ESC16 (from August 2014)

Deferral of date when tax is due for farm in and carry agreements

Where a seller, prior to commencement of petroleum production from this or any other licence, makes a part disposal of a licence which accrues a chargeable gain under Section 141 Taxes Ordinance 1997 and the receipt of all or part of the consideration is deferred, the payment of the tax charged on the disposal of the licence may be deferred as below, subject to a formal written agreement being entered into between the taxpayer and the Falkland Islands Government (FIG).

The gain on the disposal will be calculated on the basis of the total consideration received and the corporation tax liability calculated on this gain. The tax will then be divided between the cash and non cash elements, and the deferred and non deferred elements, on the basis of the proportion that each bears to the total consideration received.

For the tax on any deferred cash consideration, deferral of payment will be to the earliest of

- Receipt of the cash amount
- The date on which the royalty is due on 'first oil' production from the licence interest disposed of
- The date on which the seller otherwise realises value from the licence (including, without limitation, the date on which cash or non cash consideration is received on a pre-sale of oil or a subsequent disposal of all or a substantial part of the seller's remaining interest in the licence)

For the tax on any deferred non cash consideration, payment will be due at the earliest of

- The date on which the royalty is due on 'first oil' production from the licence interest disposed of
- The date on which the seller otherwise realises value from the licence (including, without limitation, the date on which cash or non cash consideration is received on a pre-sale of oil or a subsequent disposal of all or a substantial part of the seller's remaining interest in the licence)

In all cases payment of the deferred tax must be made by the later of the normal due date and 30 days from the date to which the charge has been deferred.

To benefit from this deferral, taxpayers will be required to enter into a formal written agreement with FIG. This relaxation to allow deferral of the due date for payment of tax will be kept under review and may be withdrawn if it appears to be abused. FIG may also require additional specific terms to be entered into within 60 days to secure the payment of the deferred tax and to protect itself from the avoidance of tax.

Example

Truman Limited has incurred £320m exploration costs eligible for depreciation allowances under Section 111(1) Taxes Ordinance 1997. Boycott Limited farms in part of the licence for a cash reimbursement of £200m for historical costs and a development drilling agreement which is considered to have a net present value of £400m. Under Schedule 2 Para 1(4) Taxes Ordinance 1997, Truman claims the balance of expenditure eligible under Section 111 which has not passed over to Boycott against the chargeable gain.

Assuming no other allowable base costs, the chargeable gain is:

	£m
Total consideration £200m + £400m	600
Less Schedule 2 Para 1(4) costs £320m - £200m	(120)
Gain	£480
Corporation tax due at 26%	£124.8
Tax on cash consideration £124.8 x 200/600	£41.6
Tax on non cash consideration £124.8 x 400/600	£83.2

Explanation

Petroleum exploration and production is a relatively new industry in the Falkland Islands and the tax legislation dealing with it is mostly untested.

This ESC applies to a part disposal of a licence which accrues a chargeable gain under Section 141 Taxes Ordinance 1997 where the consideration is not received immediately.

There is a tax charge on the profit made on disposing of a licence and this includes farm in and carry contracts. The tax charged is based on both the value of the work programme envisaged and any other consideration, including cash paid to reimburse the seller's previous expenses. However, because some of the tax charge is based on an amount where no money or other benefit has been received by the seller there can be situations where the seller has insufficient funds to pay the tax at the time it arises or where payment of the tax would reduce the funds available for future development within the Falkland Islands. This ESC therefore allows the taxpayer to enter into an agreement with FIG to defer the payment of the tax in such situations.