THE FISCAL REGIME GOVERNING PETROLEUM PROFIT TAXATION IN NIGERIA

BABATUNDE AJANI ADEYEMI*

INTRODUCTION

Tax is a compulsory financial exertion by government on its citizens aimed at servicing the needs of the State. Such levies take different hues, as they vary from government to government. In Nigeria, there are about five major statutes enacted for this purpose and they are: Personal Income Tax;[1] Companies Income Tax Act;[2] Capital Gains Tax Act;[3] Petroleum Profit Tax Act;[4] and Value Added Tax Act;[5]. Together, they form the hub around which government exercises its power of sovereignty by charging those that fall into each bracket, tax on income, gain, profit or purchases, as the case may be.

The Petroleum Profit Tax is perhaps the most important source of revenue generation for Nigeria, and this is not difficult to explain. The shift from an agricultural based economy before and the early part of our independence in 1960, to Petroleum based, particularly from the first military coup of 1965, has been monumental.
Equally significant, has been government's fiscal teeth on profits accruing from the resource.

Petroleum has been central to the economy as it has consistently provided over 90% of the foreign exchange earnings and had at various times contributed about 80% of the Gross Domestic Product (GDP).[6] With this type of imposing statistics, the Revenue Officials and other agencies of government, had never stopped tinkering with how best they can extract the maximum tax from the fertile source. From a seemingly moderate and equitable 50/50 provision in the 60s, the scale gradually steeped to 85% of the profit from petroleum exploitation of today.[7]

---

* Babatunde Ajani Adeyemi, LLB, BL, LLM, is a Lecturer at Babcock University School of Law and Security Studies and Barrister and Solicitor of the Supreme Court of Nigeria.
[1] No.104, 1993
[2] Cap 60 LFN 1990
[3] Cap 354, LFN 1990
[4] Cap 354, LFN 1990
[5] No.102, 1993
[6] Adeyemi, B.A – *The Problems of Crude Oil Ports in Nigeria – The Brass Terminal Experience* Research Diploma in Shipping & Transport submitted to the City of London Polytechnics London 1987
[7] Etikerentse G. *Nigerian Petroleum Law* (1985) Macmillan Publishers, London p133

Electronic copy available at: http://ssrn.com/abstract=2703616

However with the decline in the global economy, and the drought in financial resources available to the multi-national oil producing companies, fresh funds to prosecute petroleum exploration and exploitation, dried up. Prices in the crude oil market dropped to an all time low, Drilling and searches for new oil reserves reduced significantly, if not halted totally, and for a non-renewable resource, National governments, particularly Nigeria, had to do something. What they did was to mid-wife an agreement christened “the Memorandum of Understanding (MOU) in 1986[8], aimed at guaranteeing a minimum profit margin of $2.00 after tax and Royalty payments on the companies’ equity crude oil and $1.00 per barrel margin on volume of crude oil lifted and sold, on behalf of NNPC, volumes, which the latter could not market on its own.

Apparently it was a compromise of existing fiscal regime to arrest the dwindling revenue from the only economic life-line of government, during the lull in the global economy. However, twenty four years after, the MOU is still alive, having gone through a number of renewals and side letters, the last signed, with a commencement date of January 1st, 2000,[9] existing side by side, with the Petroleum Profit Act.

Given the time-tested axiom that while Revenue, (government) will always find ways of exerting the highest tax possible, and the Tax payer (International oil companies) will always strive for ways of paying the lowest tax possible, there must be obvious gaps between the PPTA and the MOU, to justify an interrogation of the fiscal regimes governing Petroleum Profit Taxation in Nigeria, with a view to bridging such a gap, to the mutual benefit of all concerned.

This paper examines the various legislative and contractual arrangements that regulate the fiscal aspects of the Nigerian Petroleum Industry, against the background of a good tax system. The impact of the various fiscal policies imposed by different agencies of government, on petroleum operations, against the backdrop of near total dependence of government on the earnings from petroleum resources will be reviewed.[1]

Law and Oil – Role of Taxation

Whether law is an instrument for social engineering, or is just one of the components (albeit an important one), of a social system, there is no argument that it performs some form of balancing in the inevitable conflicting interests often arising between the individual and

---

[8] See Chapters, infra

[9] The 2000 version with commencement date of January 1st,2000, has been suspended since 2008, with an on-going debate between the IOCs and the NNPC, on behalf of Government.

[1] Because almost all sectors of the Country’s socio-economic activities depend on oil money for existence, virtually every government, and for that matter (many that do not) want to make an input into how oil money is taxed and appropriated.

Electronic copy available at: http://ssrn.com/abstract=2703616

the society to which he belongs.[2] Thus, while it is usual to hear that there is no common law of tax, or there is no equity in tax, since adjudication in tax conflicts are usually between the tax-subject and the State, moderated by the judiciary which itself, is an agent of the latter, one may venture at least, to suggest that provisions of tax legislation should not be narrowly construed. Liberal interpretation, that takes into view the tax-subject's peculiar circumstances, should be employed by the courts.

