



TAXATION OFFICE
FALKLAND ISLANDS GOVERNMENT

Public Consultation Paper

**Schedule 6 - withholding taxes
for oil contractors**



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1 - Introduction and executive summary

Essential tax collection provisions exist in Schedule 6 to the Taxes Ordinance 1997 (TO1997) which are relevant to oil licensees and non-resident oil contractors engaged to work in the Falkland Islands (FI) oil industry. However, the operation of Schedule 6 TO1997 is currently administratively burdensome for the Falkland Islands Government Taxation Office (FIGTO), and collection of taxes due is often delayed by an unacceptably long period.

Improvements to the operation of Schedule 6 TO1997 are needed to reduce the time FIGTO spends administering the system and hasten the recovery of taxes due and payable by non-resident oil contractors performing activities within FI and its continental shelf.

FIGTO are working on administrative changes to improve the functionality of Schedule 6 TO1997. In addition to these administrative improvements, significant advantages could be gained from introducing a statutory withholding tax to collect monies in advance of the submission of a tax return and normal due date for payment of tax.

A statutory withholding tax would also reduce the residual liability imposed on an oil licensee by Schedule 6 TO1997. Only where the withholding is less than the tax due on the taxable profits arising from the relevant contract, and the contractor fails to pay the balance, will the oil licensee be served a 'Recovery Notice' in respect of the unpaid tax.

This consultation seeks to engage with stakeholders in order to gather views on the introduction of a withholding tax in a structured and open manner. Stakeholders' views will be used by FIG to develop policy and carry out further technical work to develop a withholding tax regime.

We hope you find this consultation process positive and productive, and that the responses we receive help us and Industry to improve the operation of Schedule 6 TO1997.

Roger Spink MLA
Portfolio Holder, Treasury & Tax

James Wilson
Financial Secretary & Commissioner of Taxation



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2 - Structure and design of the consultation

This consultation has been approved by the Executive Council of the FIG on 29th January 2020 for issue on the FIG website and for distribution through stakeholder groups based in FI and internationally through the FI Petroleum Licensees Association (FIPLA) and its member companies.

We thank both the FI Chamber of Commerce and FIPLA for their support in communicating this consultation to their members, and for the collation of their members' views on the consultation.

The consultation is open for a period of six weeks, concluding on 13th March 2020.

Ways to respond:

Email <mailto:consultations@taxation.gov.fk>

Write to Schedule 6 WHT Consultation
Falkland Islands Government Taxation Office (FIGTO)
St Mary's Walk
Stanley
Falkland Islands
FIQQ 1ZZ

Questions on this consultation can be sent to the above email contact or by calling (+500) 28470 during public office hours (9am to 12pm).



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3(a) - An overview of the current Schedule 6 TO1997 regime

The current domestic tax legislation, comprised of TO1997 and subsidiary legislation, can be found on the Statute Law Database at www.legislation.gov.fk.

Currently there is harmonisation of the rates of Income Tax and Corporation Tax (CT), at 21% and 26% respectively. There is a Payment on Account of Taxation (POAT) regime which collects the majority of Income Tax at source for employees, and a simple residency test for individuals based on days physically present within a tax year. A pay and file regime exists for companies. CT is due eight months plus a day after the end of the accounting period and the CT return and accounts are required to be filed nine months after the end of the accounting period.

Schedule 6 TO1997 makes provision with respect to the recovery of tax assessed on persons (including companies) not resident in the FI on profits or gains arising or accruing out of or in connection with hydrocarbon exploration or exploitation activities or rights. It has effect by virtue of section 185 of TO1997.

Provisions like those in Schedule 6 TO1997 have been a longstanding feature of the FI Taxes Ordinances, and formed part of the 1994 Ordinance as Schedule 2A in relation to CT. Schedule 6 TO1997 extended the scope of the prior legislation to cover the unpaid POAT liability of the employees engaged to work in FI in connection with a licensee's activities.

Non-resident contractors

Schedule 6 TO1997 works by requiring an oil licensee, upon receipt of a notice from FIGTO, to provide a return to FIGTO containing particulars of the oil licensee's transactions with non-resident supply chain contractors, so that FIGTO knows who is operating in its jurisdiction and can engage with them directly, reminding them of their filing and payment obligations under FI legislation.

