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The Story of the UK Oil and Gas Taxation Policy: History and Trends
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The Story of the UK Oil and Gas Taxation Policy: History and Trends

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Abstract:

Different oil producing countries adopt different types of oil and gas agreements to regulate their relationships with international oil and gas companies. These countries tailor petroleum fiscal regimes to fit their own desires. However, in some cases a host country may amend its petroleum fiscal regime due to changes in the internal and/or international economic and/or political environment or due to changes in the host government's energy policy. The story of the UK petroleum concession and fiscal regime may be unique; this is due to the employment of a unique concession type of agreement which no longer includes a royalty charge as a key element of its fiscal regime. The UK concession model is described as accommodating private interest under public control.

This paper details the UK petroleum fiscal regime in its historical context. The aim is to illustrate the development of the UK oil and gas taxation system on one hand and to highlight the many trends that developed in this fiscal regime over time. Our approach will be based on detailing the many changes to the UK petroleum tax regime and on calculating the resulting marginal petroleum tax rate as a consequence of any petroleum tax reform.

Keywords: Fiscal, Gas, Marginal, Oil, Tax, UK

Introduction

The UK has been using the concession type of oil and gas agreements to regulate its oil and gas operations. This introduction will briefly describe this type of agreement and how it is applied in the UK.

Concession agreements were established in the early 20th century, and this system was the fashionable form of petroleum agreement between host governments and international oil and gas companies until the 1950s.[1] In the 1940s concession agreements on their traditional principles started to be less frequently used. In 1943, Venezuela set taxes on the profits of international oil companies in addition to royalties, and in 1948 Venezuelan tax law presented the concept of a 50-50 profit-sharing scheme. This was taken up by Saudi Arabia in 1950, and then most of the concession agreements around the world started to follow suit. So, profit-based taxes became a main financial feature of the new concessions, besides royalties which are not profit related duties. Other changes to the traditional concession forms started to appear, such as changes to royalty rates, and the method of paying them. In 1952 the Iraqi Government and Iraq Petroleum Company (IPC) introduced a new agreement based on a 12.5 % royalty to be paid in kind or in cash equivalent. Furthermore, the introduction of a different types of bonus payments, the introduction of price controls, and the removal of tax holidays were all new features of the new concessions.[2]

Generally, under the concession system the landowner (proprietor) receives his rent for granting a lessee a right to his land in the form of royalties in kind, cash or even a percentage-based royalty. The landowner receives his rent, which may or may not take account of issues such as limitations on production volumes, selling prices, and profit. Under concessions, the tenant, ‘the oil and gas company’, is the legal owner of the minerals during the concession period, but not of the land or the sea where the

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[1] See, e.g., T. N. Machmud, *The Indonesian Production Sharing Contract*. The Hague, Kluwer Law International (2000).
[2] See, e.g., Ibid; Z. Gao, *International Petroleum Contracts: Current Trends and New Direction*. London, Graham & Trotman Ltd. (1994).

minerals lie. At the end of the concession agreement the ownership of the minerals returns to the state, 'the land/sea owner', unless the concessionaire carries on by making a new agreement with the state or by some extension of the concession agreement.

Further, according to this system the oil and gas company, or 'the contractor', pays all of the costs associated with exploration, development, drilling, and production activities without any view to recovering these costs if oil and gas are not discovered. However, if commercial reserves are discovered and oil and/or gas produced, then title to the oil or gas resources ('production' in the UK case) will pass to the contractor.[3] At this stage, the contractor should pay royalties to the host government when production occurs.[4] In terms of a concession period, because there is no standard format for concessions, duration is extremely long as it could run for about 75 years as in the Middle East and Indonesia[5] while in terms of concession area, the agreement may bound a whole country or a defined area of the country in question.[6] Countries having concession systems are, sometimes, referred to as tax/royalty countries.

However, the case of UK concessions is different. The law grants the concessionaire the right only to obtain the products from the concession area of the UK land or sea and gives him a title to these products only. The right here is similar to the right granted to catch fish. Hence, it gives the concessionaire a title to the production but not to the minerals *in situ*. Also the Government keeps the right to change any of the concession terms.[7] In other words, In the UK case the concessionaire is granted mining rights and economic rights, but not mineral rights.[8]

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[3] R.A. Gallun, C.J. Wright, L.M. Nichols, J.W. Stevenson, *Fundamentals of Oil & Gas Accounting*, (4th ed.) Tulsa, PennWell (2001) (the ownership of a piece of land that contains minerals could be separated into ownership of the surface and ownership of the minerals. In such a case a piece of land might have two owners: one has the right to the surface and another has the right to the minerals. So, minerals rights refer to the ownership of any minerals beneath the surface).

[4] See, e.g., Ibid.

[5] See, e.g., Machmud, supra note 1.

[6] See, e.g., E. E. Smith, *From Concession to Service Contracts*, 27 TULSA LAW JOURNAL 493, 493-520 (1991).

[7] See, e.g., H. Abdo, *Readings in the International Oil and Gas Agreements and the Economic Rent Concept: The Governance of Petroleum Resources*, Vol. 9, Issue 3 INTERNATIONAL ENERGY JOURNAL 163-173 (September 2008); D. P. Cameron, *Property Rights and Sovereign Rights: The Case of North*

The old concept of concessions was no longer useful for countries wishing to place more control on their petroleum resources.[9] In this regard, Mikesell[10] argues that most of the old concession agreements in developing and producing oil and gas countries were established and negotiated while these countries were under the control of developed countries. So, when these developing countries became independent, they started to put extra control on their natural resources with the purpose of gaining extra revenues and developing their own national resources. Government action gradually took two forms:

1. Renegotiation of old concession agreements with international oil and gas companies;
2. Establishment of national oil and gas companies to carry out national petroleum policies and dominate the countries' oil and gas operations.

Thus, the management issue was a major reason for countries to start thinking about reforming the old concession system into a new format which would enable them to have more control over their oil and gas resources, or present a new type of agreement providing the required control. The alternatives to the concession were production sharing contracts and/or service contracts. Machmud adds:[11]

> "If one's aim is to achieve a level of control or involvement in the exploration and production activities greater than that offered by the usual concession agreements, the solution must be sought in a risk-service or production-sharing type of agreement."

If production sharing and service contracts are the most suitable alternatives to the concession system, the question arises of why Western countries continue to use the concession type of agreement. Machmud argues that the reason the West never adopted the PSC system is that the concession concept fits the Western way of doing

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Sea Oil, New York, Academic Press Inc. (1983); HMRC, *A Guide to UK and UK Continental Shelf, available at* http://www.hmrc.gov.uk/international/ns-fiscal3.htm (2010).

[8] Machmud, supra note 1 at 37, (defines mineral rights as: "the rights that deal with the ownership of the minerals in the ground", mining rights as: "the rights to bring the minerals to surface", and economic rights as: "economic rights deal with the ownership of the minerals once they have been mined.").

[9] See, e.g., Gao, supra note 2 ; see, e.g. Smith, supra note 6.

[10] See, e.g., R. F. Mikesell, Petroleum Company Operations and Agreements in the Developing Countries. Washington, Resources for the Future (1984).

[11] See, e.g., Machmud, supra note 1 at 22.

business as the concession provides governments with a good level of control over their oil and gas industry. Moreover, it ensures a reliable supply of oil and gas, even if private oil and gas companies are running the industry. Machmud continues by saying that Western governments are able to control their petroleum industry indirectly, and this can be done through representation or shareholding; taxation is also used as an instrument of collecting rent. As a result, Machmud[12] points out that the UK found that there was no reason to change its regulatory policies. This is because the Government decided to retain more influence over exploration, development, and production activities. The current fiscal policy enabled the Government to have more control and manage its oil and gas resources through the concession system. In this regard, the UK had her own concession model that was, in fact, a modified version of the traditional concession concept. This model has often been referred to as 'the North Sea Model'. The main features of the North Sea Model are as follows:

1. Due to lack of knowledge and experience in the oil and gas industry and the need for such experience, dependence on the international oil and gas industry was essential for the UK.
2. Licences were granted according to administrative allocation in smaller areas than in other producing oil and gas countries.
3. Gaining the required experience in the oil and gas industry, and at the same time benefiting from the oil and gas wealth, was to be achieved through state participation and the introduction of special additional petroleum taxation.

