UNITED KINGDOM: INVENTORY OF ESTIMATED BUDGETARY SUPPORT AND TAX EXPENDITURES FOR FOSSIL-FUELS

Energy resources and market structure

There are no energy-price controls in the United Kingdom and all prices are set freely by the market. The Office of Gas and Electricity Markets (Ofgem) regulates electricity and gas network access charges through five-year price control periods that set the maximum amount of revenue which energy network owners can take through charges they levy on users of their networks. These prices are meant to cover their costs and earn them a return, while providing incentives to be efficient and to innovate technically.

Oil and gas production is subject to three taxes: the Petroleum revenue tax (PRT), which is levied at a rate of 50% on gross profits made on fields that were approved for development before 16 March 1993; the ring-fence corporation tax (30%); and a supplementary charge (which was raised from 20% to 32% in March 2011). PRT is a deductible expense for corporation tax and the supplementary charge. Various allowances are available in computing tax liabilities, including a new-field allowance that was introduced in 2009 for small, ultra-high-pressure and high-temperature oil fields, and ultra-heavy oil fields. This allowance was subsequently extended by the government to cover remote deep-water gas fields (March 2010), very deep fields with sizeable reserves (March 2012), and certain large shallow-water gas fields (July 2012). Other measures to support certain types of production include Promote licences, which allow small and start-up companies to obtain a production license first and secure the necessary operating capacity and financial resources later through reduced rent for the first two years.

Energy sales are subject to VAT (at a rate of 20%), excise taxes, and a Climate Change Levy (CCL). A reduced rate of VAT of 5% is applied to domestic fuel and power, as well as to the installation of certain energy-saving materials into domestic properties. Excise taxes are levied on oil products used for both commercial and non-commercial purposes. Businesses users pay the CCL on purchases of oil products (excluding transport fuels), natural gas, coal and electricity, though there are discounts and exemptions, depending on the source and use of the fuel (power generators are exempt, for example).

There are very few measures other than tax exemptions or reductions that support energy consumption in the United Kingdom. Schemes such as winter fuel payments for the elderly or cold-weather payments do not depend on the price of fuels and are provided in-cash to eligible households. Most of the remaining measures target consumption technologies such as low-carbon vehicles and hydrogen refuelling equipment rather than energy use *per se*.

Data documentation

General notes

The fiscal year in the United Kingdom runs from 1 April to 31 March. Following OECD convention, data are allocated to the starting calendar year so that data covering the period April 2005 to March 2006 are allocated to 2005.

Producer Support Estimate

Taxation of the oil and gas sector in the United Kingdom occurs through a variety of taxes. Fields approved for development prior to 16 March 1993 remain subject to the old Petroleum Revenue Tax (PRT), which was instituted in 1975. The PRT is a project-based tax that is levied at a rate of 50% of the profits from a given field. It allows for the full deduction of both operating and capital expenditures. The PRT does not, however, allow the deduction of interest costs and other financing charges from taxable profits.

Meanwhile, oil and gas corporations are also subject to a modified version of the regular corporation tax, namely the Ring-Fence Corporation Tax (RFCT). The imposition of a "ring fence" around upstream oil and gas activities means that these particular activities are to be treated separately for tax purposes from any other trade in which oil and gas companies may be engaged. This therefore allows upstream oil and gas activities to be taxed differently at the company-level. Differences in taxation include, for instance, the impossibility for companies to use losses in other activities as deductions against the income arising from oil and gas extraction.

While all fields are subject to the RFCT, those that were approved for development prior to 16 March 1993 can deduct the amount of PRT taxes paid from their RFCT tax base. This ensures that the fields that are still subject to the old PRT regime are not taxed twice on the same profits. In addition, all types of fields are liable to the so-called Supplementary Charge (SC), which was introduced in the Finance Act of 2002. The SC is a 32% tax on profits from oil and gas production that is levied on top of the RFCT.

The immediate write-off of both capital and exploration-and-development expenditures is normally considered under the systems in many countries to amount to a preferential tax treatment. The reason is that in calculating taxable profits in most income-tax systems, capital expenses are allocated over the period to which they contribute to earnings. Allowing the immediate writing-off these types of expenditure therefore provides companies with something akin to a zero-interest loan from the government since it delays the collection of taxes. A present-value calculation would indeed show a positive transfer from the government to the companies benefiting from such provisions.

However, when combined with impossibility for companies to deduct interest costs and other financing charges, the immediate write-off of both capital and exploration-and-development expenditures may not be considered a preferential tax treatment. This is due to the fact that this particular combination of tax provisions may approximate what is known as a "cash-flow" tax system. Cash-flow tax systems can be theoretically equivalent to the more common imputed-income tax systems where the objective is to levy a neutral business tax (Boadway and Bruce, 1984). For that reason, provisions such as the expensing of exploration and development costs may not be preferential tax provisions in the particular case of the United Kingdom.

