



Briefing: Product Transfers in the Downstream Oil Industry

- Oil companies transfer crude oil and oil products between different business units both within the UK and throughout the world
- Economically efficient global markets in crude oils and oil products exist
- Integrated oil companies are required by UK law and OECD guidance to use arm's length, market-related transfer prices between affiliates
- The UK oil industry currently contributes £40bn in duty and taxes. Hence, authorities are keen to ensure that these are validated on a proper basis

Oil Industry Structure

The oil industry supply chain involves exploration, oil production, transportation, refining, product distribution to terminals and marketing. Although the largest oil companies may operate throughout the whole chain most oil companies in the UK are active only in parts of the chain. For example, upstream companies may be active only in exploration and production of crude oil. Additionally, as supermarkets have demonstrated, there is no need to own a refinery to market oil products. The trend in the sector is probably towards specialisation in areas of the supply chain rather than integration, as can be seen by recent divestment of one oil majors UK refining operations and moves by others to concentrate on refining/wholesaling by withdrawing from retail and commercial sales.

Nature of Oil Markets

Efficient and transparent oil markets benefit the consumer by facilitating this specialisation and increased competition. Oil products themselves must meet pan-European standards set out by EU law. Prices of benchmark crude oils and oil products are quoted daily by the press and by independent specialist trading services. Oil is easily shipped and stored, and barriers to imports from the EU and beyond are low. There are therefore many third party shippers and storage

companies, as well as speculative traders, which is a testament to the transparency of the markets.

Basis for Product Transfers

UK tax law (Schedule 28AA of the Income and Corporation Taxes Act 1988) requires that goods be transferred between affiliated companies at prices that would have been obtained by a third party, and that the OECD guidelines in this area are followed. The oil markets provide an excellent point of reference for observing these laws in action. Furthermore, UK companies are required to maintain documentation showing how the arm's length price had been derived for possible audit.

Enforcement

The UK oil industry contributes over £40bn pa in taxes to the Exchequer, of which £25bn is collected as duty from road fuels on its behalf (Fig.1). UK tax authorities therefore carefully police all aspects of product transfers through the UK supply chain. In addition, UK tax legislation has imposed a "ring-fence" around North Sea production, requiring upstream oil industry profits to be separately identified and taxed at higher rates than other UK business.

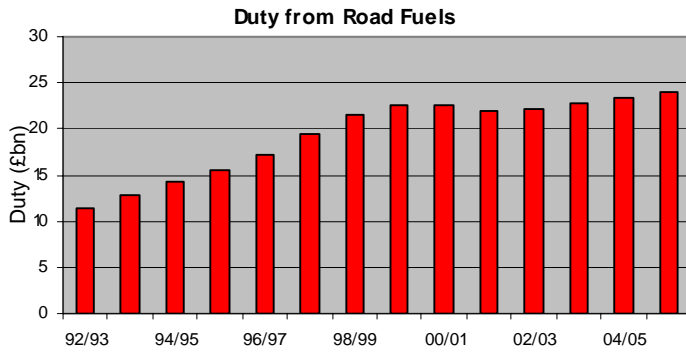


Figure 1: Duty from road fuels

This is the context that UKPIA members transfer crude oil and oil products between related affiliates both within the UK and globally, and measure and report the profitability of their refining and marketing businesses in the UK.

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