PETROLEUM REVENUE TAX - Claim to allowance for expenditure on the drilling of unproductive wells - Unproductive exploration wells drilled within 5000 metres of the boundary of an existing formally determined oilfield - Whether the exploration expenditure needed to be incurred for a "field purpose" - Section 3(1)(a) Oil Taxation Act 1975

THE SPECIAL COMMISSIONERS

AMERADA HESS LTD Appellant

- and -

THE COMMISSIONERS OF INLAND REVENUE Respondents

Special Commissioners: T H K EVERETT

STEPHEN OLIVER QC

Sitting in London on 26 and 27 June 2000

Jonathan Peacock of Counsel, instructed by Messrs Freshfields, Solicitors, for the Appellant

Timothy Brennan of Counsel, instructed by the Solicitor of Inland Revenue, for the Respondents

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DECISION

Amerada Hess Ltd ("AHL") appeal against the disallowance by the Oil Taxation Office of the Inland Revenue of two separate petroleum revenue tax expenditure claims dated respectively 28 February 1995 and 31 August 1995. The claims were refused by notices of decision dated respectively 11 May 1995 and 12 September 1995.

1. The evidence before us consisted of two bundles of agreed documents, the first of which contained a statement of agreed facts and issues and the agreed witness

statement (qualified by the terms of a supplementary statement) of Helen Hichens, the central north sea manager of the Oil and Gas Directorate at the Department of Trade and Industry. As the contents of her witness statement (as subsequently qualified by the terms of her supplementary statement) were not challenged by AHL, she did not appear and was not cross-examined.

2. Ms Hichens' witness statement and supplementary statement will be available to the Court should these appeals proceed further.

The issue

3. The issue in these appeals relates to the deductibility for Petroleum Revenue Tax ("PRT") purposes under section 3(1)(a) of the Oil Taxation Act 1975 ("OTA 1975") of expenditure incurred in connection with drilling two exploration wells in the vicinity of the Rob Roy field in the North Sea in 1994 and 1995.

Section 3(1)(a) OTA 1975 provides as follows, were relevant:

"3.-(1) ... the expenditure allowable under this section for any oil field is any expenditure (whether or not of a capital nature) which ... is incurred by a person at or before the time when he is a participator in the field to the extent ... that it is incurred for one or more of the following purposes, namely -

(a) searching for oil anywhere within the area of the field as subsequently determined under Schedule 1 to this Act or not more than 5,000 metres beyond the boundary of that area."

The facts

From the evidence before us we find the following facts:

1. AHL was incorporated in the United Kingdom on 1 June 1964 (No. 807346) and has been resident in the United Kingdom for tax purposes at all times relevant to the subject matter of these appeals. AHL is, and has been throughout the relevant period, a wholly owned subsidiary of Amerada Hess Corporation, a United States Corporation registered in Delaware and quoted on the New York Stock Exchange. AHL is subject to PRT in respect of the oil and gas production which it derives from the Rob Roy field.

2. PRT is charged under the provisions of OTA 1975, as supplemented and amended by subsequent Finance Acts and by the Oil Taxation Act 1983. It is charged on each participator in a relevant field, by reference, broadly, to the net profit of the participator from that field taken separately from any other oil or gas field interests of the participator. Profits or losses are determined by reference to chargeable periods of six months commencing on 1 January and 1 July in each year. In respect of chargeable periods relevant to these appeals the rate of PRT was 50%.

3. AHL, together with three other companies, is entitled to explore for and exploit oil and gas from the area which includes the Rob Roy field under licences P218 and P588 granted by the Secretary of State for Energy on 10 June 1972 and 17 August 1987 respectively. (Licence P218 superseded exploration licence E218, which had been granted to Monsanto Oil Company of the UK Inc. on 21 June

1984; AHL acquired Monsanto Oil Company of the UK Inc. in 1985.) Under each of these licences, AHL is a participator as to 42.084%, the other participators being Veba Oil & Gas UK Ltd (as to 43.333%), Kerr-McGee Oil (UK) Plc (as to 10.833%) and Premier Pict Petroleum Plc (as to 3.750%) (together with AHL, "the participators"). For the purposes of these appeals, AHL represents the participators.