The North Sea Model allowed private and international oil and gas companies to be granted licences to participate in exploration, development, and production activities and to be regulated under which royalties and special taxation to be paid in addition to ordinary company taxes. In other words, and consistent with Noreng's statement, "it accommodates private interests under public control."[13]

The next section characterises the evolution of the UK petroleum fiscal regime under the concession system by explaining the taxation system applied to the UK upstream

[12] See, e.g., Machmud, supra note 1.
[13] See, e.g., ∅. Noreng, *The Oil industry and Government Strategy in the North Sea*. London, Croom Helm, (1980).

oil and gas industry. Therefore, developing trends in the legal, regulatory and contractual instruments are clarified based on a time-scale method.

THE EVOLUTION OF THE UK PETROLEUM FISCAL REGIME

Oil and gas are arguably the most important natural resources to be discovered and produced in the UK during the last century. They provide energy and essential chemicals for the home, industry, and the transport system, as well as earning valuable export and tax revenues to support the UK economy.[14] UK North Sea oil has become an important source of world energy supply. In 1985 the UK produced more oil and gas than Saudi Arabia,[15] 4.58 % of the world's daily oil and gas production,[16] its world ranking was fifth at this time in terms of output. In many subsequent years it ranked sixth.

The North Sea has three unique characteristics, which make it a recognised oil and gas region. These are: 1) rapid development when the world demand for energy was heavy, and when the Organization of the Petroleum Exporting Countries (OPEC) was at its most powerful; 2) location in the centre of a major refining and consuming area; and 3) the creation of highly active spot and forward markets for crude oil.[17] On the other hand, the water depth and the weather conditions make the North Sea different from other oil and gas producing areas, for example, the Middle East and the Gulf of Mexico. However, during the 1960s, the North Sea was still a new oil region, and it had development and production problems.[18]

This paper aims to provide a basic description of the fiscal regime which applied to companies engaged in oil and gas extraction activities in the UK Continental Shelf (UKCS) up to the year 2010. This is to highlight trends in the developmental process

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[14] See, e.g., R. Mabro, R. Bacon, M. Chadwick, M. Halliwell, D. Long, *The Market for North Sea Crude Oil*. Oxford, Oxford University Press (1986).
[15] Ibid.
[16] See, e.g., Petroleum Economist, *Statistical Annual*. London, The Petroleum Economist Ltd., CHASE Oil & Gas Group (1995).
[17] See, e.g., Mabro et al, surpa note 14.
[18] See, e.g., Noreng, supra note 13; A. Seymour, *The Oil Price and Non-OPEC Supplies,* Oxford Institute for Energy Studies Papers on the World Petroleum Market. Aldgate Press. (1990).

of the UK fiscal regime which uses a concession type of oil and gas agreements. It will address the history of oil and gas legislation in the UK focusing on the period from 1964 onwards. For the purpose of this research, the history of the UK oil and gas industry will be divided into six periods: up to 1964, from 1964 to 1974, from 1975 to 1982, from 1983 to 1992, from 1993 to 2001 and from 2002 to 2010. The justification for these divisions is that in 1964, the UK Government approved the international legal framework with regard to division of the sub-sea bed resources. The other periods' starting dates have witnessed significant tax changes and these are worth highlighting in some detail.

Over the last 40 years or so, the UK has developed into one of the world's major oil producing countries. Successive administrations have developed a fiscal regime under a concession, which provides taxation incentives to oil and gas companies to explore and develop the UK oil and gas reserves while at the same time securing an appropriate share of these resources for the nation. Fiscal policy has had to remain flexible enough to cope with changes in oil prices but at the same time provide the industry with the necessary stability for future planning. From the introduction of the first duty (royalty) on UK oil and gas production, up until 2010, four special taxes were used beside the standard ring-fenced Corporation Tax (RFCT). These taxes are: Petroleum Revenue Tax (PRT), Supplementary Petroleum Duty (SPD), Advance Petroleum Revenue Tax (APRT) and the Supplementary Charge (SC). Removing PRT, SPD and APRT duties defines the UK petroleum fiscal regime as one that would fall into the non-proprietorial regime.[19]

In the subsequent sections the specific details of the introduction of, and changes to, these taxes will be charted along with defining changes to the petroleum marginal tax rate after each change.

Components of UK Petroleum Fiscal Regime

Royalty

Royalty on oil and gas is, in fact, not a tax: it is a charge on the value of production,

[19] See, e.g., Abdo, supra note 7.

and therefore it is not a profit-related duty. In the UK oil industry, a royalty was introduced at a rate of 12.5 % of the landed value of the petroleum production less an allowance for the costs associated with the conveying, treating and initial storage of the oil and gas between the well- head and the point of valuation, usually the terminal onshore.[20] However, as royalties allowed for costs of conveying, transportation and treatment, this meant that the actual rate of royalty, according to this basis, was less than 12.5 % of the well-head value.[21] In the UK, royalties were not charged on a field basis but on the licence. There are several cases where a licence covers more than one field, or where a field is covered by more than one licence.[22]

All petroleum production licences were to pay royalties to the Secretary of State for Energy. The Secretary of State formerly had the option and power to require royalties to be paid in kind, but this option was abolished from 1st January 1989.[23] A royalty was paid even if the international oil and gas company's profit was zero as it was not a profit-related duty.[24] Royalties were deductible against PRT and RFCT profits; they were entirely abolished effective from 1st January 2003.

Petroleum Revenue Tax (PRT)

PRT was introduced in 1975 to target economic rent. This tax is similar to Resource Rent Tax (RRT) and Cash Flow Tax. The UK Government intended that PRT, the royalty charge, and Corporation Tax (CT) would secure 70 % of oil net revenues for the United Kingdom Exchequer, and would, therefore, be available to the nation for the achievement of wider economic objectives.[25]

PRT is applied on a field-by-field basis, or is 'ring-fenced'. This ring-fence concept means that profits arising from each field are charged to tax separately from other

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[20] See, e.g., HMRC (2010b).
[21] See, e.g., Mabro et al, surpa note 14.
[22] See, e.g., S. Bond, M. Devereux, M. Sauders, North Sea Taxation for the 1990s, IFS, Report Series No. 27 (1987); HMRC, supra note 7; C. Nakhle, *Petroleum Taxation: A Critical Evaluation with Special Application to the UK Continental Shelf*, PhD Thesis, Surry University (2004).
[23] See, e.g., KPMG, *A Guide to UK OIL and Gas Taxation*, 10th Edition. UK, Summerhouse Communications (2000).
[24] See, e.g., A. G. Kemp and B. Mommer, *Pros and Cons of Petroleum Royalties,* 25 OXFORD ENERGY FORUM 12-15 (1996).
[25] See, e.g., Department of Energy, *The Challenge of North Sea*. Cm. 7143. London, HMSO (1978).

fields' profits. Therefore, losses in one field cannot be deducted from profits in other fields. The Secretary of the State for Energy determines the extent of each field. PRT is a deductible charge when calculating profits for RFCT purposes.

The aim of PRT was to allow each project to recover its costs rapidly, then to tax it highly. The various allowances and the safeguard gave protection to a number of oil and gas fields from PRT where no economic rent was likely.

Supplementary Petroleum Duty (SPD)

SPD was introduced in 1981 and it was one of the windfall profit taxes, like PRT, that were used to curb international oil companies' profits. Governments set such taxes against international oil and gas companies' revenues in cases where present fiscal regimes did not secure a fair share of profits for the host governments, in particular during periods when oil and gas prices were increasing.[26] SPD was introduced mainly to take a reasonable share of the high profits occurring in the industry as a result of the oil price increase in the late 1970s and the early 1980s. SPD was charged at a rate of 20 % of gross production revenue, minus an annual allowance of one million metric tonnes a year.[27] Like PRT, a ring-fence was applied to this tax. SPD was a deductible charge against PRT profits.[28] SPD was abolished in 1983.