Consequently, both the legislative and implementation stages, any tax legislation that fails to put those to be taxed in contemplation, would be fraught with a number of predictable consequences. For example, nowadays, enlightened tax payers employ ingenuous devices to avoid payment of tax legitimately by exploiting all the technical loopholes in the tax statute, relying on the fact that tax avoidance, as opposed to tax evasion, is acceptable and not negative from an input point of view.

The Oil Industry as a tax-subject is not immune to the impact of taxation. In a world market which is only a telephone call away, and with a web-site that can be surfed for varied options, investment decisions are made only after a thorough comparison of the fiscal policies of target countries.

It is against this preliminary observation that it is contended by this writer that the subject-matter of this research, should benefit from a brief, but comprehensive over-view of the Petroleum Industry generally and particularly in Nigeria, so that the relevant laws can be realistically and objectively evaluated, with a view to filling the lacunae that inevitably dodge literatures on the subject, as a result of inadequate familiarity with the Industry, and how it works in practice.

Conceptual Overview of The Oil Industry

The Oil business is a risky business. Investment in the search for and discovery of hydro--carbon, is fraught with innumerable uncertainties, in spite of the technologies of today. Assumptions based on seemingly faultless data and predictions based on intricate analysis and interpretation, often come to nought, when another dry hole is struck. The huge investments in the Chad basins of Nigeria, cannot be said to have been based on mere speculations, yet multi-nationals, with proven world-wide expertise, had found no oil to justify efforts and resources expended so far.

Even when the oil has been discovered in commercial quantity, its exploitation presents another daunting problem for the Oil companies. Oil is where it is found, and this may be the arid desserts of the Middle-East, or the impenetrable mangroves of the Niger Delta. It could even be found in environmentally unfriendly continental shelf, straddling both

[2] *ibid.*

national and international boundaries. To harness this resource, as we will see later, recourse has to be made to global expertise in the production and storage of petroleum, before its 'sale', or 'disposal'.[3]

Another aspect, which is little understood but which is very crucial to the Petroleum Industry, is the volatility of crude oil prices in the international oil markets. It used to be the case that the multi-national oil companies of the years gone by, control the production, transportation, refineries and retail outlets, as a completely integrated entity. Under this regime, the management of their investment left nobody in doubt about who was in the driving seat. Crude oil producing countries, contributed nothing but concession rights, for meagre returns in the nature of royalties.

Then something drastic happened to the Industry, in the aftermath of the Yom-Kipur war and the coming together of the Oil producing Countries to form what is today known as the Organisation of Petroleum Exporting Countries (OPEC) cartel. The Multinational Oil Companies ceded control of the Industry to the Cartel, albeit most unwillingly. Production rate and prices became what the cartel decides. The control of world economy momentarily moved to the Oil Producing nations, and both the multi-national Oil companies and the world that had got addicted to previously cheap, but now expensive oil for their day to day needs, had no choice but to abide with the 'Posted Prices'[4] as dictated by the producing countries.

Predictably, something gave again. At the height of the OPEC control, a barrel of crude oil which was sold for above $40 in 1979, inevitably started its downward nose-dive. The world economy was faced with one of the worst recessions and alternatives, including stringent measures, were mobilised under the aegis of Organisation of Economic Co-operation and Development (OECD), to moderate oil consumption. Tacit support by the home governments of oil multinationals and cheap funds hitherto available to these 'majors' as they are often called, found other more profitable outlets.[5] Imperceptibly, but undeniably, financial speculators entered into the oil market, and since then, neither the Oil Companies nor the Oil producing nations as major stake holders, had known any peace or certainty, in the control and / or determination of the Oil price.

The world oil market is today dominated by financial speculators who treat oil merely as they treat commodities like Cocoa and Coffee. Not only do these new controllers not know the colour of crude oil, they do not care what the level of price could be, inasmuch they can get their margin, from merely fiddling with computer key-boards, on which they play

---

[3] PPTA S.2 – Part of definition of "petroleum operations"

[4] Petroleum (Drilling and Production) Regulations, para 60(4) under S9 of Petroleum Act, Cap 350, LFN 1990

[5] Layade P.S.A – *Fiscal Reform Measures in the Oil and Gas Industries*: A New approach for foreign investment (1999) Mandatory professional training of Nigeria p.2&

the oil game, oblivious or indifferent to the pains of the Stake holders.[6] They are not bothered about the years of dogged and persistent exploration and the rigour associated with oil extraction from notably unfriendly environments by the Oil companies, who as in the case of Nigeria, are in Joint Venture participating agreements with the government, the huge investment notwithstanding.

This graphic detail is considered very crucial if our evaluation of the fiscal regimes governing petroleum profit taxation in Nigeria will not be a mere exercise in abstract speculation,[7] or an arid academic exercise.

The world has moved on from the 1959 oil industry environment that midwifed the Petroleum Profit Tax Act,(PPTA). The PPTA is all about taxation of profits from petroleum operations. In Section 2 of the Act, petroleum operations include

'the winning or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a company for its own account by any drilling, mining, extracting or other like operations or process, not including refining at a refinery, in the course of a business carried on by the company engaged in such operations, and all operations incidental thereto and any sale of or any disposal of chargeable oil by or on behalf of the company.'