4. The Rob Roy Field was discovered in May 1984, formally determined by the Department of Energy in February 1986 and developed over the period from 1986 to 1989. Production commenced from the field in July 1989. Two other fields, the Ivanhoe and Hamish fields, were discovered, respectively in October 1975 and January 1988 (and determined respectively in January 1986 and January 1990) within close proximity of the Rob Roy field. All three fields are exploited using a single semi-submersible floating production facility (called AH001) stationed above the Rob Roy field. AHL is the operator of all three fields on behalf of the participators and is the "responsible person" for the purposes of PRT. The participators have continued to conduct exploratory drilling in the area since determination of these fields.

5. Pursuant to a Deed of Variation to Licence P588 which was granted by the Department of Trade and Industry ("the DTI") in August 1993, the participators were allowed to avoid the mandatory relinquishment of the licence that would have been required in June 1993, on the basis that the participators undertook to drill five further wells (of which three were to be firm and two contingent) no later than June 1996. Exploration Well 15/21b-53 (Well 53) satisfies this obligation in respect of one of the firm wells. Well 53, located approximately 3.5 kilometres to the North-west of the Rob Roy field in the Theta South Prospect, was approximately 8,500ft deep. It was drilled by AHL on behalf of the participators under Licence P588 to explore certain sandstones of the Piper formation, which is the geological producing horizon which contains the reserves exploited by the Rob Roy, Ivanhoe and Hamish fields, with certain Claymore sandstones as a secondary target.

6. The participators approved the drilling of Well 53 during the first half of 1994 and the necessary consents were obtained from the Department of Transport ("DoT") and the Health and Safety Executive ("the HSE"). Drilling commenced on 28 August 1994. In mid-September 1994, in the light of disappointing results, AHL obtained the consent of the HSE to the abandonment of Well 53 and it was subsequently abandoned pursuant to such consent.

7. Exploration Well 15/21a-54 (Well 54), located approximately 2.2 kilometres to the East of the Rob Roy field in the Rho B Prospect, was approximately 10,500ft deep. It was drilled by AHL on behalf of the participators under Licence P218 to explore the Oxfordian/Kimmeridgian sandstones of the Piper formation. As in the case of Well 53, the intention was that commercial oil reserves discovered could rapidly be brought into production by means of a submarine pipeline to AH001, AHL's production facilities at the Rob Roy field.

8. The participators approved the drilling of Well 54 during the second half of 1994 and the necessary consents were obtained from the DoT and the HSE. Drilling commenced on 13 December 1994. At the end of January 1995, following disappointing results, AHL obtained the consent of the HSE to the abandonment of Well 54 and it was subsequently abandoned pursuant to such consent.

9. The purpose of the participators and of AHL as operator in drilling Wells 53 and 54 was in each case to search for commercial reserves of oil in satellite deposits

of hydrocarbons. AHL does not claim that the extension of the Rob Roy field (or of any other existing field) was the purpose of the drilling of Wells 53 or 54.

Paragraph 5.3 of Ms Hichens' witness statement states as follows:

"If the Wells [53 and 54] had proven economic or oil accumulations, it was understood from communications with Amerada Hess that the discoveries would have been tied back to the AH001 production facility on the Rob Roy field, either using these existing Wells or by drilling dedicated production Wells. As hydrocarbons were not found evacuation did not need to be considered, but if the Wells had proven economic oil accumulations it appears likely that any proposals for production would have led to the consideration of a new field or fields."

10. Ms Hichens' conclusion as stated in her witness statement (as amended to take account of her supplementary statement) is as follows:

"When the applications for consent to drill Wells 15/21b-53 and 15/21a-54 were made, the mapping took account of the geological information available between the field boundaries and the untested prospects, and it was considered that the prospects were likely to be entirely separate from the Ivanhoe and Rob Roy fields."

11. By PRT expenditure claim No.15 dated 28 February 1995 in respect of the Rob Roy field, AHL made a claim for deductions for PRT purposes in respect of expenditure incurred by the participators in relation to the PRT chargeable period beginning 1 July 1994 and ended 31 December 1994. This claim included an amount of £4,464,156 claimed pursuant to section 3(1)(a) under Schedule 5 OTA 1975 in respect of Well 53 ("the Well 53 claim"). By notice of decision No.2 dated 11 May 1995, the Inland Revenue Oil Taxation office ("the OTO") disallowed the entire amount of the Well 53 claim.

