[2021] UKFTT 254 (TC)

TC08200

PETROLEUM REVENUE TAX (PRT)—Oil Taxation Act 1975 Sch 3 para 8—Allowable expenditure—Expenditure by Appellant gas terminal owner on modification to the terminal in order to comply with new environmental regulations—Reimbursement by owners of oil fields using the services of the terminal of a pro rata share of the expenditure pursuant to applicable contractual arrangements—Whether the expenditure was to that extent "met directly or indirectly" by a person other than the Appellant

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2018/07772

BETWEEN

PERENCO UK LIMITED **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: JUDGE CHRISTOPHER STAKER

The hearing took place on 29 and 30 April 2021. With the consent of the parties, the form of the hearing was V (video). The remote platform was the Tribunal Video Platform. A face to face hearing was not held, the parties having agreed due to Coronavirus (COVID-19) to a video hearing. The documents to which I was referred are the hearing bundle (356 pages), the supplementary hearing bundle (84 pages) and the authorities bundle (451 pages).

Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

John Brinsmead-Stockham, counsel, for the Appellant

Elizabeth Wilson QC, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION AND SUMMARY

1. The Appellant, a UK company operating in the oil and gas sector, appeals against a decision of HMRC relating to petroleum revenue tax ("**PRT**").

2. The Appellant is the owner and operator of a gas terminal that processes gas from various oil fields in the southern North Sea. In respect of those oil fields using the terminal in which the Appellant has less than a 100% interest, the contractual arrangements between the Appellant and field owners for the services provided at the terminal are set out in transportation and processing agreements ("**TPAs**").

3. As a result of new environmental regulations relating to the use of Freon coolant, the Appellant undertook works to replace the cooling plant at the terminal (the "**Freon replacement works**"). Three of the TPAs had provisions permitting the Appellant to give notice of additional charges to the oil field owner if the Appellant was required to modify the terminal as a result of any amendment to relevant regulations. Pursuant to those provisions, the Appellant received from the owners of those three oil fields a pro rata share of the cost of the Freon replacement works (the "**additional sums**").

4. In its PRT expenditure claims for the periods 1 January–30 June 2015 and 1 July–31 December 2015 (together the "**relevant period**"), the Appellant claimed the expenditure on the Freon replacement works. However, the position of HMRC is that the allowable expenditure falls to be reduced by an amount equivalent to the additional sums received by the Appellant pursuant to the three TPAs. HMRC contend that for purposes of paragraph 8(1) of Schedule 3 to the Oil Taxation Act 1975 ("**OTA 1975**"),[1] the Appellant's expenditure was to that extent "met directly or indirectly" by the owners of the three oil fields.

5. In this decision, the Tribunal finds that in the circumstances of this case, the owners of the three oil fields, by paying the additional sums pursuant to the TPAs, did not "meet directly or indirectly" part of the Appellant's expenditure on the Freon replacement works within the meaning of that provision. The Tribunal finds that the additional sums were part of the contractual consideration paid by the oil field owners for the services supplied by the Appellant pursuant to the TPAs, and that the contractual consideration paid for the services cannot be treated as indirect payment of the service provider's expenditure incurred in supplying those services.

BACKGROUND FACTS

6. On 1 November 2012, the Appellant acquired from BP a package of assets, which included a 100% interest in the Dimlington gas terminal, a 100% interest in related offshore facilities, platforms and pipelines (the "**offshore system**"), interests in various offshore oil fields in the southern North Sea, and the rights and obligations under a number of TPAs.

7. The offshore system in fact consists of three independent systems, which all connect into a single onshore system at the Dimlington terminal. Each of the three independent systems has a number of different offshore oil fields tied in to it, and each oil field is tied in to only one such system. This appeal is concerned only with one of those systems, the West Sole offshore

[1] Paragraph 8(1) Schedule 3 OTA 1975 provides that "Expenditure shall not be regarded for any of the purposes of this Part of this Act as having been incurred by any person in so far as it has been or is to be met directly or indirectly … by any person other than the first-mentioned person".

system, which has 22 oil fields tied into it. Although technically referred to as "oil fields", they are in fact all gas fields.

8. The Appellant has a 100% interest in 10 of these 22 oil fields, including the West Sole field (after which the West Sole offshore system itself is named), and interests between 50% and 71.3% in a further five. The Appellant has no interests in the remaining seven, which include the Babbage, Seven Seas and Johnston fields.

9. Raw gas from all these oil fields undergoes initial processing in the offshore system, and is then transported by sub-sea pipelines to the Dimlington terminal at which it is further processed. The terminal is connected with a meter to the National Transmission System (NTS). The gas is sold by the Appellant on behalf of the field owners to various third-party gas distribution companies at the entry point to the NTS.

10. In respect of each of the fields in which the Appellant has less than a 100% interest, there is a TPA setting out the contractual arrangements between the field owner and the Appellant for the processing, transporting and metering of the gas from that field through the offshore system and the terminal. These TPAs were all already in place when the Appellant acquired the package of assets in 2012, and the Appellant became a party to these contracts as successor to the previous owner.

11. As a result of new Regulations made in 2009 and 2011 relating to the use of Freon coolant,[2] the Appellant was required to replace the cooling plant at the Dimlington terminal with a non-Freon cooling plant. The Appellant began incurring costs on this project in the planning stage on handover from BP in November 2012. The works were largely completed by mid-2016, but the staged commissioning of various parts of the works did not fully complete until late 2017.

12. During 2013, the Appellant reviewed all of its TPAs, and determined that only three of them enabled the Appellant to require the field owners to make additional payments to the Appellant in relation to the Freon replacement works. These were the TPAs relating to the Babbage, Seven Seas and Johnston fields.

13. Notices of the additional payments in respect of the Freon replacement works were given to the operators of these three fields on 20 December 2013, 30 May 2018 and 11 March 2015 respectively. None of the field operators gave notice that they wished to terminate their TPA, and all of them paid the additional sums.