For non-resident taxpayers who fail to engage with FIGTO and do not file accordingly, or who file but fail to remit the monies due within 30 days after they became due, Schedule 6 TO1997 allows FIGTO to refer the unpaid liability plus interest to the oil licensee and demand payment from the oil licensee as if it was in fact their liability.

If a 'Recovery Notice' is issued to an oil licensee under Schedule 6 TO1997, the oil licensee has 30 days to make payment of the unpaid tax specified in the notice, otherwise they theoretically risk having their licence revoked.

These provisions are important to the FIG Exchequer because of the weakness in FIGTO's ability to otherwise identify non-resident taxpayers who are taxable under TO1997, estimate their liability once they have been identified, and ensure payment is made.

Schedule 6 TO1997 is also intended to encourage oil licensees to try and procure that their contractors pay their liabilities promptly. It does so by making an oil licensee the taxpayer of last resort in the event of non-compliance by one of its non-resident contractors.

Payments of contractors' taxes are not a deductible expense for an oil licensee against its CT liability in any circumstances (whether the relevant contractor is able to pay but unwilling, or whether they simply cannot pay, which may be the case if the contractor is insolvent).



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Schedule 6 TO1997 represents a 'fiscal risk' for an oil licensee because they could be asked to pay the FI tax assessment of non-resident contractors with whom they are not connected. Such fiscal risk is intended to incentivise an oil licensee to select its contractors with due care. This reflects the fact that the oil licensee is expected to know the market well, and may have worked with the same oilfield service providers previously in other regions in which it operates, such that it is able to leverage existing business relationships to the benefit of its FI activities.

POAT obligations

Schedule 6 TO1997 extended the scope of the prior legislation to cover the unpaid POAT liability of the employees engaged to work in FI in connection with the licensee's activities. Paragraph 2(1)(b) requires an oil licensee, upon receipt of a notice from FIGTO, to provide a return to FIGTO containing particulars of the emoluments and other payments made to persons (by employers) carrying out activities within the licensee's area.

For an employer identified by a licensee (in response to a notice from FIGTO) which has failed to correctly pay amounts to FIGTO as required by the POAT regulations, Schedule 6 TO1997 allows FIGTO to refer the unpaid liability to the oil licensee and demand payment from the oil licensee as if it was in fact their liability.

If a 'Recovery Notice' is issued to an oil licensee under Schedule 6 TO1997, the oil licensee has 30 days to make payment of the unpaid tax specified in the notice, otherwise it theoretically risks forfeiting its licence.

3(b) - FIG's approach to tax

Given the size of the business community in FI and the resources available to FIGTO, FIG aspires to have a simple tax regime which is (within reason) easy to understand and comply with from a taxpayer's perspective but one that offers FIG enough protections in areas of high importance and risk.

4(a) - Withholding tax

In order to reduce the reliance placed on the Schedule 6 TO1997 regime for the recovery of taxes due and payable by non-resident oil contractors, a withholding tax regime could be introduced to capture a proportion of the consideration paid to non-resident oil contractors at the point that they are paid by the oil licensee.

Such a withholding can either be written into the tax regime via an amendment Ordinance (a 'statutory' withholding regime) or could be developed by the oil licensee within their contractual terms and conditions for operating within a region (a 'non-statutory' or 'contractual' withholding regime). It would not replace the Schedule 6 TO1997 regime, which would need to remain in place because any withholding tax collected may not fully cover the relevant contractor's tax liabilities

The following example illustrates how both models could work: an oil licensee contracts with a non-resident contractor for goods or services that are worth £100,000 (the 'Contract'). At the point that the contractor requires payment, the consideration actually paid to the contractor is some lower amount, for example £95,000. The £5,000 that has been held back by the oil licensee can then be treated in two different ways, as described at sections 4(b) and 4(c) respectively.



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4(b) - Statutory withholding tax

Under a statutory regime, the withheld amount is paid over to FIGTO and kept on account for the non-resident oil contractor until it files its CT or Income Tax (for unincorporated businesses) return.

If the statutory withholding collects more than the tax liability eventually due, the contractor would be entitled to claim a refund for the overpayment. This would be the case if, for example, the contractor's final assessed tax liability in respect of the Contract was £3,000; the contractor would be entitled to claim a refund of £2,000 (equal to the £5,000 withholding less the £3,000 tax actually due and payable). In these circumstances, FIGTO would expect the contractor to file a return as soon as possible on which they would show any overpayment.