The main activities involved in petroleum operations include:

(a) Exploration;
(b) Appraisal;
(c) Drilling/Mining;
(d) Extraction;
(e) Transportation by Pipelines;
(f) Sale of Chargeable oil; and
(g) All other operations incidental to any of the above.

These activities belong to the upstream sector or the oil industry which attract a Petroleum Profit Tax of 85%, charged under the PPTA.

The following activities are not covered under Petroleum Operations:

(a) Petroleum Products Marketing;
(b) Crude Oil Refining Operation;
(c) Gas Refining and Distribution; and
(d) Crude Oil Transportation by Ocean going vessels.

---

[6] Atheme echoed by an Agip Expert Analyst at a workshop "Oil Market" at IAFE Management Centre, Castle Gandolfo, Italy May 29th-June 2nd, 2000

[7] Thought on Law should find practical application rather than being a mere abstract concept.

These activities are classified as the Downstream sector of the oil industry, taxed at a lower rate of 30% and charged under the Company Income Tax Act (CITA).

Petroleum is defined in the PPTA as Oil and Gas[8]

Crude oil is a complex mixture of hydrogen and carbon atoms that was formed million of years ago in a process that begun with decomposing sea organisms. These tiny sea creatures as they decayed, sank to the bottom of the sea to become trapped in layers of mud .Due to the effect of a complex reaction involving heat, time pressure, and other factors, including bacterial actions, crude oil is generated in sedimentary strata [9]

Gas is often found with oil and is formed in the same process, although some say it is from decayed vegetable matters in former marshy areas. Natural Gas is hydrocarbon in gaseous form and can be found on its own in natural gas reservoirs. This paper is confined to crude oil, since gas had been severed and is now taxed under another tax Act. [10] The term crude oil is broadly used to describe hydrocarbons in their more liquid form. The search for oil in Nigeria was triggered off in this century, by the German company, the Nigerian Bitumen Company in 1908.[11]

The first piece of legislation on Petroleum in Nigeria was the Petroleum Ordinance of 1889,[12] followed by the Mineral Regulation (Oil) Ordinance of 1907, both of which laid down a basic framework for the development of Petroleum and Mineral Resources. The Oil Pipelines Act of 1956 was a logical enactment in response to the level of Shell-Bp's activities at that time. Amendments to the provisions of this Act were reflected in the Oil Pipelines Act of 1965, which is now consolidated under Cap 338 of the Laws of the Federation of Nigeria, 1990.

Similarly, the whole of the Mineral Oils Act 1914, the Petroleum Act 1918 and the Petroleum Control Act 1967 were repealed and replaced by the Petroleum Act 1969.[13]Just as would be expected, a legislation specifically targeted at taxing petroleum profits, separate from those of other companies engaged in other enterprises, Petroleum Profits Tax Act was promulgated in 1959,[14] but with a retroactive effect from January 1, 1958.

The Petroleum (Drilling and Production) Regulations made pursuant to section 9 of the Petroleum Act, put in statutory form regulatory and operational details governing field exploration, development and production and transportation of crude oil.Before 1971, the

---

[8] PPTA, 1959 As Amended, S.2

[9] Opec Secretariat, op.cit p5

[10] CITA vide finance (Miscellaneous Taxation Provisions) Decree No.18, of 1998

[11] Olisa ,M.M-*Nigerian Petroleum Law and Practice*, 2nd Edition (1997) Jonia Ventures Ltd, Festac Lagos, p2

[12] Afsegbua, L. – *Nigerian Petroleum Law – Thee Acquisition of Oil Rights in Nigeria*, Renstine Nigeria Publishers Ltd, Lagos –Footnote p5

[13] Olisa M.M. op.cit p3

[14] Cap 354 LFN 1990. Also see Atsegbua op.cit p8

concession granted to Shell, Mobil, Chevron, Agip, Elf Texaco and the other companies operating in the country were wholly owned by them.[15] But this position was altered when Nigeria joined OPEC in 1971, and in compliance with the cartel's resolution XVI Article 90 of June 1968, which enjoined its members to take a stake in the operations of oil companies operating within their respective countries, decided to adopt the Joint Venture route to participation. Joint Venture Participation Agreements with the major oil companies in Nigeria by the government is about 58%. Apart from SHELL, where NNPC' participation is 55%, the interests in others like MOBIL,CHEVRON, NAOC, ELF and TEXACO, are 60%. The sum of their production account for over 97% of the national total.

By Decree 18 of December 1971,[16] the Nigerian National Oil Corporation (NNOC), was incorporated to among other things, oversee Government interests in the Joint Venture holdings with the companies. Later on, the corporation was merged with the former Federal Ministry of Petroleum resources, to form what is today known as the Nigerian National Petroleum Corporation, (NNPC) on April 1st, 1977. The Statutory instrument, Decree No 33 of 1977, which established the corporation, created a public organization to manage the nation's oil and gas resources from exploration to production, refining and petrochemical to marketing and distribution.[17] It is however sufficient for our purpose to recognise that this corporation plays a prominent role in the management and direction of the Oil Industry in Nigeria.

