

The Transparency Initiative: Are You Ready? Are you a UK company that operates in an EXTRACTIVE INDUSTRY?

Friday, October 31, 2014

Are you a UK company that operates in an EXTRACTIVE INDUSTRY?

If so, do any 2 of the following apply to you:

- You have a balance sheet in excess of £18 million;
- You have net turnover of over £36 million; or
- You have more than 250 employees

If so, do you make annual payments to any Government of over £86,000?

If the answer to the above is YES, then from 1 January 2015 you will most likely be required to comply with the UK's new Transparency Initiative Regulations.

Introduction The UK is set to become the first EU member state to transpose the most recent EU directives on accounting and transparency rules in an effort to satisfy growing demands for a European-wide strategy to fight corruption in relation to substantial payments that oil and gas companies are often required to make to **government entities by way of signing bonuses, taxes or royalties.**

The UK has kick-started with **Directive 2013/34/EU (the "EU Accounting Directive")** which, among other things, provides in its Chapter 10 for new reporting obligations for certain types of companies. By doing so, **UK registered companies operating in extractive industries such as oil, gas and mining** will be required to disclose certain payments made to governments in the various countries they operate in, on a country-by-country or project-by-project basis. The draft UK regulations, referred to as "The Reports on Payments to Governments Regulations 2014", have not yet been passed by Parliament, however are proposed to come into force on 1 December 2014, more than 7 months ahead of the deadline imposed by the EU Accounting Directive.

Additionally, companies that are not incorporated anywhere in the EU but are listed in the UK can expect similar rules from the Financial Conduct Authority as a result of its early implementation of Directive 2013/50/EU (the EU Transparency Directive).

Similar rules already exist in the US, according to which companies engaged in the commercial development of oil, natural gas or minerals are required to disclose payments made to the U.S. federal government and all foreign governments.

Applicability The draft regulations provide that the directors of "**large undertakings**" or "**public interest entities**", in either case, which are incorporated in the UK and involved in extractive industries (which includes, the extraction of crude petroleum and natural gas) are required to disclose on an annual basis any single or series of related payments over £86,000 which have been made to any government. The reporting obligation comes into force for the financial year commencing on or after 1 January 2015 and companies have 11 months from the end of their financial reporting year to prepare and submit the report. This is not applicable, however, to UK subsidiaries of parent companies which are obliged to report under the laws of another EU member state, in which case these requirements are only applicable to the financial year commencing on or after 1 January 2016.

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Article By [Bracewell LLP Energy Legal Blog](#)
[Ben James](#)

[Environmental, Energy & Resources](#)
[United Kingdom](#)

A “large undertaking” is defined as an entity which meets any two of the following three criteria:

- total balance sheet in excess of £18 million;
- net turnover in excess of £36 million; and
- average number of employees in excess of 250.

A “public interest entity” includes entities listed on a regulated market in any EU member state, credit institutions, insurance undertakings and entities designated as public interest entities.

If any undertaking referred to above is a parent undertaking that is obliged to prepare consolidated group accounts, the relevant directors must prepare a consolidated annual report (see below under Disclosure Required) to satisfy the disclosure obligation required of that undertaking. We note that in this case, a parent undertaking will be considered a company involved in the extractive industry if its subsidiary is a company involved in the extractive industry.

Payments to be Disclosed Only payments, whether in cash or in kind, related to the relevant activities covered by the draft regulations (i.e. those involving the exploration, prospection, discovery, development and extraction of minerals, oil, natural gas deposits and other materials), are included in the definition of payments to governments that must be disclosed.

The list of the various categories of payments that are caught by the draft regulations is exhaustive and provides as follows:

- production entitlements;
- taxes on income, production or profits (excluding VAT, personal income tax or sales tax);
- royalties;
- dividends (other than ordinary course payments), provided these are paid to the government on the same terms as to other shareholders and not in lieu of production entitlements or royalties;
- signature, discovery and production bonuses;
- licence, rental and other fees and considerations for licenses or concessions; and
- payments for infrastructure improvements.

Disclosure Required The disclosure must be made to Companies House in the form of an annual report with the following information:

- the government and country to which the payment has been made and total amount paid; and
- total amount per type of payment made to each government.

In the case of a consolidated annual report, the relevant information listed above must be included for the parent undertaking and any subsidiary undertaking included in the consolidated group accounts of that parent undertaking. However, certain payments of subsidiary undertakings may be excluded from the consolidated report, as is the case when the relevant information cannot be obtained without disproportionate expense or undue delay or when subsidiaries are held exclusively with a view to subsequent disposal.

Payments must be listed on a project-by-project basis or at an entity level if the payment obligations are imposed upon a particular project or entity, respectively. In either case, the draft regulations emphasise that the disclosure must reflect the substance of the payments, rather than the form.

The concept of government is also very broadly defined in the draft legislation to include national, regional or local government authorities and their departments, agencies and subsidiary undertakings.

Exemptions An exemption from the reporting obligations provided under the draft regulations applies if a company or its parent is subject to equivalent reporting requirements (i.e. from another country as determined by the European Commission from time to time), which include the payments made to governments, although we note that the information contained in such equivalent report must be delivered to the UK registrar.

Furthermore, directors of a parent undertaking will not be required to prepare a consolidated report if:

- the group meets any two of the following three criteria: (i) total balance sheet under £21.6 million; (ii) net turnover under £43.2 million; and (iii) average number of employees less than 250 (unless any group member is a public interest entity); or
- a parent undertaking under the draft regulations has itself a parent undertaking that is governed by the law of an EU member state other than the UK (i.e. a holding company will not have to report in the UK if its parent company is obliged to report elsewhere in the EU).

We note however, that this does not exempt the relevant director from having to disclose payments of the relevant parent undertaking, only that such disclosure does not have to be on a consolidated basis for the group.

Penalties Directors will be subject to criminal liability for not complying with these disclosure requirements, which may be punishable with unlimited fines or potential jail terms.

EU entities Every EU member state country will be required to introduce similar legislation at the latest by 20 July 2015.

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