[2021] UKFTT 0265 (TC)

TC08211

Corporation Tax – oil contractor activities – s356L CTA 2010 –sum paid on early termination of contract for provision of oil rig – whether arose from oil contractor activities.

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2020/1743

BETWEEN

WILHUNTER (UK) LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE CHARLES HELLIER

The hearing took place on 3 and 4 June 2021. With the consent of the parties, the form of the hearing was by Video link on the Tribunal video platform on the first day and CVP on the second. A face to face hearing was not held because of the Covid 19 pandemic.

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.

Kevin Prosser QC instructed by Herbert Smith Freehills LLP for the Appellant

Christopher McNall instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This appeal relates to the provisions of Part 8ZA Corporation Tax Act 2010 ("CTA") which deal with the tax treatment of "oil contractor activities". Loosely speaking these are activities which involve providing or operating an oil rig for work in UK territorial waters ("UKCS") where the rig has been hired from an associated person.

2. The provisions have three major effects: (i) they treat oil contractor activities as a separate trade (the "ring fence trade") so that profit from it is computed separately, (ii) in computing profits of the ring fence trade they cap the deductions for the hire of the rig from the associate company and deny or reduce deductions in relation to loan relationships, management expenses and group relief, and (iii) they limit the set off against ring fence profits of losses of the contractor to those losses which arise from the ring fence trade.

3. In this appeal the Appellant ("WHUK") received a lump sum on the termination of an agreement under which it provided a crewed oil rig which it had hired from an associated company. The issue is whether that sum was one "arising from" oil contractor activities. If it did not so arise it fell outside the ring fence and WHUK's brought forward non ring fence losses could be set against it; if it did fall within the ring fence those losses could not be set against it and a tax liability arose.

The History of Part 8ZA

4. Part 8ZA was inserted in to CTA 2010 by Finance Act 2014. The Chancellor's 2013 autumn statement presaged the introduction of measures to "cap the amount deductible for intra-group leasing payments for large oil and gas assets, known as bareboat charters, and introduce a new ring fence to protect the resulting revenue." Consultations were promised. In a consultation document of 3 February 2014, the proposals were elaborated:

> "3. The use of intra-group payments by oil companies to shift profits made in connection with the UK Continental Shelf overseas, has resulted in up to 90% of profits made in the UK not being taxed here. In 2012 for example more than £1.75bn was paid by operators to contractors known to use bareboat charters as part of their tax structures…
>
> 4. Oil and gas producers are taxed at high rates on production to ensure a fair return for the nation on exploitation of the country's oil and gas assets…
>
> 11. The aim of the measure is to amend the rules so that more of the profits made by Oil contractors in the UK are subject to UK tax regardless of where the contractors are based or the assets owned…"

5. Paragraph 21 described the approach to the ring fence: activities "carried on in connection with the exploitation or exploration of the seabed and subsoil of the UK Continental Shelf and territorial sea" would fall within it and in that context:

> ""in connection with" takes its natural meaning and so includes all activities from exploration to ultimate decommissioning"

6. It was not necessary that a contractor be a licensee, only that it carried out activities in connection with someone's exploitation or exploration.

Part 8ZA

7. Section 365L provides:

> (1) The definitions in this section have effect for the purposes of this Part.

(2) "Oil contractor activities" means activities carried on by a company ("the contractor"), which are not oil-related activities (within the meaning of section 274), but are-

(a) exploration or exploitation activities in, or in connection with, which the contractor provides, operates or uses a relevant asset (see section 356LA) in a relevant offshore service, or

(b) otherwise carried on in, or in connection with, the provision by the contractor of a relevant offshore service.

(3) The contractor provides a "relevant offshore service" if the contractor provides, operates or uses a relevant asset in, or in connection with, the carrying on of exploration or exploitation activities in a relevant offshore area by the contractor or any other associated person

(4) "Exploration or exploitation activities" means activities carried on in connection with the exploration or exploitation of the seabed and subsoil and their natural resources.