The Heads of Agreement, which was the forerunner of the Joint Operating Agreement governing the operational relationship between the Oil Companies and Government is handled by the corporation. The following quotation of a clause in a recently signed Memorandum of Understanding between the Federal Government and a Company will illustrate the type and effect of the power vested in the corporation on matters concerning the industry.

It is very important to know that the agreements setting out the terms and conditions of the acquisition by Government or NNPC of the undivided percentage interest in the major oil companies referred to above, is called Participation Agreements. This is an assignment of a fractional interest in the petroleum estate together with the assets and funds employed in the development of the leasehold. According to Olisa[18] "It is an example of agreements that create the common law relationship of co-ownership, co-tenancy or concurrent ownership."

The costs and expenses required for approved operations under the operating agreement are contributed in the proportion of the parties' undivided percentage interests in the joint

---

[15] Atsegbua, L op.cit p41
[16] Olisa, M.M. op.cit p202
[17] NNPC Act 1977, 2nd September para 8(2)
[18] *Nigerian Petroleum Law & Practice* – p71

venture and in accordance with the procedure set out in the agreement. This is accomplished by a call for cash, popularly referred to, as cash call, by the operator, from each party in the joint venture. NNPC is a party to seven joint venture operating agreements in the Nigeria Oil Industry.

THE PETROLEUM PROFITS TAXATION ACT: BROAD OVERVIEW

The Act is divided into two parts constituted by 58 sections. Part 1 contains the preliminary provisions. Perhaps the more important of its two sections is section two, which is the interpretation section and which provides a definition for the words used for the purposes of the Act. Part 2 consists of five sections[19] and provides for the administration of the Act and provides in sections 3(a)[20] that the Act shall be administered by the Federal Board of Inland Revenue constituted under section 1 of the Companies Income tax Act. (CITA). [21]

Part 3 is perhaps the most important of the Acts segments. It is headed "imposition of Tax and Ascertainment of Chargeable Profits" and it makes provision regarding the very basis of petroleum profits taxation in Nigeria. The following four parts, complement these provisions, providing for much matters as the assessment of taxes payable[22], the persons who may be charged to tax[23] and the preparation and return of accounts and particulars of "petroleum operations" by companies engaged therein, to the Federal Board of Inland Revenue FBIR (the Board). Part 8,[24] contains provisions for appeal from decisions of the Board and other bodies. Part 9,[25] provides for the collection, recovery and repayment of tax, while part 10[26] makes provision for offences against the Act and the penalties thereof. Part 11,[45] contains the miscellaneous provisions, which range from the restrictions of the effect of the Personal Income Tax Decree provided in section 5, through provisions on double taxation,[46] to the power to amend the first schedule. [47]

The Act, also contains four schedules. The first, deals with the powers or duties to be performed, or exercised by the Board alone, while the second deals with capital allowances that may be deducted from profits before taxation. Schedule 3, makes provisions regarding the time for making instalmental payments of petroleum profits tax and the fourth schedule, deals with the determination of the value of chargeable natural gas disposed of, by a company during an accounting period.

[19] SS 3-7
[20] S.3(a) merely refers to "the Board". This is defined S.2
[21] Cap 60 LFN 1990
[22] Parts 4&7; SS 19-21 and 33-37
[23] Part 5; SS 22-27
[24] SS 38-40
[25] SS 41-47
[26] SS 48-54
[45] SS 55-58
[46] 1994
[47] S.58

Finally, annexed to the Act is the subsidiary legislation made by the Minister of Finance pursuant to section 56 of the Act. The order makes provisions for the deduction of tax at source from payments due in respect of services and activities.

These provisions are designed with a view to taxing activities in the Nigerian petroleum industry. Before inquiring into the adequacy or inadequacy of this, a more indepth analysis of the provisions of the Act is required.

ADMINISTRATION OF THE ACT

The due management of the Act and the tax shall be under the management of the Federal Board of Inland revenue which may do all such acts as may be deemed necessary and expedient for the assessment and collection of the tax and shall account for all amounts so collected in a manner to be prescribed by the Minister (of Finance)[48]. The FBIR was established under Companies Income Tax Act (CITA).[49] It consists of a Chairman appointed by the President and members many of whom are directors of relevant federal parastatals like the Federal Inland Revenue Service (FIRS), the Ministry of Finance, the National Revenue Mobilization and Allocation Commission etc. The Board also comprises a technical committee, charged with the responsibility of handling matters that require professional or technical expertise.[50] This committee is made up of members of the FBIR.