14. The additional sums receivable by the Appellant under the three TPAs during the relevant period amounted to only a portion of the total expenditure incurred by the Appellant on the Freon replacement works in the relevant period. The additional sums were a pro rata share of the cost of the Freon replacement works based on the proportion of the throughput at the terminal that was attributable to the particular oil field in question.

15. The Appellant claimed the expenditure on the Freon replacement works in its PRT expenditure claims for the relevant period. On 21 September 2015, HMRC commenced enquiries into those expenditure claims. In two decision notices dated 20 May 2016, HMRC disallowed part of the expenditure claimed for the relevant period. On 1 June 2016, the Appellant appealed against these decision notices. In the course of further exchanges between the parties, agreement was reached on certain matters, but there remained a dispute in relation to the issue that falls for determination in this appeal. In letters dated 20 November 2017 and 14 June 2018, HMRC set out their final view that the additional sums receivable in the relevant

[2] The Ozone–Depleting Substances (Qualifications) Regulations 2009, SI 2009/2016, and the Environmental Protection (Controls on Ozone-Depleting Substances) Regulations 2011, SI 2011/1543.

period by the Appellant under the Babbage, Seven Seas and Johnston TPAs in connection with the Freon replacement works are to be treated as a "subsidy" under paragraph 8 Schedule 3 OTA 1975, such that the allowable expenditure for the relevant period falls to be reduced by an amount equal to those additional sums.

16. On 19 September 2018, the Appellant requested an independent review of the HMRC decision. The HMRC review conclusion letter dated 31 October 2018 upheld the HMRC decision. On 29 November 2018, the Appellant commenced the present appeal to this Tribunal.

THE ISSUE

17. The issue in dispute between the parties is whether the additional sums received by the Appellant pursuant to the Babbage, Seven Seas and Johnston TPAs in respect of the Freon replacement works "met directly or indirectly" the Appellant's expenditure on those works within the meaning of paragraph 8 Schedule 3 OTA 1975.

18. Both parties request the Tribunal to give only a decision in principle on this remaining issue in dispute. They are satisfied that they can thereafter agree on the consequential computations. Almost all of the relevant facts in this appeal have been agreed between the parties. Additionally, apart from this one issue still in dispute, the parties are essentially agreed on the way that the complex legislative provisions apply to the facts of this case. This decision therefore does not set out in unnecessary detail the facts, the applicable legislation, or the computations of relevant amounts. For the Tribunal's own background understanding, these matters were dealt with by counsel at greater depth at the hearing, and the Tribunal is grateful to counsel for both parties for the clarity and helpfulness of their explanations.

19. The parties have also agreed for purposes of this appeal that the Babbage TPA should be treated as representative of all three TPAs in issue in this appeal. Accordingly, while the terms of the Babbage TPA were referred to in detail at the hearing, the Tribunal has not been provided with copies of the Seven Seas or Johnston TPAs, or of any of the other TPAs to which the Appellant is a party. The Tribunal proceeds on this basis, and references below to the Babbage TPA and the parties thereto are therefore deemed to apply in the same way to the Seven Seas and Johnston TPAs and the parties thereto, notwithstanding that there may be differences of detail between them.

APPLICABLE LEGISLATION

20. PRT was introduced by the OTA 1975. Section 1(2) of that Act provides that a "participator" in an "oil field" (as defined in s 12) is to be charged PRT on "the assessable profit accruing to him in any chargeable period from that field, as reduced under section 7 of this Act by any allowable losses …" Chargeable periods are the half years to the end of June and December of each year. It is common ground that the Appellant is a "participator" in relation to the West Sole oil field.

21. Sections 2 to 4 OTA 1975 (and the Oil Taxation Act 1983 ("**OTA 1983**")) provide for the computation of assessable profits. Section 2 OTA 1975 provides that the assessable profit (or allowable loss) is the difference between "positive amounts" for the chargeable period in question (defined to include gross profit) and the "negative amounts" for that chargeable period. Broadly speaking, expenditure (whether or not of a capital nature) is allowable if it is "incurred" by a person at or before the time when that person is a participator in the field for one or more of the purposes specified.

22. Section 6(1) OTA 1983 provides that in computing the assessable profit in any chargeable period ending after 30 June 1982, the "positive amounts" for the purposes of s 2

OTA 1975 shall be taken to include any "tariff receipts" of a participator. Section 6(2) OTA 1983 goes on to define "tariff receipts" as follows:

> (2) Subject to the provisions of this section and section 6A below, for the purposes of this Act the tariff receipts of a participator in an oil field which are attributable to that field for any chargeable period are the aggregate of the amount or value of any consideration (whether in the nature of income or capital) received or receivable by him in that period (and after 30th June 1982) in respect of—
>
> (a) the use of a qualifying asset; or
>
> (b) the provision of services or other business facilities of whatever kind in connection with the use, otherwise than by the participator himself, of a qualifying asset.

23. Section 8 of that Act defines "qualifying asset" for purposes of the Act. It is common ground between the parties that the Dimlington terminal was a "qualifying asset" in relation to the West Sole field throughout the relevant period.

24. Section 6A OTA 1983, which was inserted into that Act in 2004, introduces the concept of a "tax exempt tariffing receipt" ("**TETR**"). Its first two sub-sections provide:

> (1) An amount which is a tax-exempt tariffing receipt (see subsection (2) below) does not constitute a tariff receipt for the purposes of the Oil Taxation Acts.
>
> (2) An amount is a "tax-exempt tariffing receipt" for the purposes of the Oil Taxation Acts if—
>
> (a) it would, apart from this section, be a tariff receipt of a participator in an oil field,
>
> (b) it is received or receivable by the participator in a chargeable period ending on or after 30th June 2004 under a contract entered into on or after 9th April 2003, and
>
> (c) it is in respect of tax-exempt business ...

25. It is common ground that for PRT purposes any tariff receipts received by the Appellant in relation to the Dimlington terminal are taxable in the West Sole field, and that accordingly any expenditure attributable to earning those tariff receipts is allocable to the West Sole field. It is similarly common ground that any TETRs received by the Appellant in relation to the Dimlington terminal are treated as attributable to the West Sole field for the purposes of allocating expenditure incurred in respect of the terminal.

