SECRET

Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

Prime Minister

Agree to the compromise proposal at X?

MES 12/9

PRIME MINISTER

Yes

BP's PROPOSED SALE OF FORTIES' INTEREST

with MES?

I have seen the minute Peter Walker wrote you on 9 September following the advice he had received from the Attorney General. In view of the risk of lengthy and contentious litigation, I agree that it would be unwise to try a blanket ban on assignments of licences, even if we had a good chance of ultimate success. This means we must take fiscal action to reduce the tax cost.

2. As I said in my own minute of 9 September, we cannot stop all the tax cost but we can reduce the PRT component (which is much larger than the corporation tax component) by curtailing the scope for companies to set exploration and appraisal expenditure against PRT on field interests which they have bought. The only way in which we could guarantee elimination of the PRT cost would be to stop companies from claiming not just past expenditure against a purchased interest but also future expenditure as well. This would, however, be difficult to defend. We would effectively be saying to companies which had not been fortunate enough to discover a PRT paying field that they could not benefit from the generous incentives to exploration and appraisal which we introduced in last year's Budget, while companies like BP can get full relief for their expenditure. And we should be departing from the corporation tax position where, if one company buys up another, although it cannot set the purchased company's past losses against its own profits, it can set off future losses. I suspect we could have difficulty in sustaining such a tough line with our

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supporters in the House and we should get the worst of all worlds if we announced tax measures now which adversely affected the BP share sale and then could not carry them through in the House.

3. I therefore agree with Peter that we should follow the corporation tax precedent and withdraw relief for exploration and appraisal expenditure incurred before the date of purchase of an interest in a mature field. This means there will still be a tax cost to the BP sale, probably amounting to between £100 million and £300 million over the next five years depending on how much current drilling there is and how easy it is for BP to find purchasers who can precisely match their drilling expenditure to cover Forties' income. But, because companies would have to incur new expenditure, the measure should lead to some extra activity in the North Sea. And it would greatly restrict the scope for other companies to follow BP's example with new and costly deals, since the substantial overhang of past reliefs would be effectively neutralised. I do not foresee difficulty in defending this line and it should not disrupt the share sale.

4. Provided you are content with this approach, I aim to make a statement on the tax change tomorrow or Wednesday in parallel with a statement by Peter Walker removing the uncertainty about whether he will approve the assignments. On this basis it should still be possible to go ahead with the BP share sale next week.

5. I am copying this to the Secretary of State for Energy, the Attorney General and the Lord Advocate.

NL

AP.

(N.L.)

(Approved by the Chancellor)

12 September 1983

Econ Pol,
Public Sector
Assets, Pt 7