The PPTA makes extensive provisions as regards the Board's discharge of its functions in relation to the administration of the Act. Apart from various powers given for the purpose of ensuring that the Board is able to discharge its functions effectively,[51] the Act in section 3(f) provides that the Board shall, in the exercise of its powers and duties under the Act, be subject to the "authority, direction and control" of the Minister of finance and any written direction, order, or instruction given out by him after consultation with the Chairman of the Board shall be carried out by the Board. Also relevant in this regard is the provision of section 6(1) to the effect that the Minister may from time to time, make rules for carrying out the provisions of the Act. Pursuant to this provision, the Minister has made the one piece of subsidiary legislation annexed to the Act, an order, governing the deduction of tax at source from payments due in respect of services and activities of bodies engaged in petroleum operations.[52]
Finally in this regard, the Act provides that anything required by the Act to be done by the Board alone,[53] may be signified under the hand of the Chairman of the Board, or an officer

---

[48] S.3(a) and see 3.2 for definitions of "the Board" and "minister"
[49] Cap 60, LFN 1990
[50] CITA, S.1(a)
[51] PPTA, S.3(b)-(e)
[52] Pursuant to S.56
[53] These powers or duties are specified in the First Schedule which Lists them on the "powers" and "duties" in sections 3(b),(d) and (e), 6(2), 10(1)(f),11(2)(6)(iii),13,29(2),35(1),46,49,50 and 53.." These powers shall only be

of the FIRS, who has been so authorised by the Board. Any such authorisation shall be signified under the hand of the Chairman.[54]

A few comments may be made in respect of these provisions. The first, is on the composition of the Board. Bearing in mind the technicality and complexity inherent in all aspects of the petroleum industry, it should be expected that the taxation of the industry cannot be any different. It is a field that must necessarily be assigned to competent professionals who will be able to tackle the problems and complexities involved therein. One may therefore be disappointed to discover that, there is no provision either in the Companies' Income Tax Act, or in the PPTA itself, which stipulates any qualification for membership of the Board. Although it is provided that the legal adviser of the FIRS should be a member of the Board, all the other members are only required to be directors in the relevant parastatals and there is no stipulation of any professional, or academic qualification. When one realises that the appointment and tenure of office of these persons are in the main, determined by political considerations and not necessarily experience, or qualification,[55] one has no choice but to come to the conclusion that, the composition of the Board does not raise optimism as to the proper implementation of the PPTA and other taxation statutes. A case should be made for special provisions to accommodate accountants, legal practitioners, professional valuers etc.

Also noteworthy in this regard is the provision of section 3(f) which, as noted above, subjects the Board to the control of the Minister of Finance. While this is desirable in that, it is necessary that there be co-ordination and harmony in the nation's fiscal policies, it does appear that the section is so couched, as to empower the Minister to give virtually any order which the Board will then be compelled to carry out. Again, this might not be too statutory in that, it may leave the taxation of petroleum profits open to the vagaries of fiscal policy, which, as is the unfortunate case in Nigeria, is often unstable and motivated by political and at times, sectional considerations. However, one hopes that with the present democratic dispensation in the country, together with the administration's declared intention of attracting investments, the activities of the Board will not be unduly interfered with, on account of considerations that are mainly political, and not economic. Perhaps, in realisation of the need for this, the proviso to section 3(f) imposes limits on the exercise of the Minister's power in respect of any particular company.

THE BASIS OF TAX LIABILITY UNDER THE PPTA

The Act has as its objective, the imposition of taxes on profits made from petroleum related activities in Nigeria. This much may be gathered from its long title which reads; "An Act

---

performed or exercised by the Board who shall have no power to authorize any other person to perform the same…."

[54] S.4(1), (2)

[55] See Naiyeju "*Critical issues in Taxation and Tax Management in Nigeria*", Nigeria Tax Review, Vol. (no2) 1997

to impose a tax upon profits from the winning of Petroleum in Nigeria, to provide for the assessment and collection thereof and for purposes connected therewith".

In pursuance of this objective, Section 8 provides that taxes shall be levied upon the profits of companies engaged in petroleum operations. It becomes immediately obvious that one has to determine what is meant by "Petroleum operations" to determine the companies that may be liable to tax under the Act and the basis for such liability. We must resort to the interpretation section of the Act,[56] for assistance.

"Petroleum operations" means the winning or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a company for its own account by any drilling, mining, extracting or other like operations or process, not including refining at a refinery, in the course of business carried on by the company engaged in such operations and all operations incidental thereto and any sale of or any disposal of chargeable oil on behalf of the company".

Some points immediately arise form these definitions. Firstly, only companies i.e. incorporated bodies that have separate legal personality within the formulation in Salomon v Salomon,[57] may be taxed under the Act. This is because, in defining "petroleum operations", Section 2, talks of petroleum activities engaged in "by or on behalf of a company" This construction is reinforced by the provision of section 22(1) which imposes criminal liability on "any person (other than a company), who engages in petroleum operations either on his own account, or jointly with any other person or in partnership with any other person, with a view to sharing profits". It is noteworthy that the Act[58] defines "company" as "any body corporate, incorporated under any law in force in Nigeria or elsewhere".