Advance Petroleum Revenue Tax (APRT)

APRT was charged from 1st January 1983 to 31st December 1986 on oil and gas revenues, less an allowance of the value of 500,000 metric tonnes of oil per field in each chargeable period. APRT was introduced to accelerate the receipt of PRT into the early years of fields' lives. This duty was similar to SPD, apart from the fact that it was not deductible when calculating PRT profits.[29] APRT was credited in full against

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[26] See, e.g., J. A. Fleites Melo, *Development in the World Oil Industry, Profiles of Major Non-United State Oil Companies and State Contractual Frameworks*. Report Commissioned (1991).
[27] See, e.g., *Finance Act 1981*, Ch. 35 in The Taxes Acts, 1997 Ed. Great Britain. Norwich: The Stationery Office (1981, S. 124).
[28] See, e.g., HMRC, supra note 20.
[29] Ibid.

normal PRT liabilities when they arose and, if it could not be set off in this way within five years, it was repaid, and no further APRT was collected.[30]

Corporation Tax (CT)

RFCT is charged on oil and gas companies' profits in the same way as on any other industry's profits. CT was first introduced in the 1964 Budget to be applied with effect from 1965 as the only tax on the profits of commercial bodies. The rate of this tax was changed many times and the current rate is 30 %, which represents one of the lowest company tax rates in the world[31].[32] RFCT is applied to all corporate bodies in the UK; therefore UK oil and gas companies are subject to this tax. In the case of oil and gas fields which were developed during the period March 1993- April 2002, RFCT was the only tax on profits.[33] Moreover, foreign oil and gas companies producing in the UK are subject to this tax for profits generated from UK oil fields.[34] Unlike PRT, RFCT is levied on the oil and gas company but not on the individual oil and gas fields.[35] In calculating oil and gas companies' profits for RFCT, royalties, PRT and SPD were deducted for this purpose.[36]

Supplementary Charge (SC)

This tax was introduced on 17th April 2002 at a 10 % rate; this rate was raised to 20 % on 1st January 2006. The profit subject to this tax is the same as for the RFCT, apart from not allowing the deduction of financing costs.[37]

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[30] See, e.g., *Finance Act 1982: Advance Petroleum Revenue Tax*, Ch. 39, Part VI, in The Taxes Acts, 1997 Ed. Great Britain. Norwich: The Stationery Office (1982, S. 139); Department of Energy, *Development of the Oil and Gas Resources of the United Kingdom*. London, HMSO (1982); D. Nigg and P. Keeling, *Accounting for United Kingdom Taxes on Oil and Gas Producing Activities*, PETROLEUM ACCOUNTING AND FINANICAL MANAGEMENT JOURNAL 59-84 (Winter 1983); C. A. Favero, Taxation and the Optimization of Oil Exploration and Production: The UK Continental Shelf. Oxford, Oxford Institute for Energy Studies (1990).
[31] See, e.g., Department of Trade and Industry, *Development of the Oil and Gas Resources of the United Kingdom*. London, HMSO (2000).
[32] Department of Energy, Development of the Oil and Gas Resources of the United Kingdom at 29. London, HMSO (1985); See, e.g., HMRC, supra note 20. (The CT rate was raised from 40 % to 52 % in 1974. In 1983, the rate was reduced to 50 % and to 45 % in 1984, then to 40 % in 1985, and to 35 % in 1986. In 1990, the CT rate was reduced to 34 % and to 33 % in 1991. This rate was further reduced to 31 % in 1997 and with effect from 1st April 1999 the rate was reduced to 30)
[33] See, e.g., Department of Trade and Industry, *Development of the Oil and Gas Resources of the United Kingdom*. London, HMSO (2000, para. 3.27).
[34] See, e.g., D. Bland, *UK Oil Taxation*, 3rd Ed.. UK, Longman (1991).
[35] See, e.g., Mabro et al, surpa note 14.
[36] See, e.g., DTI, supra note 31.
[37] See, e.g., HMRC, supra note 7.

The above-mentioned duties were the main ones introduced in the UK fiscal regime between 1964 and 2010. The next sections will demonstrate the historical changes and trends to the UK fiscal regime, under the concession type of oil and gas agreements, based on periodic divisions, as was mentioned earlier in this paper. In so doing, tax reforms and their effects on the marginal tax take will be discussed and illustrated in detail. This research focuses on the period 1980-2010, but historical events before 1980 will be outlined in this paper as a historical background to the UK fiscal regime.

The Period Up to 1964: a historical background

Britain had been producing oil for more than a hundred years before the discovery of North Sea oil. The history of the exploration and development of oil and gas resources in the North Sea is extensive. For centuries small quantities of oil were extracted in Britain from shale to produce kerosene, known as lamp oil. In 1913 production was over 3.25 million tonnes. The First World War conditions created difficulties in importing oil to the UK.[38] Therefore, the UK Government considered the idea of exploring and drilling for oil in UK territory. This idea was officially expressed in the Petroleum (Production) Act of 1918. This Act granted the Crown the right to control petroleum activities in the UK and to grant licences for exploration and production purposes.[39] In 1934 a new Petroleum (Production) Act was passed, and this new Act replaced the 1918 Petroleum Act. The Petroleum (Production) Act of 1934 established the national ownership of petroleum resources existing in natural conditions in the UKCS and granted the Crown property rights to onshore petroleum exploitation and the power to grant licences for its exploration and development.[40] In other words, this Act established the Government's authority to regulate and grant applications for issuing licences, to define the licences' contents and set licence fees.[41]

The international oil and gas industry first took an interest in the UK North Sea waters in 1959. This was after one of the biggest natural gas fields had been discovered by

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[38] See, e.g., Department of Trade and Industry, *The Energy Report, Oil and Gas Resources of the United Kingdom*, Vol. 2. London, HMSO (1996).
[39] See, e.g., HMRC, supra note 20.
[40] See, e.g., Ibid; DTI, supra note 38.
[41] See, e.g., Arthur Anderson, *Guide to Upstream Oil and Gas Taxation in the UK* (2000).

the Shell and Esso oil and gas companies in the mid 1950s in the Netherlands.[42] In 1962 the UK Government received the first application for agreements to explore for oil and gas within the UK Continental Shelf. The UK was not able at that time to respond positively to these applications, as the Continental Shelf had not at that time been divided among UK, Denmark, West Germany, Netherlands and Norway. In 1964 the UK approved the international legal framework which was provided by the 1958 Geneva Convention with regard to the division of sub-sea bed resources. The most significant rule of the Geneva Convention in 1958 was that countries with coastlines were given rights to explore and produce the natural resources in the Continental Shelf to a distance of 200 miles from shore.[43] In 1965 the above-mentioned five countries were able to establish the median line, which divided the area of the 62nd Parallel between the UK and Norway.[44]

The Period 1964-1974

In 1964-65 the UK Government put into operation the first comprehensive regime for exploration and production of petroleum in the North Sea. The important features of this regime were that the UK Government had the right to control the working programme, and that a system of relinquishment had been adopted.[45] In June 1970, the Conservative Government came to power. The new Government reviewed the existing licensing system. At that time, because of the price increases caused by the 1973 Arab-Israeli War, the UK had to consider the possibility of domestic oil production to cover local demand. The new British oil policy aimed to maximise exploration and development efforts, and to grant a good representation of British interests.[46]

In the mid 1970s there were some remarkable changes in the UK oil industry. These were a sharp increase in the oil and gas prices resulting from the 1973 Arab-Israeli conflict; the recovery of oil and gas production; and 40 new offshore discoveries over

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[42] See, e.g., C. Robinson and E. Marshall, *Oil's Contribution to UK Self-Sufficiency*. London, Policy Studies Institute and the Royal Institute of International Affairs (1984).
[43] See, e.g., HMRC, supra note 20.
[44] See, e.g., Robinson and Marshall, supra, note 42.
[45] See, e.g., Noreng, supra note 13.
[46] See, e.g., A. G. Kemp, *Development of UK Policy Towards Oil and Gas and Their Effects* at 93-114, in Cairns, WJ, NORTH SEA OIL AND THE ENVIRONMENT. Elsevier Applied Science (1992).

the period of 1970-1974. These changes, besides the advantage of the proximity of the North Sea to the European market, led to a boost in the UK oil and gas industry and resulted in high profits.[47] This in turn created a need for the new legislation of 1975 in order to capture the expected high profits. On 11th July 1974 the Government published a 'White Paper' entitled "United Kingdom Oil and Gas Policy".[48] This paper was presented to Parliament by the Secretary of the State for Energy. Besides an optimistic vision aiming at a higher production and tax take, the White Paper encouraged the adoption of a new system of state participation in new licences, and renegotiating existing licences to obtain more state participation. The Government hoped to do this without causing harm to licensees as it recognised that the costs of exploration and development had been heavy. Furthermore, the White Paper proposed the creation of the British National Oil Corporation (BNOC), to act as a Government representative in the oil industry. It was suggested that the BNOC would gain the power to extend its future activities to the refining and distribution of oil and gas products.[49]

In 1974 when oil prices increased, the Labour Government introduced a policy aimed at providing more protection for national interests in relation to North Sea oil. This protection was seen through state participation in oil and gas operations alongside international oil and gas companies. Liverman states:[50]

> "Mr Wilson's Government of March 1974 pursued the same principal objectives as Mr Heath's, namely the increase of government take and an improvement in security of supplies, together with a greater degree of government regulation over development and production… The Labour manifesto included a commitment to bring UKCS oil and gas operations under full government control with majority public participation."

