Case Comment

Energy (Oil and Gas) Profits Levy Act 2022

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With the Spring Finance Bill 2023 finalising the latest set of changes to the Energy (Oil and Gas) Profits Levy ('the Levy'), this is an opportunity to reflect on the twists and turns we have seen in the implementation of this new tax. The Levy applies to certain profits of oil and gas companies from upstream activity in the UK and on the UK Continental Shelf arising over the coming years, and was intended to help fund measures to subsidise household energy bills. The government consultation on their proposals ran from 21 to 28 June 2022, allowing little time to comment on the draft legislation. Fortunately, however, a number of important changes made their way into the legislation as enacted on 14 July 2022 in addition to some more minor changes to make provisions work as intended. Further tweaks followed, first in the Finance Act 2023 enacted on 10 January 2023 ('the FA 2023'), and then in the Finance Bill printed on 21 March 2023 ('the Spring Finance Bill').

Calculating the Levy

The starting point for identifying profits subject to the Levy is the company's ring fence profits or loss for the period, from which a number of adjustments are made – including leaving out of account financing costs (as is the case for the supplementary charge) and decommissioning costs. In response to feedback from the industry on the draft legislation, an amendment was made to provide that repayments of petroleum revenue tax related to losses generated by decommissioning expenditure will not be taxed under the Levy. These are repayments that are typically taxed under the ring fence corporation tax and supplementary charge and as explained by the Chief Secretary to the Treasury, at the Second Reading of the Bill in the Commons,[1] this approach is 'consistent and fair' since wider decommissioning expenditure is also left out of account for the Levy. The adjusted profits are then charged at the rate of the Levy; this was originally set at 25 per cent, but the 2022 Autumn Statement ('the Autumn Statement') announced a plan to raise this to 35 per cent, as then enacted in the FA 2023.

Investment allowance and decarbonisation

Alongside relief for qualifying losses, the Levy provided for an investment allowance. In parliamentary proceedings, it was emphasised that, as the Levy is targeted at extraordinary profits from oil and gas upstream activities, any relief for investment must be related to oil and gas upstream activities and this is how the legislation was drafted. However, some uncertainty remained about whether this would include spending on decarbonising oil and gas production, for example by using electrification (such as expenditure on generators which includes wind turbines, transformers and wiring).

During the Levy's passage through parliament, the Chief Secretary to the Treasury confirmed that capital expenditure on electrification, as long as it relates to specific oil activities within the ring fence, will qualify for the allowance. The allowance was not intended to apply to carbon capture, usage and storage, however, as these are not 'oil-related' activities. Efforts to have the legislation for the Levy amended so as to expressly state that electrification investment which decarbonises upstream oil and gas activities is eligible for relief failed. The Financial Secretary to the Treasury confirmed during the Committee Stage in the Commons[2] that there would instead be clarification in written guidance. In response to criticism in parliament that the allowance does not incentivise expenditure on renewables, the Financial Secretary to the Treasury pointed to other tax and non-tax levers to support non-oil and gas investment, including the (now defunct) super-deduction and the UK's research and development tax credit scheme.

The government also appears to have taken this criticism on board when lowering the investment allowance. While the Autumn Statement announced, and the FA 2023 enacted, a decrease in the allowance from 80 per cent to 29 per cent 'to maintain the overall cumulative cash value of the relief against the higher tax rate', the Spring Finance Bill preserves the 80 per cent allowance for capital expenditure incurred on or after 1 January 2023 on

1 https://hansard.parliament.uk/commons/2022-07-11/debates/CDDDF326-8810-47DB-B3EE-CAE1893344C3/Energy(OilAndGas)ProfitsLevyBill.

2 https://hansard.parliament.uk/commons/2022-07-11/debates/494EDB6D-97F1-OO9F2398D942/Energy(OilAndGas)ProfitsLevyBill.

decarbonisation of upstream petroleum production. The expenditure must be incurred in qualifying circumstances and the main purpose, or one of the main purposes, in incurring the expenditure must be to reduce greenhouse gas emissions in the carrying on of its ring fence trade. The Spring Finance Bill defines the qualifying circumstances for the decarbonisation allowance to include, among other categories, carbon capture and investment in using non-fossil fuel generated electricity to power upstream petroleum activities. Setting out these qualifying circumstances in the Spring Finance Bill provides more clarity and certainty for the taxpayer than mere written guidance could have done.