26. Paragraph 8 Schedule 3 OTA 1975 provides:

> (1) Expenditure shall not be regarded for any of the purposes of this Part of this Act as having been incurred by any person in so far as it has been or is to be met directly or indirectly by the Crown or by any government or public or local authority, whether in the United Kingdom or elsewhere, or by any person other than the first-mentioned person.
>
> (1A) But sub-paragraph (1) above does not apply to any expenditure for which the relevant participator is liable that has been or is to be met directly or indirectly out of a payment made by the guarantor under an abandonment guarantee.
>
> (1B) In sub-paragraph (1A) above—

(a) *"abandonment guarantee"* has the same meaning as it has for the purposes of section 3 of this Act (see section 104 of the Finance Act 1991), and,

(b) *"the guarantor"* and *"the relevant participator"* have the same meaning as in section 104 of that Act.

(2) In considering, for the purposes of this paragraph, how far any expenditure has been or is to be met directly or indirectly by the Crown or by any authority or person other than the person incurring the expenditure, there shall be left out of account any insurance or compensation payable in respect of the loss or destruction of any asset.

(3) This paragraph is subject to paragraph 11A (transfers of interests in oil fields: post-transfer decommissioning expenditure).

27. PRT applies only to fields that were approved before 16 March 1993. Since 1 January 2016, PRT has been zero rated. The relevant period for purposes of this appeal is the 12-month period immediately prior to that, at which time PRT was charged at 50 percent of the assessable profit accruing to a participator from an oil field.

THE ISSUE IN CONTEXT

28. In the Appellant's PRT return for the West Sole field for the relevant period, the additional sums receivable in respect of the Freon replacement works under the Johnston TPA was treated as a tariff receipt, and the additional sums receivable under the Babbage and Seven Seas TPAs were treated as TETRs.

29. The Appellant argues that a tariff receipt or TETR, by definition, cannot be a payment that meets expenditure of the participator within the meaning of paragraph 8 Schedule 3 OTA 1975. Counsel for HMRC, while not acknowledging that this is correct as such as a matter of law, accepted at the hearing that this is the practical effect of the legislation.

30. However, the position of HMRC is that the additional sums received under the three TPAs were neither tariff receipts nor TETRs, but rather subsidies or some other kind of payment to which paragraph 8 Schedule 3 OTA 1975 applies.

31. If the additional sums received under the Johnston TPA are tariff receipts, these additional sums will be included in the calculation of the assessable profit, while the proportion of the Freon replacement works that the additional sums reimburse will be included in the allowable expenditure, such that the two will cancel each other out.

32. If the additional sums received under the Babbage and Seven Seas TPAs are TETRs, they would not be included in the calculation of the assessable profit as they are tax exempt. Under the terms of the legislation, the proportion of the Freon replacement works that these additional sums reimbursed would in principle also be excluded from the allowable expenditure, as expenditure related to the use of an asset for tax exempt tariffing purposes is not allowable for PRT.

33. However, the qualifying asset in this case, the Dimlington terminal, is used partly in connection with the Appellant's own oil fields, and only partly for tax-exempt tariffing. The expenditure on the Freon replacement works therefore needs to be apportioned on a just and reasonable basis to the respective uses of the asset.

34. Paragraph OT15920 of the HMRC Oil Taxation Manual deals with the methodology for making this allocation. It notes as follows. In most situations where a just and reasonable apportionment of expenditure is required, HMRC consider that operating expenditure incurred in connection with an asset should be allocated by reference to the throughput of the fields

using the asset during the claimed period, and that expenditure incurred for long term assets should be allocated by reference to the fields expected to use the assets on the basis of their expected recoverable reserves. However, industry representative bodies had raised several points concerning how cost allocation should apply in tax exempt tariffing situations, including in particular that a throughput basis of apportionment was not necessarily appropriate in all cases. While HMRC did not accept that these points were valid for all tax-exempt tariffing situations, a modified approach has been formulated following discussion with industry representative bodies, and there is an expectation that the modified approach will be followed in the majority of tax-exempt tariffing situations. Where the modified approach applies, the expenditure allocable to the tax-exempt tariffing use will be the amount equivalent to 50% of the gross tariff from the user field, subject to the limitation that the expenditure allocated cannot exceed average cost or be less than the incremental cost.

35. The practical difference between the normal throughput methodology for making a just and reasonable allocation and the modified approach will vary, depending on the circumstances in the individual case. In some but not all cases, the modified approach will lead to less of the expenditure incurred being allocable to the TETR than under the throughput basis, with the result that more of the expenditure will be allowable for PRT purposes than under the throughput basis.

36. The parties are agreed for purposes of this appeal that amounts paid for the terminal's services pursuant to the Babbage and Seven Seas TPAs are TETRs rather than tariff receipts, and that the modified approach falls to be applied to determine the allocation of expenditure. The result in practice in the circumstances of this particular case is the following. If the additional sums received pursuant to the Babbage and Seven Seas TPAs in respect of the Freon replacement works are TETRs and paragraph 8 Schedule 3 OTA 1975 does not apply to them, these additional sums will not be taken into account when computing the Appellants' assessable profits (since TETRs are tax exempt), but the expenditure incurred by the Appellant that was reimbursed by the additional sums will nonetheless be claimable expenditure. On the other hand, if, as HMRC contend, paragraph 8 Schedule 3 OTA 1975 does apply to that expenditure, it will not be claimable.

RELEVANT CONTRACTUAL PROVISIONS

37. The Babbage TPA is concluded between BP on the one hand (to whose rights the Appellant is the successor) as operator and owner of the "System", and, on the other, three companies having ownership interests in the Babbage field (referred to jointly in the agreement as the "Babbage Group"). The "System" is defined in clause 1.1 of the agreement to mean the Dimlington terminal and the West Sole system. The Appellant (as successor to BP) is both the "System Owner" and the "System Operator". The Babbage Group is one of the "System Users".