The Period 1975-1982

The year 1975 was significant for the UK oil industry. In this year, as the White Paper of 1974 had proposed, the UK Government created the British National Oil

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[47] See, e.g., J. G. Liverman, *Without Precedent: The Development of North Sea Oil Policy*, 60 PUBLIC ADMINISTRATION 451-469 (1982).
[48] See, e.g., Department of Energy, *United Kingdom Offshore Oil and Gas Policy*. Cm. 5696. London, HMSO (1974).
[49] See, e.g., Noreng, supra note 13.
[50] See, e.g., Liverman, supra note 47- 458.

Corporation (BNOC),[51] the aim of which was to represent the state in the oil and gas industry. In doing so, and to involve the BNOC in oil and gas operations, negotiations began with private oil companies that already had activities in the North Sea. The consequences of such negotiations resulted in nationalised companies, such as BNOC and the British Gas Corporation (BGC), acquiring participation rights. The aim of these rights was that national companies should control at least 51 % of the oil extracted from the UKCS. This was achieved through the right to purchase this 51 % of produced oil from private companies at market price. The UK Labour Government aims of this policy were as follows: 1) The BNOC would be used as a device to secure the national ownership of produced oil; 2) The BNOC would be used as a control device over the conduct of the oil industry within the UKCS; 3) State revenues would be increased from the oil industry through this Corporation; 4) The 51 % share would help the Government to control fluctuation in oil prices in the short term; and 5) The 51 % share would secure access to oil and gas which was produced in the UKCS, and would be employed to ensure security in oil supply.[52]

The interesting point here is that the UK form of participation in the oil and gas operations was different from participation elsewhere, both under concessions and PSCs, in the industry. This is because the BNOC was given the option to buy up to 51 % of the oil at market price. This form of participation is referred to as 'a purchase agreement'. Furthermore, the Labour Government insisted that the BNOC should have representation on all of the operating fields. The Corporation was allowed to obtain licences outside the normal licensing rounds, and it was exempted from paying PRT. The BNOC was given a seat on the licence operating committee. These features gave the BNOC a very powerful position in comparison with other private oil and gas companies operating within the UKCS.[53]

In 1975, recognisable profits were generated and more were expected and received from UK North Sea oil in the 1980s and 1990s due to increases in production and prices. These profits resulted from an increased production rate, and also from the

[51] Ibid. (The BNOC was formally established on 1 January 1976).
[52] See, e.g., Robinson and Marshall, supra note 42; See, e.g., Machmud, supra note 1.; Kemp, supra note 46.
[53] See, e.g., Robinson and Marshall, supra note 42.

very sharp increase in oil and gas prices arising from the Arab-Israeli conflict in 1973. In the light of these events, the UK introduced the Petroleum Revenue Tax (PRT) to tax a high proportion of the high profits from the exploitation of the UKCS's oil and gas. In other words, PRT was a suitable device to secure more economic rent, or 'take', in accordance with the aims of the White Paper of 1974. In this regard, the Oil Taxation Act, 1975, stated:[54]

> "A tax, to be known as petroleum revenue tax, shall be charged in accordance with this part of this Act in respect of profits from oil won under the authority of a licence granted under either the Petroleum (Production) Act 1934 or the Petroleum (Production) Act (Northern Ireland) 1964."

The Oil Taxation Act of 1975 introduced a 'safeguard concept', which aimed to encourage the development of explored marginal fields. This concept meant that a participator would pay PRT when his adjusted profits for a period exceeded 15 % of his accumulated capital expenditure, provided the total payment of PRT did not exceed 80 % of the participator total gross profits.[55] The safeguard concept aimed to provide a form of marginal relief that would benefit less profitable fields, regardless of the fields' reserves. Also in this year (1975) the concept of a 'ring-fence' was introduced for the CT payments around any oil company's North Sea trade. This concept meant that losses from abroad or from other activities could no longer be set against profits from North Sea production to reduce tax liabilities. The ring-fenced RFCT was an instrument which helped the UK Government to capture more of the high profits earned by oil and gas companies during this period.[56] Based on a combination of royalty at 12.5 %, PRT at 45 % and RFCT at 52 % the marginal tax rate for PRT paying fields was 76.9 %, and 58 % for fields not paying PRT.

In March 1978, a White Paper entitled "The Challenge of North Sea Oil" was presented to Parliament.[57] This White Paper listed the benefits of North Sea oil. It would: 1) boost the total national income; 2) help the balance of payments; and 3)

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[54] See, e.g., *Oil Taxation Act 1975*, Ch. 22 in The Taxes Acts, 1997 Ed.. Norwich: The Stationery Office (1975, S. 1).
[55] See, e.g., Nigg and Keeling, supra note 30 ; I. Rutledge and P. Wright, *Taxation Petroleum: Don't Forget the Upstream* 1-12, Energy Economist Briefing, FINANCIAL TIMES ENERGY (Oct. 2000); Mommer (2002); KPMG, supra note 23; Great Britain, supra note 54 (S 9).
[56] See, e.g., HMRC, supra note 20; KPMG, supra note 23-75.
[57] See, e.g., DOE, supra note 25.

increase the Government's revenues by about £4 billion a year by the mid 1980s. The White Paper presented very ambitious plans based on income from the extra oil and gas revenues. It proposed using the oil revenues in many different ways: a) investing in industry; b) improving industrial performance; c) investing in energy; and d) increasing essential services..[58] In this regard the DOE stated in the White Paper:[59]

> "North Sea provides a unique opportunity for Britain to improve her economic performance, raise her living standards, move forward to full employment, and develop as a socially just society. It will also put her in a stronger position to discharge her international responsibilities, not least in relation to developing countries."

The main fiscal changes during 1979 were to reduce the uplift for allowable expenditure from 75 to 35 %. The oil allowance for the purpose of PRT profits calculations was reduced from 500,000 to 250,000 metric tonnes a year.[60] Also, in 1979, the rate of PRT was increased from 45 to 60 %;[61] by so doing, the Government marginal tax take rate from its petroleum resources increased from 76.9 % to 83.2 % (58 % for non PRT paying fields).

By the early 1980s, the UK was experiencing a significant decrease in the number of new oil and gas projects being brought forward by the industry. Therefore, the Government made changes to the oil taxation system in order to encourage exploration and development activities.[62]

When the new Conservative Government came to power, in mid-1979, the advantages of the BNOC compared with private companies decreased for two main reasons. The first was the change of policy of the new Government, which focused on and supported the private sector; the second was that the oil volumes that the BNOC had to purchase were very large and inflexible in the short term. This caused problems as the BNOC did not have major storage facilities, and did not operate actively in the

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[58] Ibid.
[59] Ibid, supra note 57-5.
[60] See, e.g., Finance (NO.2) Act 1975, Ch. 45 in The Taxes Acts, 1997 Ed. Great Britain. Norwich: The Stationery Office (1975).
[61] See, e.g., Great Britain, supra note 54.
[62] See, e.g., H. Abdo, *Evaluating the Usefulness of the Interventionist Approach as a Policy Tool to Influence Oil and Gas Investment Activities: the Case of the UK*, V. 10, Issue 2 INTERNATIONAL ENERGY JOURNAL 1-9 (June 2009).

forward market.[63] It was suggested that while the BNOC could operate on a self-financing basis during times of rising oil prices, it experienced increasing difficulties when oil prices decreased from their peaks of the early 1980s. Oil and gas companies refused to buy back their own oil, which had been previously sold to the BNOC to fulfil the 51 % requirement. This was because these companies could purchase the oil from other suppliers for cheaper prices on the spot-market. Therefore, the BNOC experienced losses during the periods of decreases in oil prices.[64] In this year the rate of PRT was increased to 70 %;[65] this consequently increased the Government marginal tax rate from 83.2 % to 87.4 % (58 % for non paying PRT fields).

