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Stamp Duty Land Tax Issues in Transfers of U.K. Oil and Gas Licences

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In the past, the position on stamp duty in respect of transfers of oil and gas interests in the U.K. was complex but established. However, on December 1, 2003 U.K. stamp taxes were significantly overhauled. This article looks at the changes to the system introduced in 2003 and seeks to determine whether experience since that date has provided any answers regarding the operation of the new regime.

The new rules relating to stamp duty land tax (SDLT) described below apply to transfers of U.K. petroleum licences completing after December 1, 2003, unless the contract was entered into before July 11, 2003.

I. Stamp Duty

Under the old stamp duty regime, certain documents executed in the U.K. (or brought into the U.K. after execution) were subject to stamp duty. These included a "conveyance on sale", that is, an instrument by which any "interest in property, is…transferred to…a purchaser". This included the sale of either the legal or equitable interest in the property.[1] Documents transferring interests in both offshore and onshore petroleum licences could be caught. The potential duty ranged from 0.5 percent to 4 percent of the value of the conveyance and so on large North Sea asset acquisitions the liability to tax was potentially huge.

For many years there was no statutory requirement placed directly on either party to a transaction to pay the tax. The practical effect of not stamping a document, however, was that it would render it inadmissible evidence in court (although by custom counsel never took the point, a judge could) or, in the case of land, render it incapable of being registered at the relevant U.K. land registration authority. Thus a party ran the risk of incurring interest payment and penalties if it did not stamp a document but it was later required in court. This risk was mitigated when the document was executed outside the U.K., as until 1999 interest and penalties did not run until 30 days after the document was first brought into the U.K. Therefore, while largely a "voluntary" tax, the practice developed of executing documents offshore and keeping them offshore until they were "required" in the U.K., if at all.

Parties would often enter into a stamp duty agreement regulating the circumstances in which each party could bring the original documents into the U.K. (for example, if they needed to be produced in evidence, or if a third party, such as Her Majesty's Revenue and Customs (HMRC), insisted on seeing a duly stamped original document).

Sale and purchase agreements to transfer petroleum interests, deeds of assignment of the interests and even Joint Operating Agreements (although technically not conveying any interest in property) were executed and kept offshore. This method did not, however, benefit those transactions which involved registered land, as U.K. land registration authorities required a duly stamped transfer document in order to register the transfer of legal title.

Under the Finance Act 2003 (FA 2003), however, stamp duty was abolished in respect of most transfers, apart from, most notably, shares and marketable securities. As a result, from December 1, 2003, stamp duty is no longer chargeable on documents assigning interests in onshore or offshore petroleum licences.

Documents which have been executed and kept offshore and which do not relate to land in the U.K., can still be kept offshore. It should be noted, however, that for any such document which was executed on or after October 1, 1999, interest on the amount of unpaid stamp duty runs from the date of execution and not the date on which the document is brought into the U.K. This will then be payable if the document is brought into the U.K.

It will be relatively rare for stamp duty to have been deferred on a document which does relate to U.K. land by the offshore execution and retention method. Where this has occurred however, there is little benefit to retaining the document offshore until it is required in the U.K. as late stamping penalties (which can be as much as the unpaid duty itself) run from 30 days after the date of execution where the document was executed after July 23, 2002. Subject to this and to the likelihood of the documents being required in the U.K., previous offshore document retention arrangements and stamp duty agreements for documents should be left in place.

II. Stamp Duty Land Tax

Under FA 2003, a new stamp tax, SDLT, was introduced for chargeable transfers of U.K. land.

Unlike stamp duty, SDLT is not a tax on documents but on "land transactions", being any "acquisition" of a "chargeable interest" for consideration, other than an exempt transaction. Where a transaction is within the charge to the new SDLT, the old practice of executing and retaining documents outside the U.K. will therefore have no impact on the liability to the new tax.

