BRACEWELL

INSIGHTS

Backing Fracking: UK Government Announces Shale Gas Incentives

July 22, 2013

*By: **Darren Spalding***

The UK Government has demonstrated its commitment to the establishment of a shale gas industry by announcing details of proposed tax incentives to be offered to project developers. Guidance relating to the planning process for obtaining project approvals has also been published. Both documents were released on 19 July 2013 and follow the Government's statements in the 2013 Budget of its determination to provide a supportive investment environment for the industry. At present, companies are subject to the "ring fence"� tax regime in respect of oil and gas production in the UK. The regime comprises three taxes "“ ring fence corporation tax at 30 per cent, a supplementary charge at 32 per cent and, for fields granted development approval prior to 16 March 1993, petroleum revenue tax (PRT). The effect of this current tax regime is a marginal tax rate of 62 per cent for oil and gas production from most fields (and 81 per cent from fields subject to PRT). Tax relief granted to companies under the existing regime takes the form of field allowances (which are granted in respect of projects that are commercially marginal and exempt a portion of production income from the supplementary charge) and a "ring fence expenditure supplement,"� which allows companies to uplift losses or pre-trading expenditure by 10 per cent for up to six accounting periods in order to maintain their time value until they can be offset against profits. The proposed tax incentives for shale gas developments take the form of a "pad allowance"� to operate in a manner similar to existing field allowances, by exempting a portion of production income from the supplementary charge. The need for a new "pad allowance,"� rather than simple application of the existing field allowances, is due to the nature of shale gas developments "“ traditional allowances rely on a clearly delineated field, whereas shale gas developments cover a larger, less well-defined area. The amount of production income that is proposed to be exempt from the supplementary charge under a pad allowance is an (as yet undefined) proportion of capital expenditure incurred in relation to the shale gas "pad"� (the drilling and production site). It is also proposed that the ring fence expenditure supplement be extended from six to ten accounting periods. This is to recognise the longer payback period for shale gas projects due to steep decline rates requiring high and continuous investment in wells. All interested parties are able to make submissions on the tax incentives proposals by 13 September 2013. The UK Government will publish a summary of responses later in 2013, with any legislation to be proposed in 2014. The proposal document can be found at ***https://www.gov.uk/government/consultations/harnessing-the-potential-of-the-uks-natural-resources-a-fiscal-regime-for-shale-gas***

. The planning guidance is intended to be used by project developers and planning authorities to set out the various consents and approvals required in relation to a shale gas project. This will be welcomed by potential investors; one of the potential barriers to the development of the UK industry has been the complicated regulatory environment. This measure follows the establishment of the Office of Unconventional Gas and Oil (OUGO) within the Department for Energy and Climate Change (DECC), which has as one of its primary objectives to ensure that "regulation of the industry, including the planning and permitting processes, is as streamlined and simplified as possible."� The planning guidance can be found at ***https://www.gov.uk/government/publications/planning-practice-guidance-for-onshore-oil-and-gas***. The UK Government's push to develop the shale gas industry is not surprising. UK net gas imports are set to rise from 45 per cent of demand to 76 per cent by 2030 according to DECC's latest projections. Most of the UK's current gas imports are sourced from Norway and Qatar, but longer term supply gap solutions of increased LNG and pipeline imports from other providers are expensive and erode the UK's energy independence. Shale gas production may help close the widening gap, although some commentators have suggested that the level of shale gas production will be insufficient to make a meaningful difference in the short to medium term. Undoubtedly, the industry is in its infancy, but Centrica's recent investment (acquiring an interest in significant onshore acreage from Cuadrilla Resources) indicates that there is commercial appetite. Further, with the latest reports from the British Geological Survey suggesting that there may be 1300 trillion cubic feet of shale gas present in the north of England alone, the prospective rewards for developers and consequent security of supply from a governmental perspective, are enticing. It is currently thought that between 10 "“ 20 per cent of this gas will be technically recoverable, a volume sufficient to meet the UK's current annual gas demand (approximately 3 trillion cubic feet) for a considerable period.