On 17th December 1981 the Oil and Gas (Enterprise) Bill was published.[66] The Bill provided for the disposal of the BNOC oil-production business to the private sector. It was proposed to carry out the disposal by transferring the BNOC's oil-producing assets into a subsidiary named 'Britoil'. It was planned that 51 % of Britoil's shares would be offered for sale to the public. The Government hoped that this would be done before 1982, and that the BNOC would remain wholly state-owned, principally to trade in oil to which it had access through participation agreements.[67] The remainder of the BNOC, 'the trading sector', kept the original name of the BNOC and retained one main role. This role was to take 51 % of North Sea oil production at market price, plus the 'in kind' royalty oil taken by the state.[68] One more reason for the disposal of the BNOC was that the strategy of the Thatcher Government, which disliked any kind of state interference, led to the close of the BNOC and the selling of Britoil. Therefore, the UK no longer had a state oil company to fulfil the role played by state oil companies elsewhere.[69]

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[63] See, e.g., Liverman, supra note 47.
[64] See, e.g., Fleites Melo, supra note 26; Kemp, supra note 46.
[65] See, e.g., *Finance Act 1980*, Ch. 48 in the Taxes Acts, 1997 Ed. Great Britain. Norwich: The Stationery Office (1980, S. 104).
[66] See, e.g., HC, *4th Report from the Committee of Public Accounts on Financial Control of BNOC; Advances to the British Gas Corporation*. HC (30), London, HMSO (Session 1981-82).
[67] See, e.g., DOE, supra note 30.
[68] See, e.g., Robinson and Marshall, supra note 42.
[69] See, e.g., Fleites Melo, supra note 26.

Following the substantial increase in oil prices in 1979/80, the 1981 Budget introduced a new tax called Supplementary Petroleum Duty (SPD). The Finance Act, 1981, stated:[70]

> "*Every participator in an oil field shall, in accordance with this part of this Act, be chargeable with a tax (to be known as supplementary petroleum duty) on the gross profit accruing to him from the field in any chargeable period to which this section applies.*"

SPD was initially introduced for 18 months but it was extended to two years ending on 31st December 1982.[71] In this regard Lawson stated:[72]

> "it was introduced on a temporary basis in order to give the oil industry an opportunity to suggest alternative ways of raising a similar level of revenue if there was a better structure."

By introducing SPD, there was thus a combination of taxes on oil and gas production during the period 1980-1981, and UK North Sea oil taxation became extremely complex and unstable. The instability of the petroleum fiscal regime came from nine major changes over the period 1975-1982,[73] the many changes of tax rates over this period, and the introduction and abolition of SPD and APRT. The complexity of this fiscal regime arose from the existence of four separate taxes at the same time, i.e., Royalties at 12.5 %, Petroleum Revenue Tax at 70 %, Supplementary Petroleum Duty at 20 %, and Corporation Tax at 52 %. This combination expresses a total of 89.9 % as a marginal tax take for the UK Government out of the final revenues (output) of the UK oil and gas resources during that time period (66.4 % from non-PRT paying fields).

With an 89.9 % marginal tax rate; the Government decided that exploration and development activities were affected by the tax regime, and the development of North

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[70] See, e.g., Great Britain, supra note 27 (S. 122).
[71] See, e.g., Ibid; Department of Energy, Development of the Oil and Gas Resources of United Kingdom. London, HMSO (1981); DOE, supra note 30)
[72] See, e.g., RT Hon. N. Lawson, MP, *Minutes of Evidence Taken Before the Energy Committee on Oil Prices* at 8, PARLIAMENTARY PAPERS, HC 332, vol. XXXI. London, HMSO (Session 1982-83).
[73] Major changes to the petroleum fiscal regime over the period 1975-1983 were: the Oil Taxation Act 1975, provisions contained in seven Finance Acts and the Petroleum Revenue Tax Act 1980.

Sea oil was put at risk by the high marginal tax rate and the frequency of changes. In other words, the Government may have decided at that time that the policy of increased taxation was harming UK oil and gas production.[74] Therefore, the Government view was that there should be a relaxation of the tax burden, as a necessary corrective action to maintain exploration and development activities .[75] In this year, the rate of PRT was increased to 75 % with effect from 31st December 1982;[76] this brought the marginal tax rate up to 91.6 % (66.4 % from non PRT paying fields).

On 31st December 1982, SPD was replaced by another tax called Advanced Petroleum Revenue Tax (APRT). APRT was abolished after one year. It was scheduled to be phased out in four stages with reducing rates as follows: 1) 1st January 1983 to 30th June 1983 = 20 %; 2) 1st July 1983 to 31st December 1984 = 15 %; 3) 1st January 1985 to 31st December 1985 = 10 %; and 4) 1st January 1986 to 31st December 1986 = 5 %, after which time the APRT was to be completely abolished.[77] These tax reforms brought the marginal tax rate back to 89.5% (58% for non PRT paying fields)

The Period 1983-1992

The year 1983 was a time of change for the UK petroleum fiscal regime. In this year and in the Chancellor's 1983 Budget Statement, royalties were abolished in the Petroleum Royalties (Relief) Act 1983 for qualifying fields receiving development approval from the Secretary of State for Energy on or after 1st April 1982.[78] In this sense, the Finance Act 1983 exempted a number of relevant new fields from royalty.[79] The Finance Act, 1983, stated:[80]

> "Relevant new field" means an oil field−

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[74] See, e.g., Liverman, supra note 47.
[75] See, e.g., Abdo, supra note 62; Robinson and Marshall, supra note 47.
[76] See, e.g., *Finance Act 1982: Advance Petroleum Revenue Tax,* Ch. 39, in The Taxes Acts, 1997 Ed. Great Britain. Norwich: The Stationery Office (1982, S. 132).
[77] Ibid, S. 139.
[78] See, e.g., Finance Act 1983, Ch. 28, in The Taxes Acts, 1997 Ed. Great Britain. Norwich: The Stationery Office (1983).
[79] See, e.g., Bland, supra note 34.
[80] See, e.g., Great Britain, supra note 78 – S. 36.

(a) no part of which lies in a landward area, within the meaning of the Petroleum (Production) Regulations 1982 or in an area to the East of the United Kingdom and between latitudes 52º and 55º north; and
(b) for no part of which consent for development was granted to the licensee by the Secretary of State before 1st April 1982; and
(c) for no part of which a programme of development had been served on the licensee or approved by the Secretary of State before that date."

According to this change, the new fields, which were developed on or after the 1st April 1982, were subject to a tax rate of 89.5 % (58 % for non PRT paying fields) against 88 % in old fields. This tax reform was a first stage of abolishing royalties. Moreover, offshore fields outside the Southern Basin of the North Sea that had development consent after 31st March 1982 were entitled to double oil allowance for the purpose of calculating PRT profits, i.e., 500,000 metric tonnes per chargeable period up to a total of ten million tonnes per field.[81] Furthermore, since 16th March 1983 exploration and appraisal expenditure outside an existing field were allowed to be deducted against the PRT income from these existing producing fields.[82]

In brief, the 1983 oil tax changes consisted of the following: 1) Phasing APRT out, which was completed by the end of 1986; 2) PRT allowance was doubled for new fields; 3) Royalties were abolished for fields outside the Southern Basin of the North Sea area that were developed after March 1982; and 4) Immediate PRT relief against any field for expenditure incurred after 15th March 1983 on searching for oil or appraising reserves discovered. The RFCT rate was reduced in this year to 50 %; this reduction made the marginal tax rate for old fields 89.062 % and from new fields 87.5 %. However, the expected adverse effects yielded by this tax relief package was a sacrificing of £800 million of the Government's revenue over the four years 1983-1987, through substantial reductions in taxes for future fields.[83]

The rate of the RFCT was further reduced to 45 % in 1984, 40 % in 1985 and to 35 % in 1986; these changes brought the petroleum marginal tax rate down to 87.97 %

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[81] Ibid.
[82] Ibid, S. 37.
[83] See, e.g, Department of Energy, Development of the Oil and Gas Resources of United Kingdom. London, HMSO (1983).