(5)" Relevant offshore area" means-

(a) the territorial sea of the United Kingdom;

(b) the areas designated by Order in Council under section 1(7) of the Continental Shelf Act 1964.

8. There is no need to set out the other provisions of part 8ZA. It is sufficient for present purposes to note that the oil rig, being hired from an associate, was a relevant asset for the purpose of s356L(3), that section 356LD defines a contractor's ring fence profits as "income *arising from* oil contractor activities", and that section 356NE provides that relief against ring fence profits for a loss incurred by a contractor is allowed only "so far as the loss *arises from* oil contractor activities".

9. The Explanatory Notes to Finance Act 2014 described (in paragraph 72) the legislation as having been introduced "to cap the deduction for companies that provide drilling or accommodation services on the UK Continental Shelf and to ensure that the profits are not reduced by unrelated tax relief. The Note described the conditions in section 356L(2) as "Leg(a)" and "Leg(b)". I shall adopt the same terminology. Those Notes described Leg(a) as requiring that:

"the activities are exploration or exploitation activities which take place as part of the provision of a relevant offshore service",

and Leg(b) as concerning:

"the situation where activities are carried on alongside the provision of a relevant offshore service."

10. The Notes described, in words reminiscent of those in the consultation document, the definition in section 356L(4) of exploration or exploitation activities as requiring –

"that those services are in connection with the exploration or exploitation of the natural resources under the sea ("in connection" takes its natural meaning so as to encompass all stages of exploration and exploitation from initial searching for oil to the final decommissioning of extraction plant")."

"in connection with"

11. It will be seen that the drafting of section 356L involves a series of nested uses of "in connection with" – Mr McNall described this as a "Quadruple expansion".

12. *Barclays Bank Plc v HMRC* [2007] EWCA Civ 442 concerned a payment made to pensioners of the bank on the withdrawal of a free tax advice service. The issue was whether the payment was made "in connection with past service". Arden LJ said that the words could describe a range of links but cited Lord Hope in *Coventry Waste Ltd v Russell* where he had said that whilst treating the words as meaning "having to do with" could solve the problem of their application it did not do so in every case and the surrounding words and their context provided the best guide.

13. Armed with that approach Arden LJ considered the surrounding provisions of the legislation and concluded that Parliament was unlikely to have intended to limit connection to direct connection in the relevant piece of legislation, it being significant that the provision was not limited to payment for services. She also concluded that a payment could have a connection to more than one thing but

> "in that situation, it is in my judgement necessary to see whether the connections can coexist, or whether one will actually exclude the other.".

14. She gave an example of an employer inviting pensioners to a quiz evening with cash prizes. As far as the employer was concerned the prize was for gamesmanship. In that situation "the link with past service may be found to have been displaced. But this must be a rare case.".

15. She held that because "in connection with" was, in that legislation, wide enough to include indirect connection "it was no answer to say that the payment had been given for the loss of the free services [because] that did not prevent it from also being in connection with past service.".

16. Mr McNall says that "in connection with" are words of wide import and that while there may be some limit to their extent the quadruple use indicates a wide meaning. A connective link he says may be broken by an intervening cause but there was no such intervention relevant to the facts of the appeal. Mr Prosser says that the circumstances surrounding the termination of the agreement, and the termination of the agreement itself, broke the link.

17. The object of the legislation is to tax income from North Sea oil and gas more highly. The provisions also limit the relevant activities to those carried on by the provider of the oil rig so that it does not extend, for example, to the activities of a catering company supplying food to those on the rig, even though those activities are connected to the supply of the rig. These factors and the description in the Explanatory Notes of the width of "in connection with" in 356L(4), and its paraphrase as "part of" in relation to its use in Leg(a) and as "alongside" in relation to its use in Leg(b) suggest to me a close connection to the physical income producing activity of providing the oil rig or the exploration activity.

Findings of Fact

18. I heard oral evidence from Roderick Smith who has been Awilco's Chief operating Officer since 2010.

19. There was no dispute as to the facts. (Some of the matters below are technically conclusions of law, but there was no dispute about them).