PRT Exemption for Sales to British Gas (data for 1997-)

Proceeds from the sale of natural gas to what was formerly the British Gas Corporation are exempt from PRT if contracts were signed prior to 30 June 1975. This provision still applies to those contracts that have not been subject to any kind of "fundamental alteration" since then. The associated revenue losses are, however, expected to become negligible over time.

Sources: HM Revenue & Customs (various years), HM Revenue & Customs (2008).

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Tag: GBR_te_01

PRT Tariff Receipts Allowance (data for 1997-)

This provision was introduced in 1983 and excludes some tariff receipts from taxable profits under the PRT regime. Tariffs are here understood as payments to a company for the use of its assets by other oil and gas companies.

We use production data from the IEA's Energy Balances to allocate the annual amounts reported in HM Revenue & Customs (various years) to oil and natural-gas extraction.

Sources: HM Revenue & Customs (various years), HM Revenue & Customs (2008), IEA.

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PRT Uplift for Certain Capital Expenditures (data for 1997-2007)

The 1975 Oil Taxation Act allows oil and natural-gas companies subject to the PRT regime to obtain an additional 35% deduction for certain qualifying capital expenditures. Eligible types of expenditure include the costs incurred in "substantially improving the rate of production or transportation". HM Revenue & Customs (2008) also mentions that this PRT uplift is meant to compensate companies for the non-deductibility of interest costs and other financing charges.

This relief is available only while the field in question is in its initial phase and has yet to recover its start-up costs. Since PRT only applies to fields that were given development consent prior to 16 March 1993, availability of the uplift is restricted to a limited number of cases.

We use production data from the IEA's Energy Balances to allocate the annual amounts reported in HM Revenue & Customs (various years) to oil and natural-gas extraction. Estimates are not available for the years following FY2007/08.

Sources: HM Revenue & Customs (various years), HM Revenue & Customs (2008), IEA.

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PRT Oil Allowance (data for 1997-)

The Oil Allowance was introduced in 1975 to encourage the development of small and marginal fields. It is a relief against PRT applicable to profits after all losses and expenditures have been relieved. The value of the allowance itself is determined using a statutory formula that depends in part on the date at which the field was developed and its location. The Oil Allowance is normally available for a period of ten years but relief can be claimed for a much longer period if there are sufficient profits to absorb all of the available deductions.

We use production data from the IEA's Energy Balances to allocate the annual amounts reported in HM Revenue & Customs (various years) to oil and natural-gas extraction.

Sources: HM Revenue & Customs (various years), HM Revenue & Customs (2008), IEA.

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PRT Safeguard (data for 1997-2007)

The PRT Safeguard is a provision contained in the Oil Taxation Act of 1975. Safeguard, like the Oil Allowance, forms part of a package of measures designed to reduce the incidence of PRT on small, marginal fields. The PRT Safeguard is a relief against the amount of tax payable, and so applies only if there remains a tax liability once all expenditure and other reliefs have been taken into account. As for the PRT Uplift for Certain Capital Expenditures, Safeguard is only applicable to a limited number of fields.

We use production data from the IEA's Energy Balances to allocate the annual amounts reported in HM Revenue & Customs (various years) to oil and natural-gas extraction. Estimates are not available for the years following FY2007/08.

Sources: HM Revenue & Customs (various years), HM Revenue & Customs (2008), IEA.

Tag: GBR_te_05

Ring-Fence Expenditure Supplement (no data available)

The Ring-Fence Expenditure Supplement (RFES) was introduced in January 2006 to replace the former Exploration Expenditure Supplement (EES). In its current version, it provides oil and natural-gas companies with a yearly 10% increase in the value of unclaimed deductions for expenses related to exploration and appraisal for a period of up to six years.

No estimates are available for this particular provision.

Sources: HM Revenue & Customs (2008).

Field Allowance (no data available)

This new allowance was first introduced in 2009 and later extended to encourage the development of small or technically-challenging fields. Before 2012, qualifying fields had to be small in size, feature ultra-high pressure or temperature, possess ultra-heavy oil reserves, or be remote deep-water gas fields. In 2012, it was then announced that new field allowances would also be extended to very deep fields with sizeable reserves, and large shallow-water gas fields. This extension is expected to generate revenue losses of about GBP 20 million per year (HM Treasury, 2012).

The field allowance provides companies with a partial exemption from the Supplementary Charge. Relief is calculated at the level of the field but is provided at the company-level. Unclaimed allowances can be carried forward.

No estimates are available for this particular provision.

