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The Rt Hon Peter Walker MP
Secretary of State for Energy
Thames House South
Millbank
London
SW1P 4QJ

7 July 1986

NBPO

Dear Peter

BGC PRIVATISATION: FINANCE BILL

Thank you for your letter of 3 July.

The Stamp Duty consequentials of the British Gas flotation will depend on the precise form that the documentation takes. I understand that your advisers have not yet settled the precise form of this documentation. To that extent - I hope a minor extent - my comments at this stage must be provisional.

Subject to that, your first question is (in broad terms) whether the interim certificates issued by the custodian bank for the British Gas sale are in themselves depositary receipts. On the basis of what your advisers have told them, and on the British Telecom precedent, the Board of Inland Revenue is satisfied, on legal advice, that the interim certificates are not in themselves depositary receipts. Therefore, the problem foreseen by your advisers does not arise, and no amendment (or new secondary legislation) is required.

Your third question is whether ADR Stamp Duty would be payable on the whole sale price at the outset. Again, the Board of Inland Revenue are satisfied, having taken legal advice, that this is not so. In this case also, therefore, no amendment (or subordinate legislation) is necessary.

As your officials have already been told - and as you acknowledge - the Board of Inland Revenue have offered to provide (for quotation in the prospectus, if you wish) a form of words recording the Revenue's view of how the legislation operates on these two matters. I am satisfied that your anxieties on this are misplaced. We are not talking here about some kind of 'comfort letter', saying (in the words of your letter) how 'officials are prepared to interpret the clause'. We are talking about a formal statement by the Board, on the record, of how they intend to implement the legislation for which they are responsible. In effect, we are talking about a straightforward - and far from unusual - Statement of Practice.

Towards the end of your letter you express a further anxiety that the Courts can and have 'overturned the intended impact of ...tax legislation'. As I have said, I am not persuaded that the doubts expressed by your advisers are well based; and I do not see this problem arising. Nor am I aware of any precedent for anyone taking the Revenue to Court for honouring a commitment to a taxpayer. In any event, however, the Board would regard itself as estopped from changing retrospectively a published statement of this kind, to the detriment of taxpayers who have relied upon it.

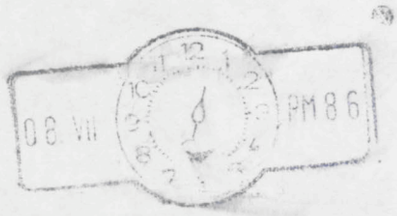
This leaves your second question, about the 'double charge'. On the straightforward principles of the ADR tax, there is, and should be, a charge on the transfer of the shares to an ADR shareholder. And similarly there is, and should be, a charge when an interim certificate is issued in ADR form. The problem that has been identified here, in the light of recent discussions with your advisers, is that you propose - unusually - to structure the British Gas flotation in a way that would constitute two chargeable occasions, each involving an ADR charge.

In order to deal with the last point, I have agreed with the Chief Whip that the final day of Report Stage be postponed until 17 July. This gives us time in which to prepare amending provisions for the Bill that will remove the possibility of a 'double charge', and Parliamentary Counsel are now working urgently on them.

I am sending a copy of this letter to the Prime Minister.

NIGEL LAWSON

NAT IND Gas PM2



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3 July 1986

BGC PRIVATISATION: FINANCE BILL

I and my advisers remain extremely concerned about the deleterious effects on the privatisation of British Gas of three provisions relating to ADRs.

The three specific issues are:-

(a) The basic definition of a depositary receipt does not clearly exclude an agreement covering the sale of shares by instalments. There is therefore a risk that 1.5% duty will be payable on the total proceeds of the British Gas sale.

(b) Clauses 67(1) and 90(1) mean that US purchasers will pay the 1.5% impost not once, but twice.

(c) Clause 90(5)(a), in Slaughter and May's view, is likely to mean that 1.5% (even if the double charge in (b) is removed) will be payable on the whole of the ADR tranche at the outset, rather than in stages as and when instalments of the share purchase price become payable.

I understand your officials accept that such effects are not intended though no agreement has been reached on a satisfactory way of dealing with them. I am concerned that the combined effect of these problems will seriously damage the British Gas sale.

In relation to (a) I believe your officials may be proposing to rectify matters by relying, in the last resort, on the power in the Bill to amend the definition by Regulation. Giving our opponents the opportunity to pray against Regulations in the run-up to the sale is surely the last thing we should be contemplating. I believe the only sensible solution is to amend the Bill.

As to (b) I believe your officials accept that the defect exists, but I am told that Parliamentary Counsel is unable produce a rectifying amendment to meet the timetable you have laid down. Parliamentary Counsel apparently therefore proposes to draft a

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regulatory-making power which will enable the Revenue to negate the Bill's provision, which is, of course, the effect. This is an absurd state of affairs. It is in no way improved by the Revenue's defence that similar provisions exist elsewhere in the Finance Bill, eg over Inheritance Tax. In any event the points I have made above about the difficulty of relying on Regulations apply again.

As to (c) I understand your officials are prepared to interpret the Clause in question in a manner which avoids the particular problems Slaughter and May have identified. They are prepared to confirm this by letter. I do not believe this achieves anything approaching an adequate degree of certainty. We could not sensibly plan and write the US prospectus relying purely on a Revenue letter, given the advice we have received from Slaughters. As you know, the Courts can and have overturned the intended impact of poorly drafted tax legislation.

It will be quite impossible to pursuade investors, notably in the USA, to accept such ill-drafted and damaging provisions. Because of the failure of the Revenue to consult my Department and advisers in reasonable time and with detailed texts, there could well be further problems in the draft Bill. I believe this is a sufficiently serious situation to warrant the Report Stage being delayed until further consultations have taken place. I would be grateful if you could consider the points in this letter with the utmost urgency.

I am copying this letter to the Prime Minister.

PETER WALKER


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