Alternatively, if the contractor's tax liability when it submits its return and is subsequently assessed exceeds the statutory withholding, the contractor will be required to pay the residual liability. If the taxpayer is unwilling or unable to pay the residual liability, a 'Recovery Notice' may be issued under Schedule 6 TO1997 to recover the balance outstanding from the oil licensee. However, the outstanding balance for which the oil licensee is liable would be significantly less than if the statutory withholding regime did not apply. For example, if the contractor's final assessed tax liability in respect of the Contract was £7,000, there would be a residual tax liability of £2,000 (equal to £7,000 less the £5,000 withholding). Under Schedule 6 TO1997, an oil licensee could be liable for that residual liability. In the absence of the statutory withholding regime, the oil licensee could be liable for the entire £7,000.

Statutory interest is charged on taxes paid after their due date at a rate of 3% per annum above Standard Chartered Bank (FI) base lending. Section 187 TO1997 provides for the payment of interest on CT refunds. However, this section only applies in certain circumstances and it is proposed that it will not apply to CT refunds which arise by virtue of statutory withholding tax.

A statutory withholding regime would not be very flexible, as a single withholding rate must be used. The application of a single withholding rate would simplify the withholding regime, but is likely to result in a mixture of under and over collections of tax, depending on the profits profile of the contractor concerned.

To introduce a statutory withholding regime, new legislation would need to be enacted. This would take the form of an Amendment Bill to the Taxes Ordinance, and would set out which taxpayers would be subject to the statutory withholding. The new legislation would also govern the calculation of interest between payment 'tax point' and the liability as assessed through the existing pay and file self-assessment regime which will remain in place.

4(c) - Contractual withholding

A withholding regime could also be introduced by the oil licensee itself, without the need for new legislation to be enacted. The oil licensee could operate a withholding regime by introducing the necessary provisions into the contractual terms and conditions on which they engage contractors in FI.

An advantage of a contractual regime would be that the oil licensee would be able to set different rates of withholding depending on its knowledge of the likely margins of profitability of the relevant contractors, and of other factors (for example the contractor's risk profile). If the oil licensee is able to set the rate of withholding accurately, it could result in withholdings from contractors being more closely matched with contractors' final assessed tax liabilities. This could lower the frequency of CT refunds, by reducing the number of instances where withholding exceeds the tax liability eventually due. It could also decrease the quantum of any residual liability for which the oil licensee might become liable under Schedule 6 TO1997, by reducing the number of cases where withholding is substantially less than the tax liability eventually due.



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Receipts would not be accelerated to FIG, except where the contractual withholding is higher than the assessed liability. In these circumstances, the contractor would want to file a return and pay the tax due in order to recover any excess withholding they have suffered from the oil licensee. This would create an additional administrative burden for FIG because FIG would need to provide statements to the oil licensee evidencing that the contractor had settled its tax liabilities for particular accounting periods.

No legislation would be required to implement a contractual withholding regime. The obligation for the withholding would not be attributable to FIG. Contractors would have to pay their actual tax liabilities up front and then reclaim any excess withholding from the oil licensee at the end of the accounting period.

There is nothing precluding the oil licensee from introducing a contractual withholding regime on contractors over and above any statutory regime that is introduced, especially where the licensee expects there to be a significant shortfall between the statutory withholding and its tax exposure should a Recovery Notice be served on it under Schedule 6 TO1997.

4(d) - Some further issues in considering the application of a withholding tax regime

How would the statutory withholding tax regime apply to POAT?

Recovery Notices issued under Schedule 6 TO1997 apply to liabilities under POAT as well as liabilities for CT (or more rarely, liabilities for Income Tax for unincorporated businesses). See also section 3(a).

In some cases the majority of a business's tax liability (or the only liability, if the business is either in a loss position based on adjusted business profits chargeable to FI taxation, or if it is not taxable on its business activities at all) is for POAT.

Whether POAT liabilities arising from the workforce deployed to FI should fall within the scope of the statutory withholding tax is being explored. FIGTO proposes that, where it needs to make repayments to a non-resident oil contractor because the withholding collected in respect of that contractor exceeds the contractor's tax liability based on assessed profits, instead of being repaid to the contractor, the excess withholding can be offset against the contractor's unpaid POAT liability (if any). Using excess statutory withholding tax to satisfy other tax liabilities due to FIGTO would allow a statutory withholding tax regime to be administered efficiently. It would be unreasonable and administratively burdensome for FIGTO to repay any excess withholding to a non-resident oil contractor only to have to seek recovery from the contractor or the oil licensee in respect the contractor's POAT liabilities.