A chargeable interest is acquired for these purposes not only where it is transferred or created, but also where it is

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surrendered, released or varied. Currently, in relation to non-residential land, the rates of tax are as follows:

Consideration	Rate
Up to £150,000	0 percent
£150,001 up to £250,000	1 percent
£250,001 up to £500,000	3 percent
£500,001+	4 percent

Under FA 2003, a chargeable interest includes "an estate, interest, right or power in or over land in the United Kingdom"[2], that is, land up to the boundary of the low water mark of every part of the U.K. which borders the sea. It also includes the benefit of an obligation, restriction or condition which affects the value of any such estate, interest, right or power.

As such, the application of SDLT does not extend to:

- the seabed under the U.K.'s territorial sea (ie,.the area of the seabed up to 12 nautical miles from the low water mark), also owned by the Crown represented by the Crown Estate Commissioners; or
- the U.K. continental shelf beyond.

It should be noted that "land" includes buildings or plant that are attached to that land and, in the view of HMRC, even structures with one end attached to land in the U.K. (such as jetties, piers and similar structures which go offshore) comprise part of the U.K.[3] This may lead to particular problems of valuation when interests in such facilities are to be transferred (see further "Valuation for SDLT" below).

SDLT is chargeable on any consideration given by the purchaser in money or money's worth. It is the liability of the purchaser. A purchaser must "self-assess" its liability to pay the tax by completing a SDLT return and submitting it to HMRC, together with payment of the tax, within 30 days of the earlier of completion and the substantial performance of the relevant contract.

There are specific rules for transfers between connected parties and exchanges of land. In outline, if the parties to the acquisition of a chargeable interest are "connected" (or the consideration for the acquisition consists of an issue or transfer of shares in a company with which the seller is connected), the acquisition will, generally, be deemed to take place at market value for SDLT purposes. Relief from SDLT may be available where the transfer is between companies in the same group.

A. Transfers of "Offshore Interests"

A licence of an area of seabed in the territorial sea[4] or in the U.K. North Sea Continental shelf (referred to as "offshore interests" below) is not a licence of "land in the United Kingdom" and so its acquisition will not be subject to SDLT.

However, once the field is in development, associated field facilities will be built – pipelines to the shore, jetties and onshore terminals. A sale of offshore interests will typically comprise the transfer of the seller's interest in these associated field facilities, as well as in the relevant licence and joint operating agreement (JOA) for the field.

Depending on the nature of these field facilities, SDLT will be relevant and since SDLT applies to transfers of beneficial, not just legal, interests in land, the tax may become due even when there is no requirement to register a change in the legal title. This will be relevant to transfers of interests in associated facilities, as often the legal title in these will be registered in the name of the field operator pursuant to the JOA.

For SDLT purposes, therefore, even where the relevant petroleum interest is offshore, the parties will need to consider whether any interests (freehold or leasehold) which the licence holder holds in land on which any plant or buildings are located, together with any interest in any fixtures to that land (such as terminal plant *etc*.) are going to be transferred to the purchaser.

For the facilities to be considered fixtures, or part of the land, they must be attached or "annexed" to the property. HMRC will consider the degree and purpose of the annexation and has stated in guidance that "heavy plant or machinery that is integral to a building, or plant or machinery whose removal would damage the building or land, is likely to be a fixture."[5]

Where an item is constructed or laid pursuant to an easement, it is often the case that the terms of that easement will prevent the item from being deemed to become part of the land. However, any transfer of the relevant item by the licence holder will also require the transfer of the interest in the easement. As such, the value of that easement will also need to be taken into account for calculation of the liability to the tax.

B. Transfers of "Onshore Interests"

For onshore interests, (that is, interests in a licensed area on land) it is clear that the associated infrastructure will again be relevant for SDLT purposes. However, the primary question in this regard is whether the licence itself is a chargeable interest.

In the case of land within the U.K. (and the territorial sea), the Petroleum (Production) Act 1934[6] (the 1934 Act) vested property in all petroleum, and the rights to explore and exploit it, in the Crown. An onshore licence, therefore, is the licence by the Crown in respect of its proprietary interest in the petroleum, and the exclusive privilege to explore and exploit it, in the licensed area.