38. Recitals (D) and (E) provide:

> (D) The Babbage Group wishes to deliver Babbage Gas into the System and to have Babbage Gas transported through the System, processed and compressed within the System and have Babbage Sales Gas delivered at the Common Delivery Point; and
>
> (E) The System Owner is willing to accept, transport, process and compress Babbage Gas in the System and to transport Babbage Gas through the System, and to deliver Babbage Sales Gas at the Common Delivery Point all in accordance with this Agreement.

39. Clause 2.1 provides that in consideration of and subject to payment of the "Gas Tariff" (or the "Operating Tariff" as the case may be), the System Owner agrees to provide the following services in accordance with and subject to the contract (collectively referred to as the "System Services"):

(a) provision of the [Babbage Reserved Capacity];

(b) acceptance of Specification Babbage Gas at the Babbage Entry Point;

(c) transportation of Specification Babbage Gas through the relevant parts of the West Sole System;

(d) processing and compression of Specification Babbage Gas within the Dimlington Terminal;

(e) delivery of Babbage Sales Gas at the Common Delivery Point at the Sales Gas Specification;

(g) treatment and disposal of produced water from Babbage Gas in accordance with the requirements and limits as set out in Schedule 1; and

(h) the Control Room Services.

40. Clauses 2.8 and 2.9 deal with the situation where the System Owner is unable to fulfil its obligations, and in order to resume performance would need to undertake repairs or reconfigurations that the System Owner considers would be uneconomic. In that situation, the System Owner is entitled to terminate the agreement on 6 months' notice. However, the System Operator is in that event required to give to the Babbage Group notice of a reasonable estimate of the costs of the repairs or reconfigurations, and the Babbage Group have the option but not the obligation to agree to pay all or part of these costs. If the Babbage Group do propose to pay all or part of the costs, and the System Operator nonetheless still does not wish to reinstate the System, then the Parties are required to meet to discuss in good faith alternative means of enabling the Babbage Owners to safeguard their interests, including the assumption of the operatorship but not the ownership of all or part of the System. In the event that no such agreement is reached in 90 days, the termination notice remains effective.

41. Clause 2.10 provides that the System Operator is entitled to trade carbon emissions allowances allocated to the System and to purchase such additional allowances as required to ensure that the System Operator and System comply with the EU emissions trading scheme or any such similar scheme, that such trading is carried out by the System Operator on behalf of the System Users and that the costs are to be prorated to the System Users on the basis set out in that clause.

42. Clause 2.11 provides that the System Operator shall operate, maintain and repair the System to the extent necessary to provide the System Services.

43. Clause 4 (entitled "Babbage Group's Obligations") states that the Babbage Group is under an obligation "to pay the Gas Tariff, Shortfall Payment and any other payment referred to in this Agreement in accordance with this Agreement" (clause 4.1(c)).

44. Clause 7 provides that in consideration of the provision of the System Services, the Babbage Group shall pay the System Owner the Gas Tariff, to be calculated in accordance with a formula set out in that clause and Schedule 2, to be adjusted annually. The tariff produced by the formula is an amount per cubic metre of Babbage Sales Gas delivered at the Common Delivery Point (that is to say, gas sold by the terminal that is attributable to the Babbage Group). It is stipulated in clause 16.3 that this Gas Tariff is deemed to include the cost of routine planned maintenance. Clause 7.9 states that in addition to the tariffs calculated under clause 7 or clause

15, the Babbage Group is to pay the System Operator the costs under clause 2.10, and the costs of treatment and disposal of produced water in excess of the stipulated amount.

45. Clause 8.1 provides that if in any year the quantity of Babbage Sales Gas is less than the contractual annual minimum quantity, then the Babbage Group is required to make a shortfall payment.

46. Clause 9.1 provides that the System Operator will send to the Babbage Group monthly invoices "for the amount of Gas Tariff (or cost share after a Gas Tariff Re-opener) payable for the System Services by the Babbage Group … and any other costs pursuant to this Agreement".

47. Clause 9.8 provides that if any default in payment due to the System Owner continues for 10 days or more, the System Owner may on 10 days' notice "suspend the performance of any or all of the System Services until payment in full … has been made".

48. Clause 9.9 provides that if any default in payment due to the System Operator under the agreement continues for 30 days or more, the System Owner is entitled to terminate the agreement on giving 20 days' notice.

49. Clause 10.2 provides that the System Operator has the right to reduce or suspend acceptance of any Babbage Gas that does not meet contractual specifications, and to dispose of any Babbage Gas or Pipeline Gas affected by such off-specification Babbage gas, and that any action taken by the System Operator according to that clause shall be at the sole expense of the Babbage Group.

50. Clause 15.1 provides that:

> In respect of any Contract Year commencing on or after 1st October 2015, the System Operator may notify the Babbage Operator by written notice given not less than twelve (12) Months prior to the start of such Contract Year that the basis of charge for any or all of the System Services shall be altered (the "Gas Tariff Re-Opener") so as to comprise an operating expenditure related tariff calculated in accordance with this Clause 15 …

51. Clause 15.2 provides that from the beginning of the Contract Year to which a Gas Tariff Re-opener relates, the Babbage Group is to cease paying the Gas Tariff calculated in accordance with clause 7 and instead pay the "Operating Tariff" calculated in accordance with clause 15. Clause 15 goes on to set out detailed provisions on calculating the Operating Tariff. In essence, under this mechanism the Babbage Group is required to pay a pro rata share of the actual operating costs of the System, the pro rata share being determined by dividing the actual throughput of Babbage Sales Gas in the relevant year by the aggregate actual throughput of all oil fields using the terminal during that year. The clause provides for monthly payments throughout the year of a provisional operating tariff, with an annual adjustment once the actual figures for the System Operating Costs and actual throughput of each user for the year are known. "System Operating Costs" are defined in clause 1.1 to mean (with some specified exclusions) "the aggregate expenditure (whether operating or capital expenditure) which is, or which it is reasonably anticipated would be, incurred by the System owner in accordance with the System Operator's normal accounting practice from time to time in operating, maintaining repairing and/or replacing any relevant part of the Babbage Transportation System to the standard of a Reasonable and Prudent Operator".

