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ARMAND HAMMER
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

14th January, 1981.

The Rt. Hon. Mrs. Margaret Thatcher, M.P.
Prime Minister and First Lord of the
Treasury,
10 Downing Street,
London, SW1.

Dear Mrs. Thatcher,

After our meeting on Flotta and the exchange of correspondence about the taxation of oil revenues, I feel you will not mind if I draw your attention to some effects of the proposed supplementary petroleum tax (SPT).

The industry is concerned with the affect the new tax may have on the level of investment in the North Sea. The tax is ineligible for foreign tax credit in the United States of America, as it is a supplementary tax not based on net income and not covered by the UK/US tax treaty. In fact this SPT will reduce the amount of taxes that at present can be credited in the USA as a foreign tax credit because by reducing the total profit of the oil company a lesser sum will be paid for petroleum revenue tax and corporation tax both of which are creditable taxes under the tax treaty.

We understand a number of oil companies are reconsidering projects already approved because of this tax, projects which if cancelled would delay the development of the North Sea and the regeneration of British Industry. We appreciate that the funds are needed by the Government and, therefore, we would like to propose some practicable alternatives which we believe would bring in a similar amount of revenue to the Government without the drastic effects which we believe the new tax may cause.

I am enclosing a copy of our letter to Sir Geoffrey Howe embodying our suggested measures.

Sincerely yours,

Armand Hammer

Armand Hammer.

P.S. I look forward very much to seeing you at 6.00 p.m. on Thursday, February 5th.

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J. Doug Ratcliffe
Chairman and Chief Executive Officer

January 15, 1981

The Rt Hon Sir Geoffrey Howe MP
Chancellor of the Exchequer
House of Commons
London S W 1

Dear Chancellor

Subject : Proposed UK Continental Shelf Tax Changes

I am writing to record with you Occidental's concerns in respect of the above arising from the statement you made in the House on November 24 last. We believe that the introduction of a new Supplementary Petroleum Tax based on gross revenue rather than profit would constitute a critical deviation from normally accepted petroleum tax principles throughout the Western World.

The UKCS Supplementary Petroleum Tax would become a fourth tier of taxation (after Petroleum Revenue Tax, Corporation Tax and Royalties) and while recognising your need to raise additional revenue, I would urge you to consider it as a temporary measure and to contain it within the existing tax structure. A further concern on a permanent SPT being introduced is that it must lead to further investment uncertainty and would lend itself to regulation by succeeding Administrations whenever there was a need for additional and immediate increase in revenue.

I am therefore setting out below our comments on SPT and PRT reliefs. We feel that Occidental is well qualified to comment on these measures, since we have more experience than any other company, except possibly BP, of the current operation of the Oil Taxation Act, due to the fact that we are at present the second largest PRT payer in the North Sea.

1. Proposed Supplementary Petroleum Tax

To satisfy the requirement for short-term revenue we suggest that for 1981 you introduce an Advance Petroleum Tax equal to £2 per barrel of gross

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production less an allowance of 20,000 barrels per day for each field. This tax would be paid monthly during 1981 and would be designated as advances of PRT or CT creditable against those tax liabilities otherwise due in following years. This measure would generate the £1,000 million which is to be raised by the proposed Supplementary Petroleum Tax. For future years, the Government stands to gain substantially from PRT and CT as a result of increased prices for oil. The incremental Government take is 87.4 per cent including royalty, PRT and CT.

We feel that one of the greatest virtues of this suggestion from the Government's point of view is that it would increase the number of companies paying PRT in 1981, but for that reason it will not be supported by all companies.

If it is felt that Government take must ultimately be increased, we would rather see an increase in PRT, say to 75%, bringing the new Government take to 89.5%. Patrick Jenkin, when Opposition energy spokesman, said to the Commons in November 1974 that 'a flat rate prior charge tax is the wrong weapon'. He advocated a variable excess profits tax levied on profits above a given standard. We agreed with that policy at the time and nothing has happened to change our mind.

2. <u>Changes to PRT Reliefs</u>

We would be prepared to forego uplift on all discoveries after January 1, 1981. At present the industry is allowed uplift of 35% on certain development expenditures, in lieu of interest, as a deduction from PRT. The industry should instead be permitted to deduct for PRT purposes, actual third party interest charges on development capital. This will spread the interest relief over a period of years and will eliminate the 'contractor financing' problem. Development capital would be the initial capital costs of new fields or new satellite developments, etc. As an alternative provision if deduction of interest is unacceptable, uplift should remain at 35% but should be spread over a five-year period and the definition of upliftable expenditure could be tightened.

The oil allowance, designed to give particular assistance to the smaller fields, exempts from PRT the value of the first one-half million tonnes in

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any one year up to a cumulative maximum of five million tonnes. Safeguard basically provides that if adjusted profits in any one year are less than 30% of accumulated capital expenditure to that date then the PRT charge is reduced to zero. Since it is proposed that Oil Allowance should be changed, it becomes even more important that safeguard should be retained for existing fields. Tightening the definition of development capital as indicated above will in any case provide some restriction. For new fields discovered after January 1, 1981, the safeguard taper rate could be increased to 90%. The present tapering provision sets a ceiling whereby the PRT charge for any year must not exceed 80% of the amount by which the adjusted profit for the year exceeds 30% of the accumulated capital expenditure to date.

We strongly believe that the combination of the new Supplementary Petroleum Tax (SPT) and the more radical of the proposed PRT relief changes could have an adverse effect upon developments in the North Sea, and the following are some examples :

- The economics of any field with a lengthy development programme will be severely impaired by the 'front-ending' of tax liability imposed by SPT.

- SPT acts effectively as a large (around 10%) increase in Royalty, and although it would clearly only be one of the factors taken into account, it will serve to render any marginal field even less attractive than before to a potential developer. At this stage of North Sea development we are forced to search for smaller accumulations of oil and SPT will therefore have a discouraging effect upon enthusiasm for exploration, which would not necessarily be the result of changing the rate of PRT or advancing it. For US companies SPT would not be a creditable tax for foreign tax credit purposes and it will also reduce PRT and CT which are creditable taxes under the US/UK Treaty.

- The proposed changes to PRT relief, especially those on uplift and safeguard, will destroy the economics of some satellite developments, and these projects offer, at least in the short term, the best prospects for British industry involvement. As we told representatives of the Inland Revenue in December 1980, our own Claymore Field Extension project is not economic if uplift is abolished (or a cut-off date is introduced) and safeguard is abolished.

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In addition to the loss of economic activity, there would of course be a total loss of tax revenue to the extent that such crude oil reserves were not produced.

- Any major projects such as the gas gathering system, planned for the North Sea, need to be funded from the companies' internal resources. The chances of such projects going ahead will be directly affected by any measures which reduce the funds available.

We are so concerned at the prospects we envisage that I felt I should bring the above to your personal attention in the hope that our suggestions might be given serious consideration.

Sincerely yours

J D Ratcliffe
Chairman and
Chief Executive Officer

copies : The Rt Hon David Howell MP
Secretary of State for Energy

The Rt Hon Sir Keith Joseph MP
Secretary of State for Industry

bcc : The Rt Hon Margaret Thatcher MP
Prime Minister and First Lord of the Treasury

Mr Philip Shelbourne
Chairman
The British National Oil Corporation

Mr Ian MacGregor
Chairman
The British Steel Corporation

Mr Robert Atkinson
Chairman
British Shipbuilders