



EUROPE

An M&A lifeline in the North Sea

CORPORATE / Assets that cut tax bills could be a blessing for UKCS operators looking for a bargain / Tom Jarvis and John Conlin

Deferred tax assets (DTAs)—assets on the balance sheet that can be used to reduce taxable profits—can be a valuable prize for a prospective buyer of an oil and gas company on the UK Continental Shelf (UKCS).

Oil and gas companies operating in the UKCS typically accrue substantial DTAs in their exploration, development and early producing years. This is because significant capital expenditure is normally needed for exploration and development, which can result in capital allowances—the UK tax equivalent of depreciation. This spending is generally funded, at least in part, through debt. Interest on that debt

may be deductible in calculating UK taxable profits.

DTAs can be valuable to a buyer of such a company—but the way in which debt used to fund that spending is handled as part of an acquisition can significantly impact the deal's value, for both the seller and buyer. This can lead to difficulties—and opportunities—when structuring a deal, especially where debt funding is from within a target oil company's group.

Retaining shareholder debt in the target oil and gas company in some form has several advantages. One benefit is the opportunity for cash repatriation. Oil and gas companies typically have negative

distributable reserves in their early years, which can prevent them from paying dividends—"dividend blocks".

Shareholder debt can be used to sidestep these blocks, acting as a "cash repatriation" or "debt service" route. Tax relief can also prove helpful. Interest on commercially motivated debt is typically deductible (as it accrues) in calculating taxable profits, whereas dividends are not. Shareholder debt can also help to lower stamp duty costs. UK stamp duty, a levy on a transaction, is generally charged at 0.5% on the consideration for shares in a UK company. Shareholder debt effectively suppresses a target's share value, which