52. Clause 15.7(a) provides that in the event that none of the System Owner's own gas is transported within the West Sole System and the terminal in the year in question, then in addition to the Operating Tariff, a System Operating Costs Uplift of 15% shall also be payable.

53. During the relevant period for purposes of this appeal, the Appellant had not served a Gas Tariff Re-Opener notice on the Babbage Group, and services were at the time still being

provided to the Babbage Group on the basis of the Gas Tariff under clause 7. The Tribunal was informed that the Appellant did subsequently serve such a notice on the Babbage Group in September 2019, and that the Babbage Group has been subject to the Operating Tariff since October 2020.

54. Clause 16.1 deals with the situation where the System Owner is required to modify or repair any part of the System as a result of any amendment to any requirement of any relevant regulations, and the modification or repair is necessary for the provision of the System Services. "Relevant Regulations" are defined in clauses 1.1 and 2.7 to include changes in legislation or regulations. Clause 16.1 provides that if the modification is required solely to transport Babbage Gas to the Common Delivery Point, then the Babbage Group is required to reimburse the System Owner for any losses or consequential loss reasonably incurred by the System Owner in carrying out the modification, and that if the modification is required to transport Babbage Gas together with gas from other fields using the system, the Babbage Group is required to reimburse the System Owner a pro-rata share of the modification costs in the proportion that the Babbage Gas throughput in the System bears to the aggregate gas throughput in the System.

55. Clause 16.2 provides that the System Owner is not entitled to seek recovery of such modification costs under clause 16.1 unless they exceed £25,000 in any contract year, but that the System Owner is nonetheless required to carry out such modifications. This clause requires the System Owner to give the Babbage Group notice of a reasonable estimate of such proposed modification costs as soon as reasonably practicable, and there is a mechanism for the Babbage Group to dispute the estimate.

56. Clause 16.6 gives both the System Owner and the Babbage Group a right to terminate the agreement in the event that the Babbage Group, within 75 days of receipt of a modification notice, do not agree to bear the costs of the modification.

THE EVIDENCE OF ANDREW SANDERS

57. Mr Andrew Sanders gave evidence on behalf of the Appellant. He has been involved with commercial operations at Perenco UK Limited since the company's entry to the United Kingdom in 2003, initially as the Commercial Manager, subsequently as a freelance consultant in a commercial advisory role. He was previously involved in similar commercial operations with another company from 1992 to 2001, after which he completed an MBA before joining the Appellant. He adopted and confirmed (with one minor correction) a formal witness statement dated 30 March 2021. His evidence included the following points.

58. The transportation and processing infrastructure for the Southern North Sea was first built to serve gas fields that the owners of the infrastructure systems were developing themselves. The owners of later gas field developments sought to make use of existing systems in the vicinity. Consequently, over the decades a large number of TPAs have been agreed to serve the interests of both system owners and third-party users.

59. The system owners typically continue to be a major user of the system. The system operating costs are predominately fixed, that is to say from a base level they do not increase or decrease proportionately with the increase or decrease in the throughput volume of gas. Consequently, the system owner can profit from the arrangement simply by getting third-party users to share in those fixed operating costs.

60. Many factors will determine the terms and conditions of a TPA. A common practice is for a TPA to provide for a profit tariff which, at the election of the system owner (but no earlier than a given date) can be subsequently replaced with a cost-share arrangement.

61. Under the Babbage TPA, consistent with standard TPA practices for the southern North Sea, the level of the gas tariff is effectively calculated to allow the terminal owner to recoup the cost of operating the system and a reasonable profit margin for the routine operation of the system. This structure keeps the level of profit tariff on routine operations to a minimum and notionally distributes the cost of modifications (if they occur) to all users of the system.

62. Mr Sanders considers that the Babbage TPA is a standard form of TPA that would be agreed between parties operating in the market at arm's length.

63. In cross-examination, Mr Sanders said amongst other matters as follows. Clause 16 only applies when the Gas Tariff is in operation. Clause 16.3 makes clear that the Gas Tariff includes routine maintenance. Clause 16 allows additional amounts to be charged where there is larger expenditure going beyond routine maintenance. Under the Operating Tariff, all expenditure would be included.

64. The Tribunal accepts the evidence of Mr Sanders as stated at paragraphs 58-63 above.

THE APPELLANT'S ARGUMENTS

65. Paragraph 8(1) Schedule 3 OTA 1975 applies only to expenditure met *by way of bounty* towards the taxpayer, or which constitutes a "subsidy", "help", "aid", "assistance" or a "donation of money". The Appellant genuinely incurred all of the expenditure it laid out on the Freon replacement works. The Babbage Group had no interest in the Freon replacement works in their own right. The Babbage Group assumed a liability under clause 16 not for the *purpose* of paying for the Freon replacement works (such that the works were an end in themselves for the Babbage Group), but only to ensure that it continued to receive the services pursuant to the TPA. The Babbage TPA was a commercial agreement on arm's length terms.

THE HMRC ARGUMENTS

66. Paragraph 8(1) is drafted in broad terms. It applies to simple or complex arrangements of any kind. It potentially covers payments made under a contractual obligation negotiated at arm's length on a commercial basis. It is the nature and purpose of the payment made that matters, not the legal status of the payer as a public or private body, and not the identity of the fund out of which the payment is made. There is no policy reason for allowing a taxpayer to claim a deduction for expenditure that is met by someone else. The underlying policy is to allow the person who in fact meets the expenditure to claim any deduction. A payment which reimburses a person's expenditure (or which is made to meet someone else's expenditure) is not "consideration" in respect of the subsequent use of the qualifying asset or the provision of services that is enabled by reimbursement, and which carries its own tariff. The additional sums paid in respect of the Freon replacement works were not made way of loan, and were not anything other than outright contributions.

THE TRIBUNAL'S FINDINGS

67. In accordance with general principles of statutory interpretation, in construing paragraph 8 Schedule 3 OTA 1975 consideration must be given not just to the literal meaning of the words of that provision, but also to the context and scheme of the Act as a whole, and to the purpose of the provision (*Pollen Estate Trustee Co Ltd v HMRC* [2013] EWCA Civ 753, [2013] 1 WLR 3785 at [24]).