20. WHUK is a subsidiary of Awilco Drilling Plc ("Awilco"). It was the lessee of an oil rig which it leased from an associated company which was another member of the Awilco group.

21. In August 2012 Awilco entered into a Drilling Contract with Hess Ltd. Under the contract Awilco agreed to provide the rig together with crew, stores and equipment for certain specified oilwell abandonment operations at specified sites on the UKCS[1]. The contract specified the work to be carried out by Awilco personnel (who numbered some 109) and that to be conducted by Hess personnel. Hess was to direct the programme of work.

22. The contract was initially for a period of 450 days but that was later extended so as to end on 1 December 2015. Neither party was allowed unilaterally to terminate without cause before that date.

23. Under the contract WHUK would invoice Hess monthly and Hess would pay within 30 days of invoice. The monthly invoices would be computed by reference to the rate for the activity of the rig on each day in the month. There was an Operating Rate for conducting the abandonment work and rates for taking the rig out of port, towing it between sites, standing by in inclement weather, an allowance for repairs, and a Standby rate which applied when the rig was prevented from operating because inter alia instructions were awaited from Hess. There were provisions for certain costs to be met by Hess.

24. The Standby rate was 98% of the Operating Rate and the other rates lay between 85% and 98% of the Operating Rate. There was thus, absent disasters, a minimum charge for the whole of the period of the contract.

25. The form of the contract was described as "term based", being for a fixed period at a daily rate rather than "work based", which would be broadly for a fixed payment for a specified set of tasks. A work based contract leaves the risk of the work overrunning with the contractor, a term based contract leaves that risk, and the risk of underrunning, with the oil company. The demand for rigs at any time affects the bargaining position of the parties. In 2012 the demand for rigs was relatively high and it appears that then, and at the times of the later extensions of the period of the contract, Awilco had the upper hand.

26. On 7 February 2014 Awilco entered into an agreement with WHUK expressed to be effective from 1 July 2011 under which WHUK agreed to perform all the obligations that Awilco had undertaken under the Drilling Contract and Awilco agreed to pass on to WHUK all the rights and benefits to which it was entitled under that contract.

27. Until June 2015 the rig was at sea almost full time, moving from well to well or from cluster of wells to cluster of wells. But by late 2014 Hess became aware that the decommissioning programme for which the rig had been contracted and provided would be completed well before 1 December 2015. Once the decommissioning programme had been completed Hess would remain on the hook for the charges calculated by reference to the daily Standby rate and certain other extra costs.

28. Awilco was willing to accommodate the use of the rig by Hess for purposes other than those specified in the contract and together they looked around the market for

[1] The Drilling Contract was based on a set of industry standard conditions for the provision of mobile drilling rigs. These were supplemented by Special Conditions. General condition clause 4 provided that WHUK should carry out the 'WORK'. Section IV of the Special Conditions defined the Scope of the Work. Drawings, plans and specifications were provided. Clause 2.1 provided that during the term of the contract it was planned to decommission up to 7 wells in one field and 18 in another. The work in each field was described in cl 3.1 and 3.3. Clause 4.8 provided that the contractor should operate the drilling unit and decommission (abandon) "the wells in accordance with Hess' programme". There was a right for Hess to alter the programme but not to change the wells which were the subject of the contract. Once all the wells had been decommissioned there was no further material work that WHUK could be called upon to perform.

opportunities to let or sublet the rig to another oil company for the remaining period. Potential opportunities were identified for such work, some of it on the UKCS and some elsewhere (off the Irish or African coast). None came to successful fruition.

29. The rig left the oilfields in late June 2015 and returned (I understood on Hess' instructions) to the port of Invergordon (which lies outside the area identified by section 356L(5)). Hess' staff remained on board until 20 July 2015 and thereafter the rig was staffed by AWUK personnel only. The presence and activities thereafter of the WHUK personnel ensured that the rig could be deployed in relatively short order.