Under FA 2003, a "licence to use or occupy land" is an exempt interest and is not subject to SDLT. It is open to debate whether or not an onshore licence is such a licence so that a transfer of it would not be a chargeable transaction for SDLT purposes.

If an onshore licence cannot benefit from the "licence" exemption, are there any other arguments that it otherwise falls outside the SDLT provisions as falling short of an interest in or right over land? These questions are not without doubt and are the subject of some academic debate.

1. Is the licence exemption available?

With respect to the licence exemption under FA 2003, we understand the use of "licence" in this sense to take its traditional land law meaning, that is, a personal right between the licensor and licensee which does not create any estate or interest in the property.

In light of the exclusive nature of the rights granted to the licensee under a landward petroleum licence, our view is that such licence equates to a grant of registrable proprietary rights. On this basis, the rights granted can not be considered equivalent to a "licence" as contemplated under the exemption. As a result the exemption will not be available in the circumstances. This being the case, we must turn to the definition of "chargeable interest" in order to explore possible alternative arguments for the dis-application of SDLT to such licences.

2. Is an Onshore Licence a "chargeable interest" in land?

There is a strong argument to suggest that an onshore licence creates a "chargeable interest" in land for the purposes of SDLT. While the 1934 Act does not give the Crown any interest in the land in or under which the petroleum is lying, the interest which is granted to the licensee under an onshore licence, namely the exclusive right to search, bore for and get petroleum in the licensed area, is comparable to a "*profit a prendre*", being a right to take something from land (*e.g.,* fish, wildlife, minerals etc). Under English law, a *profit a prendre* is a proprietary interest. If the analogy is correct, then SDLT will apply in relation to a transfer of an onshore licence.

We are aware that HMRC has expressed the view on at least one occasion that an onshore licence is a chargeable interest in land for SDLT purposes. It is highly likely, therefore, that where such an interest is transferred directly (rather than indirectly through a share sale of a company holding such an interest), SDLT will be payable. The value ascribed by the parties to the licence will therefore be important (see further "Valuation for SDLT" below).

In addition to the onshore licence being a chargeable interest simply because it is a right to take petroleum from the land, there is an argument that, where the licence applies to Crown land, an associated property right across contiguous land also owned by the Crown must necessarily be created; this would also attract SDLT in the event of a transfer. However, this issue is academic, since whether or not this is the case, an operator will invariably need to acquire rights in other land to begin exploration, development and production in the licensed area. If owned by the Crown, the land will be leased or licensed separately to the parties to the JOA. If not, the land may be acquired by private agreement with the landowner or through the various compulsory purchase procedures which may be available (or upon application under the Petroleum Act 1998). Any transfer of interests in an onshore development will, therefore, necessarily involve the transfer of these interests in land, attracting SDLT.

C. Valuation for SDLT[7]

The parties to an asset transfer of a chargeable interest will need to agree the valuation of that interest for completion of the transfer. While a variety of approaches to the valuation can be taken, in most acquisition situations the parties may be unwilling to spend the time and money associated with a professional valuation of the interest. In addition, in order for any such valuation to occur, the seller will need to agree to provide access to the sites and accurate plans of the extent of the interest.

As a result, the value ascribed to the interest will often be a figure agreed between the parties before completion on a common-sense commercial basis. This value will be relevant in the context of the division of the consideration set out in the Sale and Purchase Agreement, which often includes a section in respect of "Balance of Interest including Licence". However, in the context of SDLT, this approach gives rise to a number of issues, even where the parties are not connected to one another:

1. On what basis must the valuation for SDLT purposes be made?

For SDLT purposes, provided the parties are not connected and the consideration is not an issue of shares in a connected company (as previously mentioned), there is no requirement that the valuation be the "market value" of the asset; the parties are free, therefore, simply to agree the price on commercial terms. This is subject to what is said in (2) below.