68. That provision is in a taxation statute. It has effect in relation to other provisions of the OTA 1975 and of the OTA 1983 dealing with the determination of allowable expenditure for purposes of computing the assessable profits on which a tax is payable.

69. Generally, businesses ultimately finance their expenditures from the proceeds of their sales. It might on one view therefore be argued that any business's customers, when paying for goods or services supplied by that business, are thereby indirectly meeting the business's expenditures. However, it would be absurd to interpret paragraph 8 Schedule 3 OTA 1975 as having such a meaning. The result of such an interpretation would be that no expenditure used to generate tariff receipts or TETRs would ever be allowable, on the basis that all of those expenditures would be regarded as having been indirectly met by the payments that constitute the tariff receipts or TETRs. Such an interpretation would defeat the purpose of the scheme of the Act as a whole, which is to enable expenditure to be deducted when calculating the profits on which the tax is payable.

70. Payments to a participator of amounts that in the hands of the participator constitute tariff receipts or TETRs therefore cannot themselves be regarded as payments that meet directly or indirectly the participator's expenditures in generating those tariff receipts or TETRs for purposes of paragraph 8 Schedule 3 OTA 1975. Indeed, both parties in effect accept that this is so (see paragraph 29 above).

71. The Tribunal therefore finds that the main issue in this appeal is whether the additional sums paid by the Babbage Group in respect of the Freon replacement works are part of the TETRs received by the Appellant pursuant to the Babbage TPA.

72. Section 6A(2)(a) OTA 1983 defines a TETR as an amount that "would, apart from this section, be a tariff receipt of a participator in an oil field". Section 6(2) OTA 1983 defines a "tariff receipt" of a participator for a chargeable period as "the aggregate of the amount or value of any *consideration* (whether in the nature of income or capital) received or receivable by him … *in respect of* … the use of a qualifying asset … or … the provision of services … in connection with the use, otherwise than by the participator himself, of a qualifying asset" (emphasis added).

73. It is common ground that the Dimlington terminal is a qualifying asset, and HMRC have not sought to dispute and the Tribunal is satisfied that the System Services provided by the Appellant pursuant to the Babbage TPA are services in connection with the use of the terminal by the Babbage Group.

74. The issue that needs to be resolved is therefore simply whether the sums paid by the Babbage Group pursuant to clause 16 of the Babbage TPA are part of the *consideration* paid by the Babbage Group to the Appellant *in respect of* the System Services provided by the Appellant pursuant to that agreement.

75. The HMRC submissions on why the clause 16 payments should not be treated as part of the consideration for the System Services are essentially the following.

76. First, HMRC argue that the plain wording of the Babbage TPA itself indicates that clause 16 payments are not part of the consideration for the System Services. In particular, clause 2.1 of that agreement says that "In consideration of and subject to payment of the Gas Tariff [under clause 7] (or the Operating Tariff [under clause 15] as the case may be), the System Owner agrees to provide the … System Services …". Thus, it is contended that the consideration for the System Services is the payment of the tariff under clause 7 or clause 15, and that any payments under clause 16 are something separate and different from the consideration given for the supply of the System Services. Indeed, clause 16(1)(b) itself states that the Babbage Group is required to "reimburse" the Appellant for a pro-rata share of the modification costs. Thus, say HMRC, according to the terms of the contract itself, the additional sums were a reimbursement by the Babbage Group of part of the Appellant's costs of undertaking certain works at the terminal, rather than payments in respect of the System Services.

77. Secondly, HMRC argue that clause 16 does not contractually bind the Babbage Group to pay the additional sums. Clause 16 stipulates that if the Babbage Group does not agree to do so, the Appellant will have the right to terminate the TPA, but unless and until the Appellant exercises such a right of termination, the Appellant remains contractually obliged to deliver the same System Services on the same terms as before, even though the Babbage Group do not agree to pay the additional sums. Thus, it is argued, payment of the additional sums under clause 16 is not payment for the System Services.

78. Thirdly, HMRC argue that the Babbage Group obtains no added value by paying the additional sums. If the additional sums are paid, the Babbage Group will receive only the same System Services that it was previously already receiving in any event. Payment of the additional sums does not lead to any increase in the quality or quantity of the System Services provided. Thus, it is argued, payment of the additional sums under clause 16 is not consideration for anything provided by the Appellant. Rather, the additional sums are simply a subsidy paid by the Babbage Group towards the Appellant's costs of modifying the terminal. The fact that the additional sums may be paid pursuant to a commercial contract, negotiated at arm's length, in the commercial interests of both parties, is said to be immaterial. The fact that the motive for making the payments may be to enable the System Services to continue to be provided does not mean that the payments are *for* the System Services.

79. The HMRC arguments are based in part on the wording of specific provisions of the Babbage TPA. These include in particular clause 2.1, which refers to the consideration for the System Services as consisting only of the Gas Tariff under clause 7 or the Operating Tariff under clause 15, and clause 16(b), which states that payments under that clause "reimburse the System Owner for a pro-rata share of the Modification Costs".

80. However, while the identification of the parties' contractual obligations is a matter of contract, the question whether those obligations answer a particular legal description is not necessarily concluded by the contract (compare *A1 Lofts Ltd v Revenue and Customs* [2009] EWHC 2694 (Ch) at [40]). The question of what consideration is given by one party to a contract in return for the obligations of the other is not solely a matter of contract, but is also a question of law. If it is in fact the case that one party is obliged as a matter of contract to give both X and Y in return for performance of the other party's contractual obligations, then in law the consideration may consist of both X and Y, even if there may be clauses in the contract that refer to the consideration as consisting only of X. Furthermore, to the extent that the question is a matter of contract, it is necessary to look at all of the provisions of the contract and their effect as a whole, and not merely the wording of certain specific provisions.