30. After some negotiations between Awilco and Hess, a Termination Agreement was signed on 31 July 2015 but expressed to be with effect from 20 July 2015 (the day of the departure of the Hess personnel). Thereafter the rig remained for the rest of 2015 fully crewed and ready for deployment at Invergordon. Further opportunities for its use were investigated but again came to nought.

The Termination Agreement

31. The Termination Agreement recited that the Drilling contract was due to expire on 1 December 2015 but that all the work under the contract was complete and the rig was on standby. It described 20 July as the date on which all Hess' equipment and personnel had been removed from the rig and provided that the contract should terminate on that date. Thereafter Awilco's liability under the Drilling Contract was to be limited to taxes, indemnities, insurance, audit and such like. Hess's liability under the contract was limited to payments for uninvoiced periods completed prior to termination and the payment of the termination fee.

32. The termination fee was $379,951 multiplied by the number of days between 20 July 2015 and 1 December 2015. The figure of $379,951 was equal to the daily Standby rate of $377,300 plus an amount calculated as 50% of the fuel, port fees, crew transport and catering costs which Hess would have had to bear on top of the daily Standby rate if the contract had continued to 1 December.

Terminology

33. In the remainder of this decision, in addition to the use of Leg(a) and Leg(b) as described above, I use "deemed Exploitation" to mean exploration or exploitation activities as defined by section 356L(4) (and so as including actual exploration and exploitation), and "UKCS" to mean the area described in section 356L(5).

The Parties' Arguments

HMRC's arguments

34. Mr McNall says that the termination fee arose from oil contractor activities and so fell within the ringfence. He says that the fee was a lump sum commutation of the payments which would have arisen under the Drilling Contract and shared the nature of those payments. Those payments arose from the Drilling Contract. The Drilling Contract was entered into in connection with the oil contractor activities of WHUK, and the payments under it therefore arose from that activity.

35. He says that "arises from" is a widely drawn phrase and denoted a connection. The termination fee sprang from the oil contractor activities

36. Although the immediate source of the termination fee was the termination agreement, the real source was the Drilling Contract. The fee thus arose from the Drilling Contract. The termination agreement and the Drilling Contract were indissoluble. The Drilling Contract

was part of WHUK's oil contractor activities because it was connected with the provision of the rig.

37. Mr McNall accepts that there are limits to 'connection'. He agrees that if the rig had been towed to Irish waters, the connection to work on the UKCS would have been broken and the activities there would therefore not be oil contractor activities. But he says that in this case there was no breaking of the link.

38. Termination of the contract was an activity. It was an activity carried out in connection with the provision of the rig. It was thus an oil contractor activity and the fee arose therefrom.

WHUK's arguments

39. Mr Prosser says that while the rig was deployed in the UKCS to assist with decommissioning, WHUK was carrying on exploration or exploitation activities within 356L(4). In connection with those activities it deployed the rig (a "relevant asset") and did so in "relevant offshore activities" within Leg(a). Therefore until the end of June 2015 it was carrying on oil contractor activities and the fees it received arose therefrom.

40. But he says that once the rig was on standby and Hess' personnel had gone, WHUK was no longer carrying on deemed Exploration so its activities could not fall within Leg(a). To fall within Leg(b) the activities had to be "in connection with" the provision of a relevant offshore service within 356L(3). That required that the contractor "operates" a rig in connection with deemed Exploration. But it was not carrying out such exploration – it had finished. Thus, had the contract continued the fees receivable under it would not have arisen from oil contractor activities. If the termination fee shared the nature of the daily fees it did not arise from oil contractor activities,

41. But also the fee could not be said otherwise to arise from oil contractor activities:

(i) it was not paid for any of the activities previously carried out in decommissioning the wells;

(ii) it was paid for giving up its right to daily fees for the remaining period: giving up that right was not deemed Exploration so Leg(a) did not apply, Leg(b) did not apply since giving up those rights was not in connection with the provision of the relevant offshore service. The connection to the relevant service previously carried on was broken by the cessation of the service. The Explanatory Notes made clear that Leg(b) was intended to relate to matters "alongside" the provision of a rig: cessation was not alongside use, and

(iii) the fee arose indirectly from the undertaking to deploy the rig as Hess required; the giving of such an undertaking was not within Leg(a) (since no deemed Exploitation was carried on by giving the undertaking) or Leg(b), since by giving the undertaking WHUK as not actually carrying on an activity in connection with the provision of the rig; and had Hess kept the rig at Invergordon there would have been no oil contractor activities, and the fact that activities had been carried on in the past could not make a difference to the nature of the activity actually conducted at a later time.