Will the statutory withholding tax apply to non-cash consideration?

FIGTO proposes that the statutory withholding tax applies to all consideration paid to a non-resident oil contractor, regardless of whether it is paid in cash, non-cash or a mixture of cash and non-cash consideration. This is much more likely to be the basis on which profits are accounted for under accruals accounting, and means that the withholding is more likely to be at an appropriate level for the debt to be materially covered.



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How will the statutory withholding tax apply to non-resident contractors that do not have a taxable presence within FI?

Not all non-resident oil contractors will have a taxable presence in FI or on the continental shelf. This may be the case if a contractor's activities are insufficiently related to petroleum exploration and extraction activities conducted in FI for there to be a FI tax charge on any resulting profits.

Under the statutory withholding tax regime, the oil licensee will have an incentive to apply the withholding to all non-resident oil contractors who have taxable profits in the region, and will have a good sense of what each contractor is doing on its behalf. For this reason, FIGTO proposes that a statutory withholding tax is introduced and that the oil licensee applies it to all non-resident oil contractors which provide it with goods and/or services that are likely to be taxable in FI. However, the oil licensee will not be under any obligation to apply the statutory withholding tax to contractors who it knows do not have a taxable presence in FI. The ultimate responsibility for operating the withholding tax, returning information about the monies withheld and remitting funds in a timely manner to FIGTO, would be placed upon the oil licensee.

The oil licensee, on an amended Schedule 6 TO1997 return, can disclose whether the statutory withholding tax has been applied and if so, how much it has collected and remitted to FIGTO in respect of each of its non-resident oil contractors. Using this information, FIGTO will be able to see which contractors the oil licensee does not consider to have a taxable presence in FI (being those contractors in respect of which the oil licensee has not applied the withholding tax). Where FIGTO disagrees with the oil licensee's assessment, it may take remedial action where needed to instruct future payments to certain non-resident oil contractors to be made subject to the withholding tax.

Should it apply to FI resident oil contractors?

Currently returns filed pursuant to Schedule 6 TO1997 must include details of payments to persons not resident in FI. However, if a statutory withholding tax is introduced that applies only to persons not resident in FI, contractors might seek to avoid the tax by operating through FI resident companies (but still not complying with their FI tax obligations). To reduce this risk, it may be necessary for the statutory withholding tax to apply equally to FI resident and non-FI resident oil contractors. The withholding tax could be accompanied by an exemption application process, whereby FI residents with a history of compliance with their FI tax obligations would be entitled to apply for an exemption from the withholding tax. FIGTO could approve such applications if satisfied that the applicant contractor has a sufficiently good history of tax compliance.

What will the rate of withholding be?

The FI ring fence rate of CT is 26%. For contractors who do not engage with FIGTO under the current operation of Schedule 6 TO1997, and so provide FIGTO with no or little information about their tax affairs, FIGTO may raise an estimated assessment. In these circumstances, FIGTO assumes a chargeable profit using information from the Schedule 6 TO1997 return provided by the oil licensee.

For some contractors, the estimated assessment will be insufficient to cover their full CT liability because their margin will be higher, but for others it will result in CT being overpaid. If the withholding is designed to cover only the CT liability of the contractor, then it is recommended that a rate of 5%, of the gross payment made to the Contractor, is used.

However, there may be grounds for using a higher percentage, especially if it is intended to contribute towards the contractor's POAT liability as well.



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What is the deadline for the submission of a return under Schedule 6 TO1997?

In practice, FIGTO requires returns to be filed pursuant to Schedule 6 TO1997 each quarter (1 January to 31 March, 1 April to 30 June, 1 July to 30 September and 1 October to 31 December). FIGTO customarily requires oil licensees to complete and submit a return within 45 days of receiving a notice under Schedule 6 TO1997. Returns can be submitted by email, and with the now widespread use of email and reduced reliance on the postal system, the deadline set by FIGTO for the submission of returns could reasonably be reduced and electronic returns introduced. However, currently FIGTO cannot prescribe a time limit for the submission of a return of less than 30 days. A decrease to the minimum time limit of 30 days is being considered.