This definition takes us to the second point. It appears to allow companies incorporated in other countries to participate in petroleum operations in Nigeria (and to be liable to taxation under section 23). While this may have been possible when the PPTA was enacted in 1959, the same cannot be said when one considers the present position of Nigerian law. This is because section 54 of the Companies and Allied Matters Act,[59] subject to a few exceptions which are not relevant here,[24] prohibits foreign companies from engaging in business in Nigeria unless the company first obtains Nigeria incorporation.

Thus, the definitions of companies in section 2, in so far as it interpretes the word to include companies not incorporated in Nigeria to engage in petroleum operations in Nigeria, is no longer valid law. The provisions regarding the taxation of the profits of companies that are

56 S.2
57 {1897} AC 22 (H.L)
58 S.2
59 Cap 59, LFN 1990

not resident in the Nigeria[60] may have been relevant in the sixties, when virtually all the operators in the Nigerian petroleum industry were British, Dutch, French and Italian companies, incorporated and resident outside Nigeria, but their continued relevance cannot be asserted with any degree of truth. It is noteworthy that all the multi-national oil companies doing business in Nigeria today must first obtain a separate Nigerian incorporation, and carry out business in Nigeria as Nigerian companies, which may be affiliated to their foreign partners.

Thirdly, a question may arise as to the extent of the activities covered by the definition of "petroleum operations" in section 2. This definition covers the "winning" or "obtaining" of petroleum in Nigeria by "any drilling, mining, extracting or other like operations or process, not including refining at a refinery, in the course of a business carried on by the company engaged in such operations, and all operations incidental thereto" In Shell Petroleum Development Corporation v FBIR,[61] a question arose as to the precise scope of this definition. In that case, the Supreme Court stressed that "petroleum operation", for the purpose of payment of profits tax by companies in that sector, includes not only "winning or obtaining" petroleum oil by drilling, mining, extracting, etc, but all operations that are incidental to such operations. It held therefore, that the payment of tax to the Federal Government by a petroleum mining company, was incidental to the business of the company. According to Uwais, C.J.N, "The definition of the phrase "all operations incidental thereto" in section 2 of the Petroleum Profits tax Act, cannot be circumscribed to "drilling, mining, extracting or other like operations." To do so would be to do violence to the true meaning of the definition of "petroleum operations".

Commenting on this, Ipaye[62] stated that, "the above analysis makes it clear that the crucial factor in PPT liability is the nature of the operations from which the profits arise and not the type of company per se. It is also clear that the taxable company is one which engages directly or indirectly in petroleum operations for its own account. Exploration and producing contractors who operate only as agents are not liable to PPT."

Petroleum operations is defined as involving the "winning or obtaining" of petroleum and chargeable oil in Nigeria. From the definition of both petroleum and chargeable oil, it is clear that they refer to petroleum products in its crude or natural rate. It is profits accruing from dealings in this that the PPTA seeks to tax. Thus, the profits of companies engaged in refining petroleum products[63] or in marketing refined products are excluded from taxation under the PPTA and would be taxable under the Companies Income Tax Act (CITA). Thus, while for example, Nigerian Agip Oil Company Limited (NAOC) will be liable to tax on its profits under the PPTA, Agip Nigeria Plc (now OANDO),will be taxable

---

60 PPTA, S.23
61 (1996) 8NWLR (pg 466) 256
62 Senior Lecturer, Dept. of Commercial Law, Unilag – Lecture Note - 2000
63 S.2 expressly excludes "refining at a refinery" from definition of "petroleum operations".

under the CITA. Also excluded from the regime of the PPTA are the profits of the oil service companies which render service to the oil companies under contact to them. Such a company will not be liable to tax under the PPTA because, it is not engaged in petroleum operations “for its own account” within the definition in section 2.

The definition of petroleum in the Act includes natural gas. The ordinary implication of this is that a company engaged in the extraction of natural gas will be subjected to tax liability under the PPTA. However, with the growth in the awareness of the benefits, economic and environmental, of natural gas, profits accruing from its exploitation have been exempted from taxation under the PPTA. In an attempt to encourage natural gas production, the Finance (Miscellaneous Taxation Provision) Decree 1998[64] as amended by the Finance (Miscellaneous Taxation Provisions) (No.2) Decree of 1998[65] provide that such companies will now be liable to taxation under the CITA. The effect of this is that profits arising from natural gas exploitation will only be liable to the substantially lower rates of taxation applicable under CITA.

DETERMINATION OF TAX PAYABLE UNDER THE PPTA

The PPTA imposes tax on the profits of companies engaged in petroleum operations. The determination of the amount payable by a company therefore involves two stages, firstly assessing the profits of the oil companies and secondly, ascertaining or computing the tax payable on these profits.

ASCERTAINMENT OF PROFITS

The process for determining the profits of a company engaged in petroleum operations is provided for in section 9-18 of the PPTA. Section 9(1) when read in the context of Decrees 18 and 19 of 1998, provides that the profits of such a company is the aggregate of the proceeds from the rate or disposal of chargeable oil sold or disposed by the company, during an accounting period and all the income of the company incidental to and arising from any of its petroleum operations.