Discussion

42. The Drilling Contract and the termination agreement were between Awilco and Hess. The parties did not seek to argue that their effects for WHUK were otherwise than if they had been between WHUK and Hess despite the fact that the agreement between Awilco and WHUK did not take the form of an assignment or agency agreement.

43. There was agreement that the rig was a "relevant asset" for the purposes of section 356L(2)(b) and (3) and that while conducting decommissioning the rig was located in a relevant offshore area for the purpose of 356L(5) but was not so located while at Invergordon

44. Section 356L speaks of "activities" in the plural. There was some discussion about the significance of the plural in relation to the single act of making the termination agreement or the Drilling Contract, but whereas the signing of an agreement is a single act, it seems to me that the making of that agreement, involving its negotiation, agreement and signature constituted "activities". Further, in relation to the question of whether income arises from oil contractor activities it seems to me that one is required to have regard to each and all of the oil contractor activities. Those activities may be singular events or continuous provision but so long as a particular singular activity is one of a number of oil contractor activities the fact that it is singular does not prevent income which arises from it to be said to arise from the activities of oil contracting.

45. Mr Prosser says that the expression "activities carried on" indicates a series of activities carried on over a period of time, not a single activity. But it seems to me that if a variety of activities are conducted during a period of time those activities together may properly regarded as having been carried on in that period.

46. Thus I conclude the making of the agreements is not by virtue of singularity precluded from being oil contractor activities.

47. Before turning to the source of the termination payment I should explain why I find that WHUK did conduct oil contractor activities.

48. WHUK did not conduct actual exploration or exploitation activities ("actual exploitation"). But it carried out decommissioning work in connection with previous actual exploitation by using its rig to cap old oil wells. It therefore carried out deemed exploitation activities (that is to say activities which are, by section 356L(4) treated as exploration or exploitation activities). (That decommissioning is a deemed exploitation activity was also the conclusion of the FTT in *Dunne v HMRC* [2019] UKFTT 96 in relation to similar legislation, a conclusion accepted by both parties)

49. WHUK provided a "relevant offshore service" within section 356L(3) when it operated the rig in its carrying on of the decommissioning (that is to say in the deemed exploitation activity) in the UKCS.

50. WHUK's activities were not "oil-related activities" within section 274 because they were not oil extraction or enjoyment activities. So they were Oil Contractor activities if they fell within Leg(a) or Leg(b). Leg(a) is satisfied: WHUK's activities were deemed exploitation activities in which it operated the rig in the provision of a relevant offshore service. Hence WHUK's activities on the UKCS were oil contractor activities.

51. It seems to me that there are only three activities from which, separately or together, the termination fee could have arisen:

    (1) from the making of the termination agreement,

    (2) from the making of the Drilling Contract,

    (3) from the actual activities of WHUK in operating the rig.

    In each case the questions will be: was the activity part of Oil Contractor activities, and, if so, did the fee come from it or from it and another oil contractor activity.

52. The words "arise from" do not seem to me to require that the activity from which income can be said to arise is the sole source of the income: so if the fee arose from one activity it does not preclude it also being said to arise from another. In the same way income can come from employment because it arises from duties performed albeit that it also arises from a contract of employment.

53. Whilst I have some doubt as to whether the making of the Termination Agreement was an oil contractor activity[2], it is not necessary for me to resolve that doubt because it is clear to me that the making of the Drilling Contract and the actual activities in the UKCS were oil contractor activities and that, for the reasons which follow, the termination fee arose from those activities.

