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

The Exchequer costs considered here arise from (a) refunds of previously tax paid (when losses as a result of decommissioning expenditure are "carried back" against past profits) and (b) lower levels of tax on current or future profits (which are reduced by current, carried forward or future decommissioning costs).

With respect to Offshore Corporation Tax (CT) – 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. This may result in a repayment of tax.

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 PRT. Such repayments are themselves liable to Offshore CT.

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

Exchequer liabilities from decommissioning

In August 2023, the NSTA's central estimate was that total industry costs between 2023 and 2063 for decommissioning all upstream UK oil and gas infrastructure would be £40 billion in 2022 prices. The Exchequer cost of tax relief from this expenditure currently projected by HMRC is £12.7 billion.[2] This is made up of £4.5 billion from tax repayments and a reduction in Offshore CT of £8.2 billion. Decommissioning expenditure reduces company profits and hence lowers the overall tax take.

The £4.5 billion provision estimate reported above appears in *HMRC's Annual Report and Accounts 2022–23* (17 July 2023).[3] Extracts from that publication follow:

> **Provision for oil and gas field decommissioning**
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> The provision for tax repayments is an estimate based on 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.

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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 (including losses arising from decommissioning PRT-liable fields) can be carried back against past PRT payments resulting in tax repayments.
2. Nominal prices with discounting.
3. Within the total provision of £4.5 billion, repayments of PRT and Offshore CT are £1.3 billion and £3.2 billion, respectively.

The key determinants of the provision estimate are: future decommissioning costs from the North Sea Transition Authority's (NSTA) Asset Stewardship Survey, oil and gas prices and production from the Office for Budget Responsibility (OBR), Department for Energy Security and Net Zero (DESNZ) and NSTA, discount rates from HM Treasury, and the US Dollar/Sterling exchange rate from the OBR.

Uncertainty around the estimate of the provision

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

The largest impact on the size of the provision, and biggest source of uncertainty in estimating it, is quantification of 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.

The provision included in the Trust Statement is calculated using the NSTA's estimate for remaining decommissioning costs due to be published in August 2023. A ten per cent increase in the decommissioning cost estimate would increase the provision to £5.0 billion. Similarly, a ten per cent reduction would decrease the provision to £4.1 billion.

A major economic determinant which drives the provision is oil and gas prices. The model has utilised certain DESNZ projections and applied a growth rate to projected prices for later years. Compared to the baseline oil and gas price forecasts a ten per cent increase (decrease) would decrease (increase) the provision by approximately £0.3 billion (£0.4 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 £0.2 billion. The same decrease in discount rates would increase the provision by £0.3 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 £0.2 billion decrease in the provision. A 10-cent depreciation of the Dollar results in a £0.2 billion increase in the required provision.

Decommissioning Relief Deeds (DRDs)

Relief for decommissioning costs incurred as a result of default by other parties may be available through DRDs. Information on these Deeds and the amounts paid and expected to be paid under them is given in Note 21 to HM Treasury's 2022–23 Annual Report and Accounts.