The PPTA levies tax on company profits for, each accounting period. The accounting period is a period of one year commencing on 1st January and ending on 31st December of the same year.[66]The period may however be shorter where the company commences operations in that year, in which case the computation starts from the date the company first makes a sale or bulk disposal of oil and ends, on the 31st of December of the same year. It would also be shorter if that were the year the company ceases to be engaged in

[64] No.18 of 1998
[65] Ibid
[66] PPTA S.2

petroleum operations. The accounting year then commences on the first of January and ends on the date the company ceases to be involved in those operations.[66a]

Thus, the scheme of the Act is to tax the aggregate of the value of oil sold or disposed by a company, or the profit and gain arising from or incidental to petroleum operation. Formally, the value of chargeable natural gas was included in the profits,[67] but it appears that by virtue of Decrees 18 and 19 of 1998,[68] this will no longer be liable to taxation under the PPTA, but will be taxed under the CITA.

The act aims to tax profits and not all income therefore, in calculating the total profits of a company, the costs incurred by the company in extracting the oil, transporting and storing the oil between extraction and sale, are deducted.[69] In effect, the total profits of the company consists of its total income from the sale or disposal of petroleum, and other income incidental to its operation minus the cost incurred in carrying out those operations.

But even then, tax liability is not imposed on the total profit of the company. Firstly, the income of the company must first be adjusted i.e. the deductions allowed in section 10 and the adjustment provided for in section 12, must first be made. After this is done, the assessable profit has to be determined. This again is done by making further deductions, this time as prescribed by section 14.[70] Section 10, permits the deduction of all expenses "wholly, exclusively and necessarily" incurred by the company for the purpose of its operations.

In Shell v FBIR,[71] the Supreme Court held that the three words used in section 10, must all qualify for the expenses deductible under the section. Thus, for an expense to be deductible thereunder, it must be not only be wholly and exclusively incurred in the company's operations, it must also be necessary to its operations. Interpreting those words, Uwais C.J.N. had this to say:[72] "According to ordinary dictionary meaning, the words "wholly", "exclusively" have virtually the same meaning. They can be said to mean "solely" or "entirely"; the dictionary meaning of the word 'necessarily' is the same as the words 'inevitably and unquestionably".

In effect the expenditure in question, to be deductible, must be solely and unquestionably devoted to the company's operations. Once this is the case, it does not matter that the nature of the expenditure necessarily involves some other result or the attainment or

---

66a Ibid,
67 Ibid S.9(1)©
68 These remove profits from Natural Gas Operations from the PPTA and place them under CITA
69 PPTA, S.9(2)(b),(c)
70 S.9(4)
71 (1996)8 NWLR (pt 466) 256
72 Ibid; (1997) 1 NRLR part 1 at 7

furtherance of some other objective, since this would necessarily be inherent in the company's activities. In any case, section 10(1), without limiting or expanding the generality of its main provisions, lists certain expenses, which are deductible. However none of the expenses mentioned in section 11, shall be deductible. Section 11, mainly clarifies section 10, and covers in the main, expenses, which are not "wholly" or "exclusively" incurred in petroleum operations.

By Section 12, where the company is engaged in transporting chargeable oil by ocean going oil tankers, such adjustments shall be made in computing its adjusted profit or loss as shall have the effect of excluding therefrom, any profit or loss attributable to such transportation. It is after making the deductions allowed in section 10, and making whatever adjustments are required by section 12, that the adjusted profits are derived.

But again, after getting the adjusted profits, section 9(4) requires that the deductions stated in section 14, should be made, to get the assessable profits. Section 14, allows the deduction of any losses incurred by the company during the previous accounting period. These losses may be carried forward from year to year, until fully absorbed.[73] Also, relief for losses may be deferred and made in succeeding accounting periods until they are fully absorbed.[74]

But even after ascertaining the assessable profits further deductions need to be made according to the provisions of section 18, to determine the profits of the company that may be charged to tax.[75] Section 18(2), allows a company to deduct some capital expenditure in accordance with the second schedule. The expenditure for which allowance made under this head are termed, "qualifying expenditures" schedule. However, the capital allowance deducted must not exceed 85 per cent of the company assessable profit for the period.[76]

It is after this deduction of capital allowances, that the assessable profits of a company are determined. It is the sum so derived that forms the net taxable income of the company. It is the sum left from the gross profits of the company, after all the deductions allowed under the Act have been made. This forms the chargeable profits of the company and it will form the basis of taxing the company.

ASCERTAINMENT OF TAX

The assessable tax for any accounting period of a company is 85 percent of its chargeable profits.[77] In effect, for every N1.00 made by an oil company and after allowing all the

[73] PPTA S.9(2)
[74] S.9(3)
[75] S.9(5); S.18(1)
[76] S.18(3)-(5)
[77] S.19(1)

deductions permitted by the Act, the company is liable to be assessed to a tax of 85 kobo. However, the company may not have to pay all of this. This is because the chargeable tax, i.e. the amount of tax payable is not arrived at, until the further deductions allowed by section 20, are made.[78] This section allows the deduction of expenses and outgoing which had not earlier been deducted.