54. Mr Prosser says that the making of the Drilling Contract was not oil contractor activity because:

> Leg (a): it was not deemed Exploration activity: it was too remote from the actual original exploration or exploitation to be in connection with it. It therefore did not fall within Leg(a).
>
> Leg (b): it did not fall within Leg (b) because it was not carried on in connection with the provision of the rig for deemed Exploration (decommissioning) in the UKCS:
>
> > (i) it was not an activity "carried on";
> >
> > (ii) a mere promise to provide something or the mere intended provision was not connected to actual provision: that was shown by consideration of the possibility that the rig might never have been used by Hess (and Mr Smith had related occasions in which rigs contracted for work were not in fact used); and
> >
> > (iii) it could not be regarded as "part of the process" or done "alongside" the provision of the rig and so was not connected to it.

55. In relation to Leg (a) I agree. The mere making of the contract did not have a close connection with the physical activity of actual exploration or exploitation.

56. In relation to Leg(b), I come to a different conclusion:

57. (i) in relation to "activities carried on I have concluded above that if more than one activity takes place the singularity of one of them does not prevent that one from being part of the "Activities carried on";

58. (ii) whilst I accept that if the rig had never been used in UKCS deemed Exploration, the making of the contract could not have been connected with the provision of a relevant offshore service, it seems to me that the fact that the rig *was* so deployed for the contracted use in the UKCS does mean that the contract was made in connection with that later use. It as pursuant to that contract that the use took place, and that, it seems to me, is a sufficiently close connection to the physical activity of providing the rig;

59. (ii) the making of the contract was not part of the physical process of deemed Exploration or of providing the rig for UKCS work, but it seems to me that legal arrangements for the provision of something may properly be regarded as part of the process of that provision or as taking place "alongside" it and so connected to it.

[2] Because it was too remote from the actual exploration to fall within deemed Exploration and thus into Leg(a), and in relation to Leg (b), it was not "in" the provision of the offshore service and so fell within this leg only if it was "in connection with" the providing of the rig in the UKCS, and at the time of the agreement no such service was being provided.

60. Furthermore, the term of the Drilling contract was also extended at times when the rig was actually being provided, and at the times so modified cannot have been made otherwise than in connection with the provision of the rig.

61. I thus conclude that the making of the Drilling Contract was part of oil contractor activities.

62. There is no doubt that the actual provision of the rig for the work done on the UKCS was oil contractor activities.

63. Taking the oil contractor activities of the making of the Drilling Contract and the actual offshore work together I now ask whether the termination fee arose therefrom. The fee involved WHUK giving up rights to future payments which arose from its agreement to carry on UKCS activities. Those activities could have consumed the whole of the period of the contract, but in fact they did not.

64. Although the fees payable under the contract were set by reference to daily rates, it is in my view a misdescription to regard each daily amount as being for the particular activity undertaken on a particular day. The fixed term of the contract left the risk of overrun and under run with Hess, whereas a work based contract (for specific decommissioning work) would have left the risk with WHUK. The reality was that the total of the sums payable under the contract were payable for the totality the decommissioning works (whether finished or unfinished within the contract period) and that therefore the right to the payments and the termination fee arose from the (nature of) the Drilling contract and that work.

65. The effect of the Drilling Contract was that, barring disaster, a minimum fee would be paid for making the rig available for the specified decommissioning work. That minimum was 85% of the Operating rate multiplied by 950 (the number of days the rig was to be provided for the work). Most fees were 98% of the Operating rate: the 85% rate was a remedial rate and for force majeure. On top of that base fee additional amounts were payable depending inter alia on the use to which Hess put the rig in the specified work. The bulk of the total receipt therefore was thus fixed. It was paid in monthly instalments, but whereas additions to it related to the actual use and prevailing conditions, the base fee was substantially fixed and represented the minimum amount accruing to WHUK for agreeing to provide the rig ready for such contracted work as could be fitted into the agreed period.