Sources: HM Revenue & Customs (2011[a]), HM Treasury (2012).

UK Coal Operating Aid Scheme (data for 2000-2002)

The UK Coal Operating Aid Scheme (UKCOAS) was a temporary programme designed to provide short-term financial support to otherwise viable coal producers. It was introduced in 2000 for a period of three years over which a total amount of GBP 162 million was to be spent in four tranches. The programme was approved by the European Commission under the rules of the former European Coal and Steel Community. Applications were closed after 31 December 2002.

We use production data from the IEA's Energy Balances to allocate the annual amounts reported in official documents to the various types of coal concerned.

Sources: DECC (2006[a]), IEA.

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Coal Investment Aid (data for 2004-2008)

The Coal Investment Aid (CIA) was introduced in 2003 to reimburse up to 30% of qualifying investment costs incurred by coal producers. Transfers were meant to secure access to reserves at twelve deep mines. Applications are now no longer accepted.

We use production data from the IEA's Energy Balances to allocate the annual amounts reported in official documents to the various types of coal concerned.

Sources: DECC (2006[b]), IEA.

Tag: GBR_dt_02

Mineral Extraction Allowance (no data available)

The Mineral Extraction Allowance (MEA) was introduced in 1986 to provide mining companies (including coal, oil, and natural-gas producers) with faster rates of depreciation for qualifying capitalised expenditures. The latter include the acquisition of mineral rights or deposits and expenditures connected to access to the reserves. Prescribed rates vary with the type of expenditure to which the provision applies. Analysis of this provision is, however, complicated by the interaction of the MEA with the general tax regime that applies to oil and gas extraction. These caveats do not apply to coal though.

Although this provision applies to the mining sector as a whole, data from the OECD's STAN database indicate that mining of fossil fuels accounts for nearly 90% of total gross output for the mining and quarrying sector (as defined in the standard ISIC Rev.3 sector classification).

No estimates of the revenue foregone due to the MEA are available.

Sources: HM Revenue & Customs (2008), Office of Tax Simplification (2011).

Abandonment Costs (no data available)

This provision allows capital expenditures connected to the abandonment of fields and mines to be deducted in full in the year in which they are incurred. Deductions are coupled with a carry-back provision which makes it possible for companies to use losses arising from decommissioning costs against profits earned in earlier years. This may therefore result in tax refunds.

Although this provision applies to the mining sector as a whole, data from the OECD's STAN database indicate that mining of fossil fuels accounts for nearly 90% of total gross output for the mining and quarrying sector (as defined in the standard ISIC Rev.3 sector classification).

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No estimates of the revenue foregone due to the expensing of abandonment costs are available.

Sources: HM Revenue & Customs (2008).

Consumer Support Estimate

Reduced Rate of VAT for Fuel and Power (data for 1997-)

The domestic consumption of both heating fuel and power in the United Kingdom is subject to a much lower rate of VAT than that applied to regular products (20% as of January 2011). Domestic fuel and power were initially zero-rated when VAT was first introduced in 1973 but subsequently became liable to an 8% rate with the VAT Act of 1994. The latter rate was eventually lowered to 5% (the EU minimum) in 1997.

We allocate the annual amounts reported in HM Revenue & Customs (various years) to the various energy sources concerned (including electricity and heat) on the basis of the IEA's Energy Balances for the residential sector. We only report, however, the amounts attributable to fossil fuels like natural gas, kerosene, and coal.

Sources: HM Revenue & Customs (various years), IEA.

Tag: GBR_te_06

Reduced Rate of Excise for Red Diesel (no data available)

The use of "red diesel" (i.e. dyed diesel) and other such petroleum products in the United Kingdom is subject to a reduced rate of excise duty. Eligible uses include off-road vehicles such as those used for agriculture, road construction or clearing snow.

No estimates of the revenue foregone due this provision are available.

Sources: HM Revenue & Customs (2011[b]).

General Services Support Estimate

Inherited Liabilities Related to Coal-Mining (data for 1997-2009)

The Coal Authority was established by the Coal Industry Act of 1994 to address those inherited liabilities for which no licensed coal-mine operator can be held responsible. Abandoned mining sites managed by the Coal Authority include all former British Coal Corporation pits. Mine subsidence and historic liabilities such as the treatment of mine-water discharges are the Authority's two main programmes that we include here.

Data come from the Coal Authority's annual reports where yearly operating income and expenses are reported for each class of business. We therefore report for each year the sum of the net expenses associated with each of these classes (excluding those classes that do not constitute general support like "licensing" or "mining assets").

We use production data from the IEA's Energy Balances to allocate the annual amounts reported in official documents to the various types of coal concerned.

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Sources: Coal Authority (various years), IEA.

Tag: GBR_dt_03

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