2. What happens if the licence is only one of the assets being acquired by the purchaser?

Where this is the case, or where two or more chargeable interests are being acquired by the same document, the consideration must be apportioned between the assets on a "just and reasonable" basis. If the licence is being transferred together with associated infrastructure which constitutes U.K. land for SDLT purposes, separate valuations will need to be provided.

While there is no definition of a "just and reasonable apportionment", should HMRC query the amount of consideration allocated to the chargeable interest, the purchaser, as the person liable to pay the SDLT, will need to be able to justify the figures used in the contract. Arguably the best evidence that the apportionment is on a just and reasonable basis is a valuation of the chargeable interest by a qualified and independent valuer.

Even this approach may not be free from challenge, however. Given the relative novelty of SDLT and the potential revenues it can generate, there may be circumstances in which HMRC considers that a different basis of valuation should be adopted from that which the parties' valuer has used. For example, it is debatable whether the value of the oil which may be extracted under the licence should be included in the valuation.

3. What happens where valuation occurs after completion?

Where the valuation for the purposes of SDLT is finalised by the parties *after* completion, the consideration is "unascertained" and the purchaser will be liable to account for SDLT within 30 days of completion on a "reasonable estimate" of the consideration that it will be paying to the seller. If the valuation is finalised within time to enable payment of SDLT within the 30 day period, then this will be preferable. This is because where the valuation is more than the "reasonable estimate", interest will run on the unpaid additional SDLT liability from the date of completion. Where the valuation is finalised some time later, the purchaser must make a further land transaction return together with the additional SDLT payment and interest.

4. What are the consequences of not apportioning the consideration on a "just and reasonable" basis?

It is important to note that an allocation of the consideration with the sole or main object of reducing the SDLT liability is

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likely to be treated as fraud for which the directors of a company that is party to the acquisition may be held personally liable.

Even if the apportionment is not engineered so as to amount to fraud, the parties can potentially be put to significant expense and inconvenience should HMRC raise a notice of enquiry into the SDLT return, requiring the purchaser to produce evidence that the correct amount of tax has been paid. While HMRC has nine months from the date on which the return is made to raise such a query, if (a) it later discovers a fact which leads it to believe that insufficient tax has been paid, and (b) it could not reasonably have expected to be aware of that fact before, it is still able to issue a "discovery assessment" up to six years after the date of the relevant transfer. The period is significantly longer if fraud or negligence is involved.

With this in mind, it is clear that a purchaser will need to pay close attention to the question of apportionment of the consideration.

D. Mitigating the impact of SDLT

The scope of SDLT is extremely wide and, while some schemes exist which could be used to mitigate the effect of SDLT, in practice it is very difficult to avoid. Importantly, any scheme or arrangement to mitigate or avoid SDLT which involves commercial property with a market value in excess of £5 million will probably need to be disclosed to HMRC under new SDLT tax avoidance disclosure rules which have been enacted following a 2005 Budget announcement.

Although "disadvantaged areas relief" for commercial property was withdrawn by the Finance Act 2005 in relation to transactions entered into on or after March 17, 2005, other forms of SDLT relief are available under the relevant legislation which may be capable of being used depending on the circumstances. In the context of petroleum licences, however, issues regarding the territorial scope of the tax and the valuation of assets being transferred are more likely to be of relevance when considering how to mitigate any charge to SDLT.

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1 Paragraph 1, Schedule 13 to the Finance Act 1999.

2 Section 48 Finance Act 2003

3 HMRC SDLT Manual, paragraph 40 - The tax – FA03/S42

4 (technically an onshore licence under the Petroleum (Production) Act 1934)

5 HMRC SDLT Manual, paragraph 4010 - Scope: How much is chargeable?

6 Now the Petroleum Act 1998.

7 Unless otherwise stated, the comments in this section assume that the consideration is an ascertained amount of cash and its payment is not contingent on the occurrence of some future event.