81. While the opening words of clause 2.1 of the TPA refer to the consideration as consisting only of the Gas Tariff under clause 7 or the Operating Tariff under clause 15, other provisions of the Babbage TPA expressly require the Babbage Group to make other payments in addition (in particular, clauses 2.10, 4.1(c), 7.9, 8.1 and 10.2). Indeed, clause 4.1(c) provides that the Babbage Group are required to "pay … any payment referred to in this Agreement in accordance with this Agreement", and clauses 9.8 and 9.9 give the Appellant the right to suspend the System Services to the Babbage Group or to terminate the TPA altogether if any default in any payment due to the Appellant under the Agreement continues for more than a specified period.

82. Thus, the wording of the agreement as a whole is consistent with all of the payment obligations of the Babbage Group under the TPA being part of the consideration for all of the System Services provided by the Appellant under the TPA.

83. Furthermore, it would be inaccurate to say that clause 16 imposes no obligation at all on the Babbage Group to pay any additional sums under that provision, or to say that the System

Services received by the Babbage Group under the TPA will be exactly the same whether or not the Babbage Group agrees to pay the additional sums.

84. Clause 16 sets out a procedure that is to be followed in cases where amendments to relevant regulations require a modification to the System. Under clause 16.2, the Appellant is required to give the Babbage Group notice in writing setting out an estimate of the modification costs, including details of the regulations that require the modification, the extent to which the modification is required in order to provide the System Services under the Babbage TPA, and the anticipated dates of incurring the expenditure. The Babbage Group then has 30 days in which it may dispute the estimate of the modification costs, setting out the basis for the dispute. If the Babbage Group do dispute the estimate, the parties are then required to meet to resolve the dispute, and if they cannot do so within 45 days, the matter is then to be referred to an expert for resolution in accordance with an expert resolution procedure set out in Schedule 3 to the agreement. However, clause 16.6 provides that if within 75 days from receipt of the modification notice the Babbage Group have still not agreed to bear its share of the modification costs, either party can terminate the TPA.

85. The Tribunal considers that clause 16 sets out a primary obligation for the Babbage Group to pay its share of the modification costs if served with a modification notice under that provision. Although clause 16.6 says that "in the event that the Babbage Group … do not agree to bear the costs of [a modification]" either party can terminate the agreement, the Tribunal does not read that clause as conferring on the Babbage Group an unfettered right to refuse to contribute to the modification costs. The Tribunal considers that the effect of clause 16.2 is that in the event of the Appellant serving a modification notice, the Babbage Group will be contractually obliged to pay the additional sums if it does not within 30 days serve a written notice disputing the estimate and giving reasons. Furthermore, the Tribunal does not read clause 16.2 as permitting the Babbage Group to dispute the estimate simply on the ground that it would prefer not to pay. Rather, the estimate would have to be disputed on grounds related to matters such as whether the amount of the estimated costs is justified, or whether the modifications are in fact required by the amendment to the relevant regulation relied upon. Additionally, if the Babbage Group does dispute the estimate, it is then required by clause 16 to engage in the expert resolution procedure. Reading clause 16.2 and 16.6 together, it is only in the event of such a dispute not being resolved within 75 days that either party (not just the Appellant) may terminate the TPA.

86. If the Babbage Group exercised its right under clause 16.6 to terminate the agreement, then clearly the Babbage Group would cease to be entitled to receive the System Services. Furthermore, if any dispute is not resolved within 75 days, then even if the Babbage Group does not terminate the TPA, it becomes subject to the possibility that the Appellant may terminate the TPA. Whether or not the Appellant would in practice exercise that right, the only way in which the Babbage Group could maintain its ongoing *contractual right* to receive the System Services is to agree to pay the additional sums. It is therefore not correct to say that the Babbage Group obtains nothing of value by paying the additional sums.

87. The Tribunal notes that while contracts may often stipulate that the consideration to be paid for services is to be a fixed sum, or a fixed rate, there exists a wide variety of other ways in which contractual consideration can be specified.

88. For instance, a contract may fix all or part of the amount of the consideration by reference to the actual costs of the supplier. An example would be a cost-plus contract, where the contractual consideration is specified to be the actual or reasonable expenditures incurred in providing the service plus an additional element to allow for profit. Indeed, under the Operating Tariff in clause 15 of the Babbage TPA, the Babbage Group is required to pay only

a pro rata share of the actual operating costs of the System, without any additional element for profit, other than in the circumstance specified in clause 15.7(a) (see paragraphs 50-52 above). Counsel for HMRC accepted that payments of the Operating Tariff made by the Babbage Group pursuant to clause 15 would be TETRs, and would not be payments to which paragraph 8 Schedule 3 OTA 1975 applies.

89. It is also possible for the contractual consideration for a service to consist of multiple components, with one or more components to apply only in the event of specified events arising, the future occurrence of which is uncertain at the time that the contract is concluded. For instance, a contract could provide that the consideration for services shall be amount X, but that if an uncertain specified event should occur, the consideration will be amount X plus the supplier's additional costs of supplying the service that are occasioned by that event.

90. Particularly in the case of long-term contracts, it is often impossible to foresee all of the future eventualities that might potentially impact on the costs of providing an ongoing service, or the precise impact that any such eventualities might have on those costs. This may make it impossible or impracticable to factor the anticipated costs of such eventualities into a fixed price at the time that the contract is concluded. Instead, contracts may in such situations have provisions which allocate risks and costs between the parties in the event of particular types of uncertain circumstances arising over the lifetime of the contract. Such provisions may also give one or both parties a right to terminate the contract in the event that such future circumstances have the effect of making the contract uneconomic for that party.

91. The Tribunal considers that the provisions of clause 16 dealing with modifications to the system required by changes in relevant regulations are an example of this. Other provisions of this kind in the Babbage TPA are clauses 2.8 and 2.9 (see paragraph 40 above), and clauses 16.4 and 16.5 (which apply to repairs to the "System Alterations" as defined in the agreement).

