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Mr Monger  
Mr Robson  
Mr Cropper  
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14 February 1985

The Rt. Hon. Peter Walker MBE MP  
Secretary of State for Energy

--- Following our meeting on Tuesday, of which I enclose a record, I thought it might be helpful if I were to write, setting out the position as I now see it.

As I explained, on our latest estimates the industry gains £1.2 billion from the corporate tax changes in last year's Budget over the years 1984/85 to 1988/89 - an average of just over £240m a year. The figures year by year are:-

						£m
84/85	85/86	86/87	87/88	88/89	84/85 - 88/89	
70	300	490	290	60	1210	

As you asked, my officials have been in touch with yours about the breakdown of these estimates, as compared with the slightly lower estimates made at the time of last year's Budget.

So far as this year's package is concerned, we agreed that there should be no action on incrementals. You referred to the possibility of continuing consultations with the industry. I agree that we should be prepared to consider any genuinely new evidence, and to look at any new ideas the industry may have. But I think the onus should be firmly on the industry, rather than the Government, to put forward proposals and, as I indicated, I would not be in favour of continuing the current review on an open-ended basis. You accepted that there could in any case be no question of holding open the commitment to backdate any future measure to projects launched following the 1984 Budget.

John Moore will, once again, be writing to UKOOA on Budget Day and I have suggested he should make it clear in his letter that, while the Government has reached a firm conclusion on the basis of the current review, we would be prepared to consider the position further if the industry were to come up with new evidence (preferably based on actual cases) or new proposals. But a lot of thorough and detailed work has been done already, and I do not think that we should deceive either ourselves or the industry that it is going to be easy to identify alternative cost-effective measures. I therefore want to steer clear of formal ministerial statements which could give misleading signals.

On the capital allowances front, I am, as you know, attracted to Option B in the Steering Group Report. I would also propose that contracts existing at Budget 1985 should be protected for 2 years. The cost to the industry of this option is



£65 million a year on average over the years 1986/87 to 1990/91. This would mean that taking the corporate tax reform packages of 1984 and 1985 together, the North Sea oil industry would come out as a substantial net beneficiary.

As I indicated, I believe there is also a good case in principle for putting development drilling (currently treated as revenue rather than capital) on to a capital basis (25 per cent reducing balance) at a relatively small cost to the industry. I told you that if you felt particularly concerned about the potential adverse, if small, effect of this change on incrementals, I would not myself make an issue of it this year. However, we may need to consider it further in any case in the light of developments on the mines and oil wells allowances to which I refer below.

I mentioned that I am proposing to retain 100 per cent scientific research allowance for ordinary scientific research, including of course scientific research carried out by the oil industry and other energy industries. North Sea related R&D expenditure which will continue to attract 100 per cent SRA, is currently running at an estimated £50 million. The industry itself has made recent representations which attach considerable importance to the tax treatment of such expenditure.

Although I did not refer to it at our meeting, I am also intending to legislate this year to put exploration and appraisal expenditure for hard minerals on to the same basis as I propose for oil (ie Option B). Other allowances under this head primarily affect hard minerals, but they are relevant to oil expenditure on licences and the costs of "farmers in". At this stage I am thinking of moving to a simple percentage allowance on an incurred basis, which could benefit the oil industry by £10-15 million a year. My officials will be consulting yours (and those of other interested departments) about these proposals very shortly.

Of the four minor items set out in the Steering Group Report, I think the only one on which you expressed any reservations was that relating to onshore fields but I myself believe that there is every justification for this, given the profitability of onshore developments.

We agreed that, when you had had an opportunity to reflect on my proposals and to look further at some of the latest figures, you would have a further talk with John Moore. Perhaps your office could get in touch with his to arrange a suitable time.

Given the sensitivity of these issues, I should be grateful if this letter could be given a very limited circulation within your Department.

NIGEL LAWSON

A handwritten signature in dark ink, appearing to read 'Nigel Lawson', with a long horizontal stroke extending to the right.