What penalties are imposed for the late filing of, or presence of inaccuracies in, a return under Schedule 6 TO1997

Penalty provisions exist under Schedule 6 TO1997 for any failure to submit a return and/or for late submission of a return. For non-compliance, currently the maximum fine is £17,500 on conviction. For returns submitted late, an initial penalty of £250 is charged, with an additional £250 penalty charged in respect of each successive period of 15 days that elapses before the return is provided. Penalties for late submission will accrue regardless of whether the relevant oil licensee is charged with an offence for non-compliance.

During the last period of oil activity there were several cases where the information provided in a return submitted pursuant to Schedule 6 TO1997 was incorrect. For example, returns included the wrong company name or stated an incorrect location in respect of where a contractor performed services. Often such inaccuracies are only discovered after FIGTO resources have been spent contacting the relevant contractor, working with them, re-contacting the oil licensee and waiting for the oil licensee to check and confirm the information provided in the return. An oil licensee who submits an incorrect return without reasonable excuse is liable on conviction to a fine currently not exceeding £17,500.

When will withholding tax be due?

If a statutory withholding tax regime is introduced, it will prescribe a payment due date. Like with other types of tax payments, interest charges and penalties for late payment will need to be considered. For administrative ease for both FIGTO and the oil licensee, it would be logical for the withholding tax payment due date to be the same as the submission due date for the relevant quarterly return submitted under Schedule 6 TO1997.

5 - Conclusions and next steps

In launching a public consultation, FIG hopes that a thoughtful and considered engagement with stakeholders can take place in a way that delivers meaningful and useful policy debate on issues of material importance to the FIG Exchequer, the FI economy and the oil industry in the region.

Transparency and openness are key features of a modern democracy and public administration. Therefore it is useful to set out next steps for after the closing of the consultation.

All responses received on or before 13th March 2020 will be thoroughly considered by FIG Officers, and summarised for Members of the Legislative Assembly. Based on policy decisions made by the Assembly and Executive Council, it is planned that legislative amendments and guidance for the introduction of a statutory withholding tax will be developed for enactment and implementation during 2020.



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Appendix 1 - List of consultation questions

Q.1) As a matter of policy, do you support the introduction of a statutory withholding tax regime in this context? Please explain the reasons for your answer.

Q.2) Do you consider that withholding tax should be a commercial matter (i.e. implemented contractually rather than through a statutory regime)? Please explain the reasons for your answer.

Q.3) Do you agree that any statutory withholding tax should encompass the POAT liability arising from the workforce deployed to FI?

Q.4) What are your views on a statutory withholding tax applying to all consideration regardless of whether it is cash, non-cash or a mixture of cash and non-cash?

Q.5) Do you agree that the ultimate responsibility for operating a statutory withholding tax, returning information about the monies withheld and remitting funds in a timely manner to FIGTO should be placed upon the oil licensee? Please explain the reasons for your answer.

Q.6) Do you agree that, if a statutory withholding tax is introduced, the oil licensee should not be required to apply it to contractors who it knows do not have a taxable FI presence? Please explain the reasons for your answer.

Q.7) Should a statutory withholding tax (and therefore the reporting of payments) be extended to FI resident companies? Please explain the reasons for your answer.

Q.8) If statutory withholding tax is applied to FI resident companies, do you agree there should be an exemption available to FI resident companies with a history of tax compliance? Please explain the reasons for your answer.

Q.9) What are your views on a withholding rate of 5% to cover CT only? Please provide supporting evidence for your views.

Q.10) What are your views on increasing the proposed withholding rate to 7%, to encompass any POAT liabilities in addition to CT? Please provide supporting evidence for your views.

Q.11) What are your views on decreasing the minimum time limit which FIGTO may prescribe to an oil licensee for submitting a return under Schedule 6 TO1997 from 30 days to 14 days?



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Q.12) What are your views on the due date for payment of the withholding tax being the same as the deadline for submission of the relevant Schedule 6 TO1997 return (noting that it is proposed to reduce the minimum time limit which FIGTO may prescribe for submitting a return to 14 days)?

Q.13) What are your views on the introduction of a statutory regime for electronic submission of Schedule 6 TO1997 returns?

Q.14) What are your views on increasing the automatic penalty for the late filing of a Schedule 6 TO1997 return from £250 to £1,000 for both the initial delay and each successive 15 day period that the information remains outstanding?

Q.15) Do you have any other comments on the introduction of a withholding regime?