66. Mr Prosser says that the fee was not paid for activities already performed or as a bonus for early completion or otherwise in connection with those previous activities. It was not paid for services rendered or for keeping the rig on Standby after 30 July. It was paid simply for giving up the right to future payments under the agreement. It therefore did not have as its source the WHUK's activities in the UKCS. The fee arose from giving up a right rather than the provision of the rig,

67. But it seems to me that it seems to me perfectly possible for income to "arise from" more than one source, and although it arose from the giving up of the right to the continuing payments under the contract (or the remainder of the amount payable under the contract) it also had its source the fixed term provision of the rig for the work. Furthermore, that argument treats the contract as if the monies were paid only for work done on a particular day and ignores the facts that, by agreeing a fixed term the rig had to be available for the specified works for the whole period, and that, although the fees were calculated on a daily basis, the reason they remained payable after the works had finished was the fixed term of the Drilling Contract.

68. Mr Prosser says that the termination fee was paid for giving up the right to daily fees for the remaining period, and that right did not arise in connection with the provision of the rig, since that had ceased. But in my judgement the source of that continuing right was the agreement to make the rig available for the decommissioning activity for the whole period.

69. Mr Prosser says that the fee arose indirectly from WHUK's undertaking to deploy the rig during the remaining period as and when instructed by Hess and otherwise to keep it on standby: the giving of that undertaking he says was not within oil contractor activities.

70. Whilst I accept that the rig was not occupied in deemed Exploration activities in the remaining period, and that its actual activity after 20 July was only tenuously connected to the decommissioning activity which had been finished, the nature of the contract was to place the burden of the cost of this period on Hess as part of the overall cost of decommissioning and to give the benefit to WHUK as payment for the provision of the rig for the agreed period for the work actually undertaken. In that way the fee was part of the cost of the agreed decommissioning activity and the income arose from it.

71. Mr Prosser says that had the rig been deployed off the coast of Africa for the remaining period of the contract, the payments under the contract would not have arisen from oil contractor activities. And Mr McNall agrees that use in Africa would have broken the connection with oil contractor activities with the result that the payments would not have arisen therefrom.

72. But such deployment could only have been with WHUK's consent. WHUK may have consented and Mr Smith's evidence was that they were likely to have done so, but it is possible that they would have been able to extract some extra payment for that consent – after all they did not have to accept the risk of its being towed to Irish waters. The payments received by WHUK would have had an additional source other than the original contract and the work under it.

73. Mr Prosser also says that if Hess had given instructions for the rig to stay at Invergordon for the whole period, there would have been no provision of a relevant offshore service and the payments under the contract or on its termination could not have arisen from Oil Contractor activities because there would have been none. It cannot make a difference, he says, if the rig was actually deployed in the UKCS during part of the period and for part stayed at Invergordon.

74. This submission is based on the premise that the Drilling Contract may be split in two. But the purpose of the contract was clearly to conduct specified decommissioning works over a fixed period: it was not one contract for a period of North Sea activity and another for a period of inactivity. The submission also involves treating each daily amount as a payment only for that day's provision of the rig and not as part of a composite fee for the whole period. It is true that the amounts vary with the activity undertaken but there was a base standby rate of 98% of the decommissioning rate and a fixed period. These to my mind indicated, not a severable rate per day but a cost expressed as a rate per day but representing the price for the period of the contract.

75. I conclude therefore that the fee arose from oil contractor activities of WHUK.

76. I take some comfort in this result because it seems to me to be consistent with the intention of FA 2014 changes to tax income arising from oil production in the North Sea separately and to the maximum extent. In broad terms I would expect the payments made by Hess to be or to represent deductions in the computation of Hess' UK oil profits (or those of another oil producer if Hess was clearing up on behalf of another), and thus in

economic terms the payments transferred that oil income to WHUK. That is likely to be the case in relation both to the earlier payments and the termination payment since both are likely to have been incurred by the oil producer for the purposes of North Sea oil activity. Bringing the amount of such a deduction into charge in the hands of the recipient providing the rig is consistent with the aim of the legislation.

Conclusion

77. I dismiss the appeal

Rights to Appeal

78. 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.

CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 14 JULY 2021