(86.25 % in new fields), 86.87 % (86.25 % in new fields), and to 85.78 % (83.75 % in new fields) respectively.

During the period 1985-1986 there were no major changes in oil taxation, as the aim was to provide stability in the tax regime applied to the oil and gas industry. However, in 1985 it was announced that immediate PRT relief from exploration and appraisal expenditure was to be withdrawn.[84] On 25th July 1986 the Gas Act allowed the property rights and liabilities of the British Gas Corporation to be transferred to a public limited company (British Gas plc). From the above date British Gas plc became one of the private companies with upstream operations and was subject to the same controls and restrictions as private companies.[85] Also in 1986, the Advance Petroleum Revenue Tax Act (APRTA) stated that if an operator who had never won a profit from UK oil and gas fields had paid APRT for a chargeable period before 31st December 1986, the APRT was to be paid back to the operator.[86]

The Finance Act 1987 introduced the concept of the 'Cross Field Allowance'. This concept allowed 10 % of the development expenditure of offshore fields outside the Southern Basin of the North Sea and approved for development after 17th March 1987 to be deducted from income in other fields for the purpose of calculating PRT. In this regard, the Finance Act of 1987 stated:[87]

> "Where an election is made by a participator in an oil field (in this section referred to as "the receiving field"), up to 10 per cent. of certain expenditure incurred on or after 7th March 1987 in connection with another field, being a field which is for the purpose of this section a relevant new field, shall be allowable in accordance with this section in respect of the receiving field…"

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[84] See, e.g., Department of Energy, Development of the Oil and Gas Resources of United Kingdom. London, HMSO (1986); Great Britain (1985, S. 90).
[85] See, e.g., Department of Energy, Development of the Oil and Gas Resources of United Kingdom. London, HMSO (1987).
[86] See,e.g., *Advanced Petroleum Revenue Tax Act*, Ch. 68, in the Taxes Acts, 1997 Ed. Great Britain. Norwich: The Stationery Office (1986, S. 1).
[87] See, e.g., *Finance Act 1987*, Ch. 16, in the Taxes Act, 1997 Ed. Great Britain. Norwich: The Stationery Office (1987, S. 65).

The Chancellor of the Exchequer announced in the 1988 Budget that all Southern Basin and onshore fields for which a development permit was given after 31st March 1982 would be exempted from royalties with effect from 1st July 1988.[88] In this regard, the Petroleum Royalties (Relief) and Continental Shelf Act 1989 stated:[89]

> "**1**. **—**(1) Petroleum won and saved from any relevant Southern Basin or onshore field or relevant onshore area shall be disregarded in determining whether any and, if so, what—
> (a) payments of royalty; and
> (b) deliveries of petroleum, are to be made in relation to chargeable periods ending after 30th June 1988 as consideration for the grant of a licence to which this section applies."

This was the second stage of abolishing royalties. In the same year, the Income and Corporation Taxes Act (ICTA) 1988 tackled interest payments to a participator on the extra payment of PRT to the Government. It stated that this interest should not be considered when calculating the operator's profits for corporation tax purposes. In this regard the Act stated:[90]

> "Where any amount of petroleum revenue tax paid by a participator in an oil field is, under any provision of Part I of the 1975 Act, repaid to him with interest, the amount of the interest paid to him shall be disregarded in computing the amount of his income for the purposes of corporation tax."

Also, in June 1988 it was announced that royalties would be taken in cash after 31st December 1988 rather than in kind.[91] In the 1988 Budget, the Chancellor of the Exchequer reduced the PRT oil allowance. In this regard DOE[92] states that there would be:

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[88] See, e.g., Bland, supra note 34; *Petroleum Royalties (Relief) and Continental Shelf Act 1989*, Ch. 1. London, HMSO (1989); Department of Energy, Development of the Oil and Gas Resources of United Kingdom. London, HMSO (1988)

[89] See, e.g., Great Britain, supra note 88 – S. 1.

[90] See, e.g., *Income and Corporation Taxes Act 1988: Petroleum Extraction Activities* (Ch. V), Ch. 1, in The Taxes Acts, 1997 Ed. Great Britain. Norwich: The Stationery Office (1988, S. 501).

[91] See, e.g., Department of Energy, Development of the Oil and Gas Resources of United Kingdom. London, HMSO (1989); SC DEB (A), *16 June 1988 c129* STANDING COMMITTEE A, Financia (NO.2) Bill. HC, 9th Sitting (16 June 1988, clause. 129).

[92] See, e.g., DOE, supra note 88 – 72.

> "A reduction in the PRT oil allowance from 250,000 to 100,000 tonnes per chargeable period with the cumulative limit reduced from 5 to 2 million tonnes. This measure would also be effective from 1 July 1988."

This proposal was amended following consultation with the oil and gas industry and the result was that the allowance was set at 125,000 tonnes with a maximum cumulative amount of 2.5 million tonnes.[93] In this context, Mr Lilley, MP, in a Parliamentary debate on the 16th June 1988 stated:[94]

> "It was no part of our objectives to increase the aggregate amount of tax paid by base fields, taken as a whole. Instead, we wanted to set the petroleum revenue tax oil allowance at a level that would leave the overall tax take unchanged over the life of the fields affected by the restructuring."

The consequence of such changes is reducing tax burdens on oil and gas production, so it in fact works as an investment incentive.

During the early 1990s the UK petroleum fiscal regime had some problems as fields that were paying PRT faced a high marginal tax rate. This high tax rate led oil and gas companies to try to avoid, to some extent, a heavy tax burden. For example, some companies tried to shift income into fields that did not pay PRT and shift expenditure into PRT paying fields, as immediate tax relief was available for PRT paying fields. This behaviour, plus the low oil prices during that period of time, resulted in a decline in the Government tax take from the oil industry. These factors made the Government consider a new relaxation package to reduce taxes in the petroleum fiscal regime.

During 1990 there were no major changes to the petroleum fiscal regime. However, the Capital Allowances Act (CAA) of 1990 set out allowances for expenditure on scientific research of a capital nature and permitted payments to research associations to be written off when computing the profits or gains of the trade for the purpose of tax.[95] In this year the RFCT rate was lowered to 34 %; this reduction made the marginal petroleum tax rate 85.56 % for old fields and 83.5 for fields developed after

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[93] See, e.g., DOE, supra note 91; Great Britain, supra note 90; KPMG, supra note 23.
[94] See, e.g., SC DEB (A), 16 June, supra note 91.
[95] See, e.g., Capital Allowances act 1990. Ch. 1, in The Taxes Acts, 1997 Ed. Great Britain: Norwich: The Stationery Office (1990, S. 136).

March 1982. The RFCT rate was further reduced to 33 % in 1991; this consequently lowered the petroleum marginal tax rate to 85.34 % for old fields and to 83.25 % for new fields.

The Period 1993-2001

The 1993 was another year of significant changes to the UK oil and gas taxation regime. In this year the Government made the following major changes.

1. PRT was abolished for oil fields with development consent on or after 16th March 1993. In this regard the Finance Act, 1993, stated:[96]

   > "(3) Petroleum revenue tax shall not be charged in accordance with the Oil Taxation Acts in respect of—
   > (a) profits from oil won from a non-taxable field under the authority of such a licence as is referred to in section 1(1) of the principal Act; or
   > (b) any receipts accruing to a participator in a non-taxable field which, in the case of a taxable field, would be tariff receipts or disposal receipts attributable to the field for any period."[97]

   The above tax reform made the newest fields, with development consents after March 1993, subject only to RFCT at a rate of 33 %.
2. The oil allowance for PRT purposes was abolished as well. In this regard the Finance Act 1993 (S. 185 (4)) stated "(e) no expenditure shall be regarded as allowable (or allowed) for a non-taxable field under the Oil Taxation Acts"
3. The rate of PRT was reduced for oil fields that had development consent before 16th March from 75 to 50 %. In this regard the Finance Act 1993 stated:[98]

   > "(1) With respect to chargeable periods ending after 30th June 1993 the rate of petroleum revenue tax (relevant only to taxable fields) shall be 50 per cent. And accordingly, with respect to such periods, in section 1(2) of the principal Act for "75" there shall be substituted "50"."

