkland Islands Oil Taxation regime. The draft consultation document is at Appendix 1;
- b) Note that the consultation is non-binding. A summary of responses will be fed back to ExCo after the consultation is complete to inform a policy decision (May/June 2018)

2. Additional Budgetary Implications

None.

3. Executive Summary

3.1 Changes to the Falkland Islands Oil Taxation regime are required to improve the commercial viability of an oil development in the region. FIG officials have been working with Freshfields law firm since April 2017 to develop policy proposals in particular areas.

3.2 The proposals are in line with international best practice.

3.3 These key work areas were summarised in the recent Strategic Oil Group (SOG) presentation to Members on 5th December 2017 and build on ExCo paper 152/17 of September 2017.

3.4 The main areas for consultation with industry are:

- Section 3: The timing and quantum of Corporation Tax deductions for finance and **interest** charges arising in relation to oil activities – a proposed new fixed ratio barrier.
- Section 4: The timing and quantum of Corporation Tax deductions for plant and machinery used in relation to oil activities acquired through **hire purchase** contracts – proposed new Hire Purchase rules.
- Section 5: The amount of Corporation Tax deductions that are permissible for **leasing** of plant and machinery used in relation to oil activities – a proposed Hire Cap mechanism.
- Section 6: The Corporation Tax relief available in relation to decommissioning expenses where these are carried back and set against taxable profits for earlier periods.

4. Background

4.1 Current Tax Legislation in force

4.2 The Taxes Ordinance 1997 was substantially amended in 2015 in relation to the taxation of oil licensees and their supply chain contractors. A number of changes made at that time have been reviewed, following the advice of Freshfields and the current Head of Tax.

4.3 One example of the 2015 changes was the denial of any Corporation Tax deduction in respect of all leasing arrangements between connected parties, and a deduction only being available for unconnected party leasing at the discretion of the Commissioner of Taxation.

4.4 **REDACTED**.

4.5 **REDACTED**.

- 4.6 Freshfields reviewed the current tax legislation in 2016/17 and wrote up their findings in a draft report and these were also presented to the previous Assembly in May 2017, during a visit to Stanley. Since then FIG Officers have been working extensively with Freshfields and the Operator of the Sea Lion field about the economic impacts of the current (2015) restrictions and future options.
- 4.7 The proposed changes draw on international best practice (the OECD¹ Base Erosion Profits Shifting² (“BEPS”) project for interest deductibility), and techniques which have been effective in the UK (the leasing Hire Cap), modified for Falkland Islands’ specific circumstances.
- 4.8 FIG Officers, supported by Freshfields and with guidance from the UK’s HM Revenue and Customs advisors, recommend the introduction of more targeted safeguards in the areas of main BEPS risk to the FI Exchequer, replacing blanket restrictions which are currently in place.

4.9 **REDACTED**.

5. Timetable

- 5.1 If approved then the consultation could be launched very shortly – certainly by the end of February 2018 - for a 6 week period, closing on Friday 6 April 2018.
- 5.2 Once the consultation has closed the responses will be written up and considered for final policy recommendation for the May 2018 ExCo meeting. Legislative drafting and enactment is targeted for the end of 2018.
- 5.3 This timetable is in line with the current decision stage gate deadlines of the Operator of the Sea Lion oilfield, Premier Oil.

6. Options and Reasons for Recommending Relevant Option

- 6.1 It is recommended that Members approve the issue of the consultation document along the lines of the draft attached at Appendix 1.
- 6.2 The reasons for recommending this option are as follows:
- Consulting with Industry in specific areas will help ensure that the future tax policy approach is clearly explained to the investment community and transparent.
 - Consulting in this way will also be helpful in building a reputation of being ‘open for investment’ and welcoming for the general business community.
 - The consultation will be a useful tool to ensure the resulting legislation is sufficiently peer reviewed to ensure it functions as intended.
 - Whilst FIG have been discussing these issues with some of the affected parties for some time now, it is right that consultation be undertaken with a wider

¹ Organisation for Economic Co-operation and Development (<http://www.oecd.org/about/>)

² See <http://www.oecd.org/tax/beps/>

audience at this time, and Industry are now expecting FIG to consult in these areas to make further progress.

- 6.3 The consultation is designed to last 6 weeks (23 February to 6 April) – a relatively short period (UK best practice for public consultations is 12 weeks). FIG have borne in mind the following factors when setting the consultation duration:
- The areas of focus are relatively technical and specific to a limited number of affected parties – we expect the number of stakeholders providing a substantive response to be small in number.
 - The consultation has already been with known stakeholders in advance, who are aware of the majority of the content and are prepared to respond quickly in line with the deadlines.
 - FIG need to allow sufficient time to consider the consultation responses and amend our approach in certain areas accordingly prior to providing policy advice to ExCo in May/June. Running a longer consultation would leave insufficient time to reflect upon the responses received.
 - When setting the dates for the consultation we have borne in mind the project deadlines for the most mature oil development, that of Sea Lion in the North Falkland Basin. The issues within the consultation are material to Premier Oil's investment decision later in 2018.
- 6.4 The scope of the consultation can, and is recommended to be, kept tight to ensure it remains focussed on the areas of most interest to FIG. For example it will not explicitly cover the fees and charges regime across FIG to the extent it impacts on the oil industry, nor will it cover the Royalty regime.
- 6.5 The 'do nothing' option, in contrast, would lose the opportunity to consult with Industry and gain insights into the impact of proposed policy changes in major areas – risking unforeseen consequences arising from the reforms FIG are considering implementing.

7. Resource Implications

7.1 Financial Implications

7.2 There are no direct financial implications from launching the consultation itself.

7.3 Human Resource Implications

7.4 There are no direct implications from the report itself, other than the amount of officer time taken up in the production of the consultation and the ongoing work with interested stakeholders.

7.5 Other Resource Implications

7.6 As budgeted in the 0997 Cost Centre, primarily the investment in Freshfields as advisers which is ongoing.

8. Legal Implications

8.1 There are no legal implications arising from this paper.

9. Environmental & Sustainability Implications

9.1 None

10. Significant Risks

10.1 **REDACTED**.

11. Consultation

11.1 The Chief Executive and Head of Tax have discussed the proposed consultation and main policy points with MLAs at the Strategic Oil Group briefing session on 5th December 2017. Other members of the Corporate Management Team, including the Director of Mineral Resources, the Financial Secretary, the Attorney General and the Head Director of Policy and Economic Development are sighted on the issues and have contributed to the discussions at Strategic Oil Group.

12. Communication

12.1 A summarised version of the approved consultation process will be communicated to interested stakeholders, including via the Falkland Islands Petroleum Licensees Association (FIPLA) who are the trade association for the offshore oil industry in the Falkland Islands and the Falkland Islands Chamber of Commerce's local membership.

12.2 A press release could also be made as appropriate. A draft is included at Appendix 2.