Anti-avoidance provision made workable

Although the investment allowance was subsequently made much less generous, the initial legislation's passage through parliament at least saw the built-in anti-avoidance provision become workable. This provision, which sets out when expenditure is incurred for 'disqualifying purposes', is no longer so widely drafted as to prevent anyone benefitting from the investment allowance (a concern with the draft legislation emphasised by Mike Lane in his post 'The "super-deduction": unobtainable by design?').[3] The then Chancellor, Rishi Sunak, envisaged the investment allowance acting as an incentive for the oil and gas sector to invest more in upstream activity in the UK in order to pay less tax under the Levy. The purpose test in the anti-avoidance provision was limited to circumstances where there are 'contrived arrangements' or an 'attempt to circumvent the intended limits or exploit other shortcomings of the legislation' so it should now be possible to invest in oil-related activities in order to get a deduction from the Levy. This is, however, subject to the points made in our earlier blog post[4] regarding the timing of when expenditure is treated as incurred being too restrictive given the long lead time for a lot of oil and gas projects. No changes were made to this aspect of the investment allowance.

Sunset delayed until 31 March 2028

In his announcement of the Levy on 26 May, the Chancellor said that the Levy would expire on 31 December 2025, but would be phased out earlier if and when oil and gas prices return to historically more normal levels. This statement attracted numerous calls for this trigger to be legislated for or for there at least to be some transparency about the circumstances that would need to exist before the Levy would be phased out. When the Financial Secretary to the Treasury was asked what the 'normal price' was, she referred to the comments that the Chancellor made when he was questioned on this by the Treasury Committee. He said:

> The last time this was done, a price target was published, which was $74 or $75 for Brent … If you look at average Brent price over the last five or ten years, that will give you something like $60 or $70 for oil … so that gives you a sense.

In the FA 2023 the Levy was extended until 31 March 2028; with the price of Brent falling to an average of $80 on the day that Act was enacted, the market might have expected the extension of the Levy to be combined with a price floor, below which the Levy would cease to apply. Although not forthcoming then, in recent days ministers have been in talks, with an announcement expected soon as part of the government's 'Green Day'. Jeremy Hunt, the current Chancellor at time of writing, is said to be interested in providing tax certainty in the hope of encouraging investment in new energy projects.

What is the expected economic impact?

The impact assessment published on 11 July 2022[5] showed the measure was expected to raise £5 billion in its first 12 months at current market prices but the table of costing was left empty. The Autumn Statement, taking into account a rise in the Levy rate as well as a drop in the main investment allowance, saw the table of costings completed, with just £1.1 billion of revenue-raise anticipated in 2022–23 and £3.5 billion in 2023–24.[6]

The Electricity Generator Levy

With the significant increase in wholesale electricity prices and the (so-called) 'windfall tax' genie now out of the bottle, the Autumn Statement announced the introduction of yet another new tax, called the Electricity Generator Levy ('the EGL'). As with the Levy this is a temporary measure, in the form of a 45 per cent tax on 'exceptional amounts of generation receipts' (subject to a threshold level of £10 million) from the generation of electricity for sale on the wholesale market, with a further threshold excluding generators whose output sits below 50GWh. Draft legislation was published on 20 December 2022 and updated in the Spring Finance Bill. The end date for the EGL is 31 March 2028, in alignment with the Levy.

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3 https://www.europeantax.blog/post/102hrd4/the-superdeduction-unobtainable-by-design.

4 https://www.europeantax.blog/post/102hrcg/energy-oil-andgas-profits-levy-bill.

5 https://www.gov.uk/government/publications/the-energy-oil-and-gas-profits-levy-bill/energy-oil-and-gas-profits-levy.

6 https://www.gov.uk/government/publications/changes-to-the-energy-oil-and-gas-profits-levy/energy-oil-and-gas-profits-levy.