

MEMORANDUM TO CABINET BY THE
HONOURABLE THE PRIME MINISTERDraft Petroleum (Production) Regulations, 1967

The Oil Committee is recommending that the attached draft Petroleum (Production) Regulations, 1967 be sent, without any commitment on the part of Government, for the comments of oil companies who have shown interest in Malta's offshore areas. This practice was followed in U.K. before the issue of the U.K. Petroleum Regulations. A copy of the covering letter is also attached.

2. It will be recalled (Memorandum 546 A), that the meeting between the Oil Committee and interested oil companies on the proposal for a collective survey were jeopardized by Shell's last minute request, making their participation conditional upon Government's willingness to discuss both the survey and the draft regulations prepared by Mr F. Rouhani, U.N. expert on oil matters. Esso refused to participate unless the regulations were first published. In view of this development, the Committee discussed both the survey and the draft. Copies of the draft regulations were given to the companies for detailed study, making it clear that there was no commitment on the part of Government. A copy of the regulations was subsequently also given to Esso.

3. The Oil Committee's recommendation stems from the companies' request to be allowed to comment on the revised draft of the regulations when, during the discussions, they were told that Mr Rouhani's draft would have to be recast to bring it in line with Maltese constitutional and legal practice.

4. Mr Rouhani's draft is based on Middle East concepts. It is very comprehensive and regulates also activities which are covered by existing legislation. The revised draft is substantially similar but follows the pattern of U.K. legislation on petroleum production. It provides for model clauses which, unless the Minister thinks fit to modify, are to be incorporated in the licence and spells out the rights and obligations, both legal and

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technical, of the licensee. It makes no mention of the financial considerations involved as these would appear in the call for applications for eventual insertion in a schedule to be attached to the licence. Licences will be executed as deeds in duplicate. The provisions in Mr Rouhani's draft relating to matters already covered by existing legislation have been omitted.

5. An important variation is the system proposed for the valuation of oil for royalty and income-tax purposes. Mr Rouhani had suggested that royalties and income-tax should be levied on the posted price reduced, each year, by various negotiated allowances to bring it in line with the current market price. The posted price is the published price at which the company would be willing to sell on the open market but this is an artificial price as it is hardly ever possible that companies succeed in charging such a price. It is now proposed that royalties and income-tax be charged on the actual market price obtaining at the time when the oil is won and saved. The latter system is far more practicable and is in line with Western European concepts.

6. The last paragraph but two of the draft letter refers to a proposed amendment to the Income Tax Act of 1948. This amendment had been proposed by Mr Rouhani to give effect to the expensing of royalties, a principle which has already accepted. At present, royalties are not treated as an expense by oil companies but any royalties paid are deductible from the tax as assessed at the rate of 10/- in the £; under this system the sharing of profits on petroleum production is made on a 50-50 basis. The proposed amendment will enable companies to treat royalties as an expense but the amount paid as royalties will no longer be deductible from the tax assessed; thus Government's total income will work out, roughly speaking, at 50% of the profit plus an amount equivalent to half of the amount paid as royalty.

7. The draft Bill on the proposed amendment was submitted by the Committee for the views of the Commissioner of Inland Revenue, along with other matters affecting his Department. The Commissioner of Inland Revenue agrees that the proposed amendment will increase the tax but he sees no reason why such an amendment should be dealt with separately and not by the proposed Income Tax Commission.

8. The Committee does not share C.I.R.'s view on this point. The proposed amendment is intimately linked with the proposed Petroleum (Production) Regulations; if the amendment to the Income Tax Act is delayed, the publication of the Regulations will have to be held up. The Committee has also stressed the fact that the special rate of taxation for petroleum producing companies is not, properly speaking, taxation but a mechanism for the sharing of profits.

9. As regards the other matters affecting the Department of Inland Revenue, these will be discussed by the legal member of the Committee and C.I.R. and a separate submission will be made in due course by the Committee regarding the results of these discussion.

10. In view of the above, Honourable Ministers are invited to advise whether the draft Petroleum (Production) Regulations, 1967, in their present form, should be sent under cover of a letter as per attached draft, to the following companies:

- (a) Shell, Agip, Sinclair (USA), E.R.A.P. (France) - the companies who have participated in the meetings with the Oil Committee;
- (b) Esso - who has expressed great interest in the area and has been given a copy of Mr Rouhani's draft regulations;
- (c) Malta - American Exploration Co. Ltd. - a local Company who was the first company to send in an application for a licence for the offshore areas in 1965; the company did not attend the meetings with the Oil Committee as it considered that the collective survey and the eventual bidding would be disadvantageous to a local company but had asked to be notified if there was a change in policy.

27th June, 1967.

D R A F T

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Dear Sir,

During the discussions with the Oil Committee last year some of the companies expressed the wish to be given a chance to comment on the recasted regulations when they were informed that it would be necessary to recast Mr Rouhani's draft to bring it in line with Maltese constitutional and legal practice.

... I am accordingly forwarding herewith a copy of the revised draft Petroleum (Production) Regulations, 1967.

The revised draft takes into account many of the suggestions received by the Committee. Certain chapters in Mr Rouhani's draft which provide for matters already covered by existing legislation have been left out.

As has already been stated, the continental shelf area will be divided into two blocks equally attractive as regard size, depth of water and accessibility to the Island. Bidding will be possible for either block or for both blocks, a maximum of three bids. The northern boundary of the continental shelf will be deemed to be the median line between Malta and Italy but this may be subject to slight modification when the actual median line is defined by agreement with the Italian Authorities.

It is not proposed to make any changes in the current rate of income tax payable on the profits derived from petroleum production (10/- in the £) but concurrently with the publication of the Regulations an amendment will be effected to the Income Tax Act of 1948 to provide for royalties to be treated as an expense and not as a deduction from income tax payments.

I should be grateful if you would be good enough to ask your Head Office to favour me with their comments, as early as conveniently possible.

It is understood that the draft Regulations are being made available without any commitment whatsoever on the part of Government.

Yours faithfully,