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[96] See, e.g., *Finance Act 1993*, Ch. 34, in The Taxes Acts, 1997 Ed. Great Britain. Norwich: The Stationery Office (1993, S. 185).

[97] Finance Act 1993 (S. 185) defines a non-taxable field as a field:
(a) for no part of which consent for development was granted to a licensee by the Secretary of State before 16th March 1993; and
(b) for no part of which a programme of development was served on a licensee or approved by the Secretary of State before that date"

[98] Ibid, S. 186.

This tax reform brought the marginal tax rate for old fields to 70.69 % and for fields developed post March 1982 but pre March 1993 to 66.5 % (41.4 % for non PRT paying fields); while fields developed post March 1993 were subject to a marginal tax rate of 33 %, which was the RFCT rate at the time.

The interesting point here is that there was a contradiction between the Government's intention of keeping the PRT rate relatively stable and what occurred in reality. In this regard Nigg and Keeling state:[99]

> "Government stated that it was a tax which would not be amended significantly. Subsequently to its introduction in 1975, the legislation has been amended in seven different Finance Acts and one Petroleum Revenue Tax Act."

The period up to 2000 had not seen major changes in the petroleum fiscal regime. However, the RFCT rate was reduced in 1997 to 31 %; this pulled the petroleum marginal tax rates for the three different areas of the UKCS down to 69.81 % for old fields, 65.5 % for fields developed post March 1982 but pre March 1993 and 31 % for fields developed post March 1993.

In 1999, the RFCT rate was further reduced to 30 %. This consequently reduced the marginal tax rates of the oil fields to 69.38 %, 65 % for fields developed post March 1982 but pre March 1993 and 30 % for fields developed post March 1993.

As can be seen from the above account, the tax regime which applies to any particular oil and gas field depends on the date of receiving development approval. Depending on the age of any field and its taxable state, the marginal rates of tax vary between 69.4 % and 30 %. If the field is liable for royalties, PRT and RFCT then the marginal tax rate would be 69.4 %. If the field is liable for PRT and RFCT then the marginal tax rate would be 65 %. The marginal tax rate would be 30 % for fields that are liable

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[99] See, e.g., Nigg and Keeling, supra note 30- 63.

for RFCT only.[100] Changes to the petroleum tax regime were initially intended to simplify the regime, as well as make the UK an attractive investment province for international oil and gas companies. This opinion was supported by a statement from Tony Blair, the Prime Minister, that the UK oil industry enjoyed an 'enormously favourable tax regime'.[101]

The Period 2002-2010

A major tax change to the North Sea regime came about in 2002 when the Chancellor of the Exchequer announced on 17 April that companies producing oil and gas in the UK or on the UK Continental Shelf (UKCS) would pay a supplementary charge (SC) of 10% on the profits from companies' ring fenced trades in addition to the 30 % corporation tax already payable on these profits. Companies paid the supplementary charge on ring fence profits at the same time as their general corporation tax liability, but special rules for instalment payments covered the transitional period (i.e. the accounting period that includes Budget day). These special rules ensure that no underpayment of instalments should arise by virtue of the introduction of the special charge (HMRC, 2010b).[102] Also in this year the Budget introduced 100 % First Year Capital Allowances to be available to virtually all ring fenced capital expenditure. This allowance was aimed at stimulating investment in the North Sea. Furthermore, in the same Budget the Chancellor for the Exchequer announced the intention of abolishing the royalty completely.[103] By introducing the SC, the marginal tax rate of the three areas of the UKCS has changed as follows: 73.75 % for old fields, 70 % for fields developed post March 1982 but pre March 1993, and 40 % for the post March 1993 fields.

Royalty was abolished effective from 1st January 2003. This in its turn changed the marginal tax rate for fields developed before March 1982 to 70 % while fields developed after March 1982 were not affected since these fields were not subject to

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[100] See, e.g., Department of Trade and Industry, *Development of the Oil and Gas Resources of the United Kingdom*. London, HMSO (2001, S. 3.28).
[101] See, e.g., R. Corzine, *Offshore Oil Sector Keen to Know What's in the Pipeline: Uncertainty Over Taxation May Hit Investment*, FINANCIAL TIMES 16 (19 May 1998).
[102] See, e.g., HMRC, supra note 20.
[103] See, e.g., Finance Act 1981, Ch. 23, available at: http://www.england-legislation.hmso.gov.uk/acts/acts2002/ukpga_20020023_en_1. Great Britain (2002).

royalty.[104] The interesting issue in this reform is that it simplified the oil and gas fiscal regime for fields developed before March 1993 since these fields became subject to the same marginal tax rate from January 2003.

The rate of the supplementary charge was raised to 20 % effective from 1st January 2006.[105] This increase in the SC rate increased the marginal tax rate for the three defined areas of the UKCS as follows: 75 % for any field developed pre March 1993, and 50 % for fields developed post March 1993.

These changes made the UK petroleum fiscal regime more complex. The regime which applies to any particular oil field depends on the date on which it received development consent.[106] Fields which received development consent before 16 March 1993 are subject to PRT, RFCT and SC, these fields pay a marginal tax rate of 75 % (50% for non PRT paying fields). Fields which received development consent on or after 16 March 1993 are subject only to RFCT and SC, these bear a marginal tax rate of 50 %. As can be seen from the above, from January 2003 the UK oil and gas resources are being extracted under a concession system but with no royalty charge; this exempts the UK from being described as a royalty/tax country although it uses the concession type of oil and gas agreements.

In 2009, the Government introduced a "Field Allowance" to encourage investment in small or technically challenging fields. This allowance was set for £75 million for small fields and £800 for ultra heavy oil fields and ultra high pressure/high temperature fields. The Government believes that the introduction of this allowance would contribute to unlocking 2 billion barrels of the remaining UK oil and gas reserves.[107]

CONCLUDING NOTES

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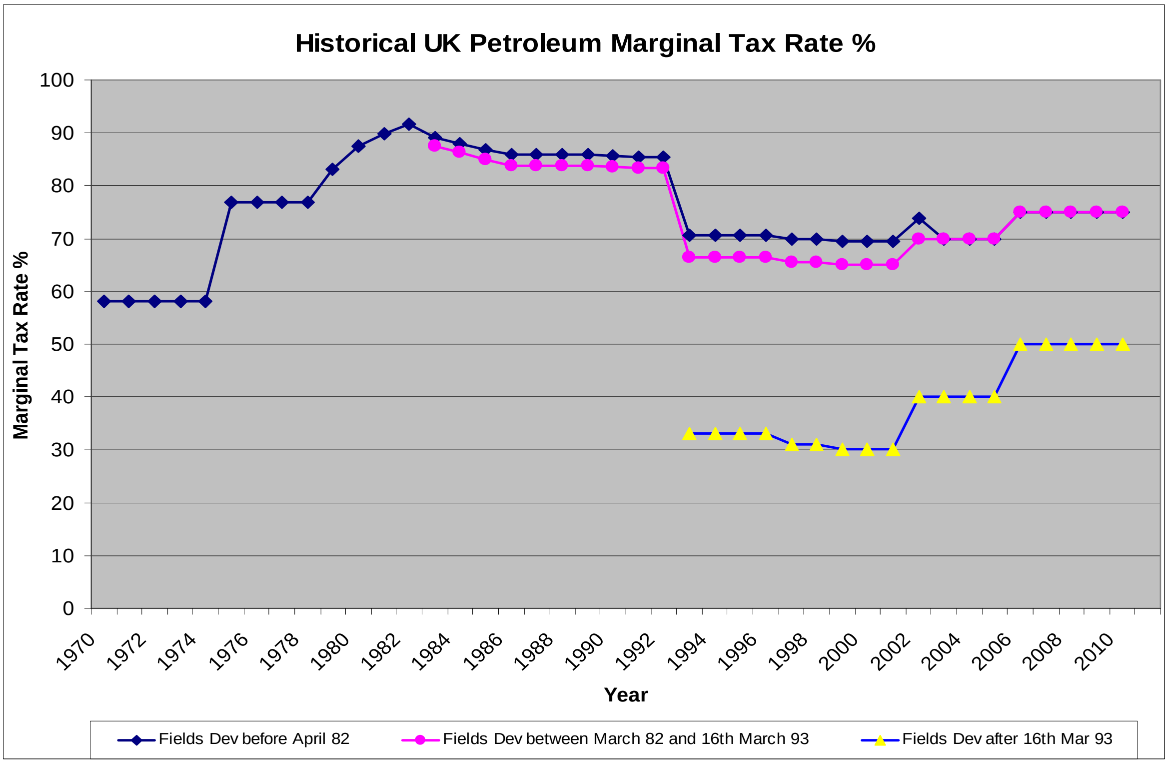
[104] See, e.g., HMRC, supra note 7.
[105] See, e.g., HMRC, supra note 20.
[106] See, e.g., Abdo, supra note 62.
[107] See, e.g., HMRC, *North Sea Fiscal Regime: Incentivising Production*, available at: http://www.hmrc.gov.uk/budget2009/bn10.pdf (2009).