12. By PRT expenditure claim No.16 dated 31 August 1995 in respect of the Rob Roy field, AHL made a claim for deductions for PRT purposes in respect of expenditure incurred by the participators in relation to the PRT chargeable period beginning 1 January 1995 and ended 30 June 1995. This claim included an amount of £2,603,085 claimed pursuant to section 3(1)(a) under Schedule 5 OTA 1995 in respect of Well 54 ("the Well 54 claim"). By notice of decision No.1 dated 12 September 1995 the OTO disallowed the entire amount of the Well 54 claim.

13. The claims set out in paragraphs 11 and 12 above were for direct drilling expenditure and for seismic costs associated therewith.

The contentions of the parties

4. Whilst conceding that both the Well 53 and Well 54 claims relate wholly to expenditure incurred within 5,000 metres of the Rob Roy field boundary, for the purposes of searching for oil, Mr Brennan, who appeared for the Respondent Commissioners submitted that neither claim qualifies for relief pursuant to section 3(1)(a) OTA 1975 on the grounds that the expenditure was not incurred for a field purpose. On a proper interpretation of the legislation the drilling must have been targeted at the field of claim in order for expenditure on such wells to

achieve relief. He referred us to Carr v Armpledge Ltd [2000] STC 410; McGuckian v CIR 69 TC 1 and Chevron UK Ltd v IRC [1995] STC 712.

5. Although placing emphasis on the word "subsequently" in section 3(1)(a), he conceded that there was no timing point to be taken in these appeals and that "subsequently determined" could be read as "subsequently re-determined".

6. Mr Peacock, who appeared for AHL submitted that his client's claims lay four square within the precise words of section 3(1)(a) and that a field purpose was not a requirement of that section, the terms of which were satisfied entirely if the exploration took place within 5,000 metres of the relevant field boundary for the purposes of searching for oil.

7. He referred us to the Cape Brandy Syndicate v CIR 12 TC 358; IRC v Mobil North Sea Ltd [1987] STC 458 and Carr v Armpledge Ltd.

8. It is common ground in these appeals that the words of the statute are not ambiguous and accordingly there is no occasion to have resort to Hansard under the rules laid down in Pepper v Hart [1992] STC 898.

9. Both Mr Brennan and Mr Peacock submitted written skeleton arguments which will be available to the Court should these appeals proceed further.

Conclusions

10. Mr Jonathan Peacock, who appeared for AHL in these appeals began his address by telling us that determination of the issue between the parties boiled down to the Tribunal's view in interpreting the 31 words contained in section 3(1)(a) OTA 1975. And it is common ground in these appeals that if we are to adopt a literal construction of those 31 words, AHL must succeed.

11. In contending for a literal construction, Mr Peacock reminded us of the well-known words of Rowlatt J in Cape Brandy Syndicate v IRC, quoted with approval by the Lord President (Hope) in IRC v Quigley at page 938h where he said:

"But in Tennant v Smith (Surveyor of Taxes) [1892] AC 150 at 154, 3 TC 158 at 163 Lord Halsbury LC said that in a taxing Act it was impossible to assume any intention, or any governing purpose, to do more than take such tax as the statute imposes. As he put it "you must see whether a tax is expressly imposed". Rowlatt J was making the same point when he said in Cape Brandy Syndicate v IRC [1921] 1 KB 64 at 71, 12 TC 368 at 366 that in matters of taxation you have to look simply at what is clearly said in the taxing Act, as there is no room for any intendment and there is no equity about a tax. The answer to the question in this case must depend therefore upon an examination of the words used in para. 4 of Sch. 6. That is the provision to which one is required to look by s.157(5) to identify the amount of the reduction from the cash equivalent."

12. Mr Peacock also sought support from Carr v Armpledge where Peter Gibson LJ said at page 416b:

"I return to the Judge's reasons. On the first reason, the absence of an expressed provision in favour of the taxpayer, Lord Goldsmith submitted that the Judge's approach was fundamentally wrong. Lord Goldsmith's proposition was that the

taxpayer is entitled to take advantage of a relief to the extent and in the manner that he wanted subject only to any expressed or implied statutory prohibition, such implication only being made where it is necessary and where the statute unambiguously so requires. We were referred to a number of authorities in support of this submission, including Farmer (Inspector of Taxes) v Bankers' Trust International Ltd [1990] STC 564, Elliss (Inspector of Taxes) v BP Oil Northern Island Refinery Ltd [1985] STC 722 and Collard (Inspector of Taxes) v Mining and Industrial Holdings Ltd [1989] STC 384. I did not understand Mr McCall to dispute Lord Goldsmith's proposition. He accepted that it was for the Crown to show that by necessary implication effect had to be given to claims to carry back surplus advance corporation tax for accounting periods in the chronological order of those periods, it being conceded by him that there were no expressed words on which he could rely for that requirement."