92. The Tribunal concludes from an examination of the Babbage TPA as a whole that the obligations undertaken by the Babbage Group in clause 16 are part of the overall consideration given by the Babbage Group in return for the obligations undertaken by the Appellant in the TPA to provide the System Services. Clause 16 is part of the original TPA pursuant to which the System Services are provided. It is to be presumed that all of the clauses of that agreement were negotiated as a package. The totality of the obligations undertaken by the Babbage Group in that agreement is the consideration given by it for the totality of the obligations undertaken by the Appellant in the same agreement. In other words, the Babbage Group's agreement to clause 16 is part of the price it paid for the Appellant's agreement to provide the System Services. At the time that the TPA was concluded, it would not have been known whether any circumstances would ever arise in which clause 16 would be invoked, or if so, what additional costs would arise as a result. No possible reason has been advanced as to why the Babbage Group would at that time have agreed to clause 16, apart from the fact that it was part of the price of the overall bargain.

93. This conclusion, based on a consideration of the wording of the TPA itself, is consistent with the evidence of Mr Sanders.

94. The Tribunal is satisfied from Mr Sanders' evidence that while each TPA is individually negotiated, various types of provisions are common in the industry, and that the provisions of the Babbage TPA would not be considered unusual in a TPA agreed between parties operating in the market at arm's length.

95. The Tribunal also finds on its own construction of the TPA that a pro-rata share of the Freon replacement works would, even in the absence of clause 16, be included in the Operating Tariff under clause 15, pursuant to which the Babbage Group is required simply to pay a share of the overall operating costs of the System (see the definition of "System Operating Costs"

referred to in paragraph 51 above). Thus, had the Operating Tariff been the applicable tariff during the relevant period, a pro-rata share of the Freon replacement works would have been part of the consideration provided by the Babbage Group for the System Services (see paragraph 88 above).

96. The provisions of clause 16 relating to modifications required by changes in relevant regulations therefore operate during periods when the Gas Tariff under clause 7 is in effect. This tariff is an amount per cubic metre of Babbage gas processed through the terminal. While clause 16.3 states that this Gas Tariff is deemed to include the cost of routine planned maintenance, it would self-evidently be difficult for a tariff such as this to factor in the unforeseeable costs of uncertain future events such as the costs of modifications to the System required by changes in relevant regulations. The fact that the obligation to pay a share of such costs is dealt with in a separate clause therefore cannot be taken to mean that this obligation is not part of the consideration given by the Babbage Group for the provision of the System Services.

97. The Tribunal takes into account that not all TPAs to which the Appellant was a party included provisions for the system user to pay a share of the Freon replacement works, and that the three TPAs with which this appeal is concerned may have been economically advantageous to the Appellant even if they had not contained such a clause, for the reasons in paragraph 59 above. However, this is not decisive. For instance, even if the Operating Tariff would be to the Appellant's economic advantage despite the fact that it contains no element of profit, this would not mean that a profit margin, if one were included in an Operating Tariff, would not be part of the consideration paid by the system user for the services provided.

98. The Tribunal therefore finds that the additional sums paid by the Babbage Group pursuant to clause 16 of the Babbage TPA in respect of the Freon replacement works were part of the consideration paid by the Babbage Group for the System Services provided by the Appellant pursuant to that agreement, and that those additional sums received by the Appellant were therefore TETRs. Paragraph 8 Schedule 3 OTA 1975 therefore does not apply to disallow an amount of expenditure on the Freon replacement works equivalent to those additional sums.

99. Having decided the appeal on this basis, it is unnecessary for the Tribunal to deal in detail with the other arguments of the parties, which focused primarily on the scope of application of paragraph 8 Schedule 3 OTA 1975 itself.

100. None of the authorities cited by counsel in argument deal with the interpretation of paragraph 8 Schedule 3 OTA 1975. The decision of the Chancery Division in *Stokes v Costain Property Investments Ltd* [1983] STC 405, [1983] 1 WLR 683, included a point of interpretation of the similarly worded s 84(1) of the Capital Allowances Act 1968. However, the decision of the Chancery Division in that case was obiter, given that it determined the case on an unrelated basis. In an appeal against this decision, in *Stokes v Costain Property Investments Ltd* [1984] 1 WLR 763, the Court of Appeal did not further consider the point relating to s 84(1) of the Capital Allowances Act 1968. Furthermore, the circumstances of that case and of other cases relied on in argument were different and arose in different contexts to that in the present case. The Tribunal does not find these decisions to be of added assistance in this appeal.

101. HMRC contend that for purposes of paragraph 8 Schedule 3 OTA 1975, expenditure may be "met" by a person other than the taxpayer, notwithstanding that the payment is made by the other person pursuant to a contractual obligation negotiated at arm's length on a commercial basis, and notwithstanding that the payment may be in the mutual economic interests of both parties. It is unnecessary to decide whether that is so, or in what circumstances that could be the case. There would undoubtedly be more scope for argument to this effect in a case where

the expenditure on the qualifying asset was reimbursed by a third party who was unrelated to the recipient of the system services, or in a case where the agreement between the taxpayer and the person reimbursing the expenditure was entirely separate from, and concluded at a different time than, the agreement relating to the provision of the system services. It is more difficult to envisage a situation in which paragraph 8 Schedule 3 OTA 1975 might apply in a case such as the present, where the reimbursement was made by the recipient of the system services pursuant to a clause in the original agreement for the provision of those services. However, it is unnecessary to decide whether such situations could exist. For the reasons given above, the Tribunal finds that paragraph 8 Schedule 3 OTA 1975 does not apply in the circumstances of this particular case.

DISPOSITION

102. The appeal is allowed, in that the Tribunal decides in principle that the additional sums received by the Appellant pursuant to clause 16 of the Babbage TPA in respect of the Freon replacement works did not meet directly or indirectly the Appellant's expenditure on those works within the meaning of paragraph 8 Schedule 3 OTA 1975.

103. If the parties are unable to agree on the amendments to the decisions under appeal required to give effect to the Tribunal's decision in principle, either party is at liberty to request the Tribunal within 90 days of the date of release of this decision to determine the matter remaining in dispute.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

104. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

DR CHRISTOPHER STAKER
TRIBUNAL JUDGE

RELEASE DATE: 09 JULY 2021