This paper briefly introduced the concession type of oil and gas agreements and uncovered the so called “North Sea Model”. This model is a tailored concession to fit the UK’s way of running its oil and gas business. This tailored style of concession made the UK concession an exceptional case since it ended with no royalty payments, which is an essential criterion of the well known oil and gas concessions around the world. The focus of the paper was on the development of and trends within the UK oil and gas fiscal regime.

The UK petroleum fiscal regime was established in 1975 and tightened up with a number of different new taxes up until 1981. The objective of the tight fiscal regime was to secure more rent from the UK oil and gas resources for the nation, in particular when oil prices increased dramatically throughout the 1970s. However, in the 1980s, the UK witnessed slow downs in its oil and gas investments. This led the Government to relax the petroleum fiscal regime in 1983. The main rationales behind that tax relaxation were to accelerate oil and gas investments and to increase Governmental revenues from oil and gas activities. The Government introduced another tax relaxation package in 1993 to further encourage investments in new and smaller fields. This last relaxation made the UK petroleum tax regime more complex and added a new split to it; by doing so, the UKCS was divided into three different tax areas. The division was not based on geographical location of oil and gas fields but based on the development date. These three divisions were as follows: fields developed before April 1982, fields developed after March 1982 but before 16th March 1993 and fields developed post 16th March 1993. Different fields were subject to different marginal tax rates. The Government abolished royalties completely in 2003, which simplified the petroleum fiscal regime and resulted in the final division of oil and gas fields as: fields developed pre or post 16th March 1993.

The introduction of the ring-fenced supplementary charge in 2002 at a 10 % rate and the doubling of this rate in 2006 represented an upward change trend after a period of relaxation extended between 1983 and 2002. Figure 1 depicts the different trends of the marginal tax rate between 1970 and 2010.

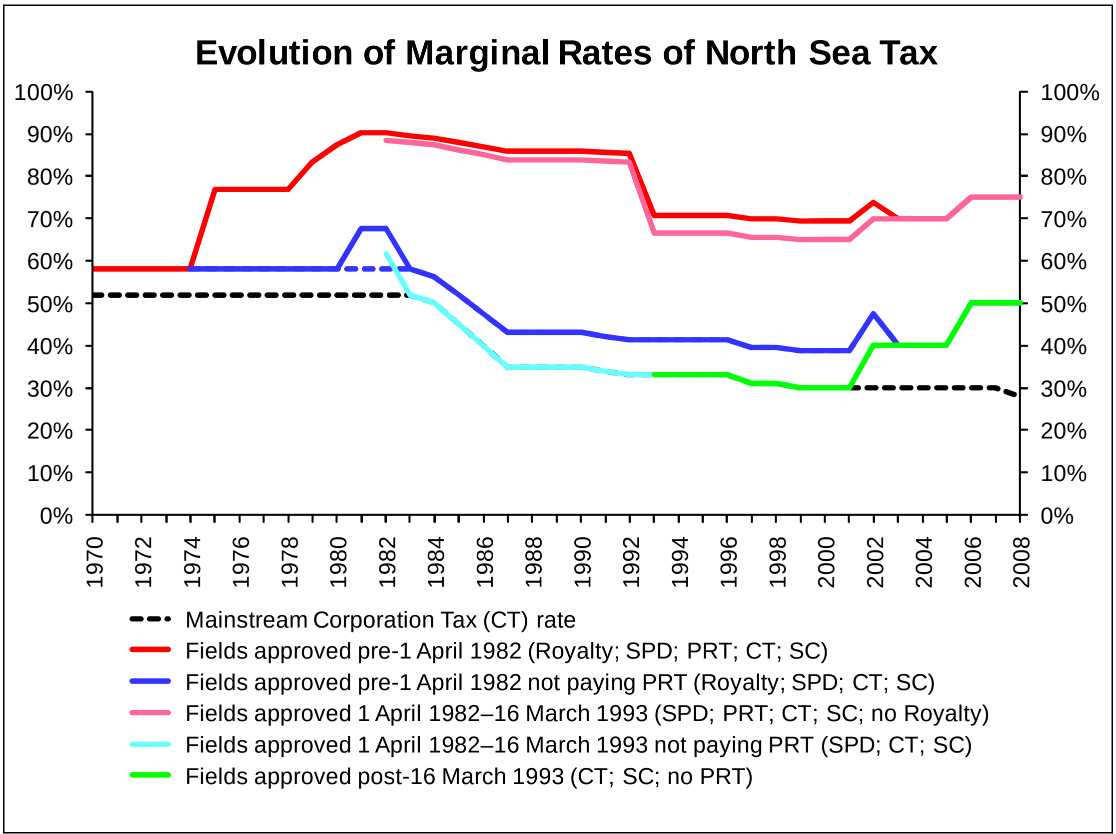
Figure 1:



Source: based on data extracted from the HMRC.

Figure 1 shows a simplistic picture of the evolution of the marginal tax rate based on periodical criteria. However, Figure 2 demonstrate a clearer picture of the different trends of the marginal tax rate based on periodical criteria and provide a clearer picture of the different taxes and duties applied to oil and gas fields in the UKCS over the period 1970-2010.

Figure 2



Source: based on data provided by Mike Earp from the DECC

It is obvious that the upward or downward trends in the petroleum marginal tax rate followed the Governments' main policy objectives, which have always shifted due to changes in the political, economic and investment needs of the UK. We may explain these changes as follows:

- During the 1970s the UK was a new oil and gas province and with the increase in oil and gas prices the Government established and quickly tightened the petroleum fiscal regime in order to capture as much economic rent as possible from its oil and gas resources; this involved introducing new taxes, i.e., SPD and increased rates of existing taxes, i.e., PRT.
- During the 1980s and 1990s oil and gas investments slowed down and oil companies lost their appetite for exploration and development investments in the UKCS. To incentivise investment in upstream oil and gas the Government introduced tax relaxation packages in 1983 and 1993.
- During the 2000s and with the increase in oil and gas prices, the Government introduced the SC and doubled its rate to benefit from the increase in prices

and to capture more tax revenue. However, since ‘energy security’ is a real concern for the UK Government, particularly with the dramatic decrease of the UK oil and gas production post 2000, the UK Government introduced a ‘Field Allowance’ in 2009 to support investment in the UKCS, particularly in smaller fields, and to maintain a supply of oil and gas from its own resources.

The UK petroleum fiscal regime has always been described as one of the weakest and more complex regimes in the World. We can add to these descriptions a non-stable regime.[108] The oil and gas licensing system in the UK has experienced different trends and changes according to the many different policy objectives shaped by different Governments in the UK, Labour or Conservatives. This issue may be the topic of further research in this area.

[108] See, e.g., Rutledge and Wright, supra note 55.

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