13. Mr Brennan contended that the law had moved on since the time of Quigley, and that a purposive approach was now generally to be adopted in taxing matters. In relation to Carr v Armpledge, he submitted that it was possible to distinguish this authority as it dealt with taxation machinery and not with substantive issues.

14. It falls to us therefore to decide whether it is possible for us to adopt Mr Brennan's purposive approach to the construction of section 3(1)(a). If we cannot, AHL must succeed in its claims.

15. It may be helpful to look at the history of section 3's relationship with other reliefs.

16. Until 1983 relief was available for abortive exploration expenditure as defined in section 5 OTA 1975. That relief was abolished in 1983 and replaced by relief for exploration and appraisal expenditure (section 5A OTA 1975 and section 2(9)(f)). Relief under section 5A was abolished in 1993. There was an inevitable overlap between the reliefs available pursuant to section 5A and section 3 and it seems to us that the knock-on effects of the abolition of section 5A on the provisions of section 3 may not have been fully appreciated by the legislature at the time.

17. In contending for a purposive construction of the legislation Mr Brennan referred us to extracts from speeches in the House of Lords in IRC v McGuckian and also to part of the judgment of Vinelott J in Chevron UK v CIR.

18. Whilst we accept that a purposive approach to the construction of tax statutes is now permissible and is frequently adopted by the Courts, that does not get Mr Brennan home. We must be satisfied that a contextual approach is appropriate in these particular appeals.

19. Mr Brennan has drawn our attention to the fact that in his submission section 3 is targeted at "the field". The opening words of section 3(1) itemise all allowable expenditure "for any oil field". Further, subsections 3(1)(c), (d), (e), (f), (g) and (h) all make reference to "the field". In addition, the opening words of subsection 3(1)(a) refers to "searching for oil anywhere within the area of the field".

We are left with subsection 3(1)(b) which states:

"making to the Secretary of State any payment under or for the purpose of obtaining a relevant licence, not being a payment by way of royalty or other periodic payment."

20. Section 3(1)(b) contains no implicit reference to "the field". Licences are not limited to the areas of oil fields, but cover blocks of the North Sea. It is possible for a licence to include more than one oil field and it is also possible for an oil field to extend beyond the area covered by one licence. And therefore it seems to us that section 3 is not entirely "field based" as contended for by Mr Brennan.

21. His attempt to draw conclusions from the relationship between section 3 and section 5 and section 5A are, in our view, not convincing. The reliefs provided by those sections are separate and any possible overlap does not seem to us to assist us in construing the words of section 3(1)(a).

22. Mr Brennan has also pointed out to us what he considers to be "odd results" of a decision in favour of AHL. However, in the light of the clear unambiguous words of section 3(1)(a) it does not seem to us that any of the examples quoted by Mr Brennan produce a result which is "odd" if we accept that the test is geographical (within 5,000 metres of the boundary of an oil field) rather than geological (i.e. linked to the area of an existing oil field).

23. It also seems to us that were Mr Brennan's submissions to be correct, a geographical limit would no longer be necessary. And the concluding words of section 3(1)(a) would be otiose.

24. In citing examples and responding to examples put before us by Mr Peacock on behalf of AHL, Mr Brennan was unable to deal with the possibility that one oil field could lie directly beneath or indeed possibly above another oil field. It is unnecessary for us to accept Mr Peacock's assurances that such formations do exist as this Tribunal has had experience of an appeal in which two separate oil fields lay one above the other.

25. Having considered the matter in the light of all the arguments put before us we have come to the conclusion that Mr Peacock's submissions are to be preferred and that we should accept a literal construction of section 3(1)(a) and the consequence that the determining factor is geographical, not geological.

26. The appeals succeed and we adjourn this hearing to enable the parties to agree figures.

T H K EVERETT

STEPHEN OLIVER QC

SPECIAL COMMISSIONERS

Date Released: 31st July 2000

SC 3118/99