



Prime Minister ^② / D

This looks acceptable. The undertaking on incremental projects will be welcomed - last year's Budget tackled smaller separate fields.

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PRIME MINISTER

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NORTH SEA FISCAL REGIME

I promised last week that I would let you have details of my Budget proposals for the North Sea fiscal regime, once I had discussed them with Peter Walker.

2. As in previous years, officials of the Treasury, Inland Revenue and Department of Energy have carried out a detailed analysis of UKCS oil and gas projects. In the light of this, I have concluded that, overall, the present fiscal regime is about right. The renewed interest shown in North Sea projects since the last Budget seems to bear out this judgement. In a later year we may need to look again at the taxation of Southern Basin gas fields but I propose no change in this area now.

3. I do intend to announce certain changes directed at reducing the tax incentives for the sale of licence interests (so called "farmouts") of which BP's disposal of part of its interest in the Forties field provides a recent example. My proposals are quite modest and should have no adverse impact on deals that have a genuine commercial motivation rather than tax avoidance. The measures I propose are:

- (i) removing a loophole which lets out of charge to capital gains tax gains by non-residents on tangible assets used in the North Sea. This is a clear anomaly;
- (ii) bringing capital gains tax on farmouts within the corporation tax ring-fence; and
- (iii) limiting the buyer's capital allowances for plant and machinery in a farmout to the seller's original cost.

BUDGET SECRET



4. I have also examined the implications for North Sea developments of my wider proposals on corporation tax. North Sea companies will gain substantially from these, particularly the existing fields. As I see no reason to relax the present fiscal regime in the North Sea, this implies that these gains should be at least partially offset. I do not want to raise the rate of PRT. Instead I intend to stop the repayment of ACT which is presently allowed when corporation tax liabilities are reduced as a result of PRT deductions. This measure should not affect development. It goes a considerable way to offsetting the gains in the North Sea from the wider corporation tax package, but a net benefit will remain.

5. Taken together these proposals will, on our latest forecasts, reduce Exchequer revenue from the North Sea by on average about £55 million a year over the next five years. The marginal rate of take on existing fields will fall from 89.5 per cent to 85.8 per cent, and on future fields (which are not liable to royalty) from 88 per cent to 83.75 per cent.

6. This leaves the problem of incremental projects in existing fields which have an important role to play in the full exploitation of the UKCS. The industry has expressed concern for some time about the impact of the present fiscal regime on such projects and the general corporation tax package will exacerbate their relative disadvantage. I believe we must give some concessions in this area, but we shall need to consult with the industry in order to identify the best options. We cannot open discussions before the Budget and so have no hope of completing consultation in time for this year's Finance Bill.

7. However, I shall be announcing in the Budget my plans for consultation with the industry and shall give an undertaking to legislate next year to improve the position of incrementals. To guard against the risk that this approach could lead to projects being deferred, I will make plain that concessions will be backdated to this year.

8. I have discussed my proposals with Peter Walker, to whom I am sending a copy of this minute. He is content.

A handwritten signature in blue ink, appearing to be 'N.L.'.

(N.L.)

2 March 1984