Such expenses include the amounts paid for royalty for the crude oil locally consumed, all non-productive rents for which the company incurred liability; the amount of investment tax credit due to the company for the accounting period in question and all sums for which liability was incurred by the company during the period, to the federal Government by way of custom or excise duty or other like charges, in respect of the company's plant and machinery.[79]
The tax chargeable on the company, is thus the assessable tax, i.e., 85 percent of the chargeable profits of the company minus the deduction allowed by section 20. This should ordinarily bring the process of calculating the tax payable by a company to an end and this is often the result. However, in certain circumstances, the company may be liable to be charged additional tax.[80] This is the case where the chargeable tax calculated according to the formula set out above, is less than the amount the chargeable tax would have come to if, in the case of crude oil exported from Nigeria, the reference in section 9(1) [81]of the Act was a reference to the amount obtained by multiplying the number of barrels of that crude oil, by the relevant sum per barrel.[82] This relevant sum is the posted price f.o.b at the Nigerian ports for crude oil of the gravity and quality in question which is from time to time established by the company after agreement with the Federal Government.[83]

The purpose of these provisions it appears, is to ensure that the revenue accruing from taxation of petroleum operations is not unnecessarily reduced by companies selling the oil they produce at prices lesser than those approved. Under the PPTA, the companies are expected to compute their taxation on the basis of whichever is higher of the posted price and the actual selling price. Thus, oil companies may have to pay more tax than would ordinarily have been chargeable, on their profits.

Every company engaged in petroleum operations is required for the purpose of assessment, to render returns together with properly audited accounts to the FBIR, within five months of the end of each accounting period.[84] For this purpose, the company is expected to prepare particulars with respect to the computation of adjusted profit or loss, assessable profits,

---

[78] S.20(1)
[79] S.20
[80] S.21
[81] S.21(1)
[82] S.21(2)
[83] S.21(5
[84] S.28(2)

residues in respect of its assets, computation of its estimated tax for the period and other relevant information.[85]

This means that companies engaged in petroleum operations are obliged to deliver their accounts to the FBIR and the FBIR need not demand the companies accounts, before they are delivered. However, by section 29 the Board is empowered to call on the company in writing to furnish better and further particulars, where the Board is satisfied that such particulars will be necessary, for the levy of appropriate tax upon the company's profits. The company must comply with the Board's demand within a reasonable time of receiving it.[86]

Although companies are obliged to render a return of their estimated tax liability to the Board,[87] the final responsibility for assessing tax lies with the FBIR. Section 33, provides that the Board shall proceed to assess every company with tax as soon as may be after the time limited for the company to deliver its accounts under section 28. Where it subsequently discovers that the assessment is less than it should have been, the Board may, at any time within six years of that accounting period, make additional assessments[88]. A notice of assessment shall be served personally, or sent by registered post by the Board to the company assessed or, to the person in whose name they were assessed.[89] If the assessment is disputed, an application may be made to the Board, by notice of objection in writing, to review and revise the amendment. The application must be made within 21 days of the service of the notice of assessment.[89] The Board on taking evidence from the applicant will either amend the assessment,[90] or send to the applicant, a notice of refusal to amend[91] Appeals from decisions of the Board lie to the Body of Appeal Commissioners established under section 53 of the Companies Income Tax Act[92] and from there to the Federal High Court.[93] The collection of disputed tax assessments shall be held in abeyance pending the determination of the appeal.

COLLECTION, RECOVERY AND REPAYMENT OF TAX

Section 42, provides for the payment of tax. The effect of the provisions therein contained is that tax shall be paid in equal monthly installments, the first of which shall be payable not later than the third month of the accounting period. The following monthly installments are due and payable not later than the end of each subsequent month. The final installment for the accounting period, is due and payable within twenty-one days, after the service of

[85] S.28(1)
[86] S.29
[87] S.31
[88] S.34
[89] S.36
[89] S.36(2)
[90] S.36(5)
[91] S.36(6)
[92] S.38(1)
[93] S.41

the notice of assessment of tax, for such accounting period. The amount payable shall be the tax assessed for that period, less all installments paid on the account. Failure to pay tax as and at when due under section 42, is an offence, if there is no lawful justification and will render the company liable to pay a sum equal to 5 percent of the amount due, as penalty in addition to the sum assessed.[94]
The same amount of penalty will be payable if the sum assessed, as payable under proceeding on appeal, is not paid within the stipulated period. This will be the case where payment of tax has been held in abeyance pending the result of the appeal. On determination of the appeal, the payment so stayed become payable within one month from the date of service on the company of the amount payable, as determined by the appeal. If the sum is not paid, the penalty becomes payable.[95]

Where a company fails to pay its taxes, the same may be recovered by action in any court of competent jurisdiction, at the place at which payment should be made, by the Board, in its official name and with the company bearing the full cost of the action.[96] The tax is recoverable as a debt due to the Federal Government.[97] The amount of tax payable, may be proved by the production of a certificate signed by any person, duly authorised by the Board and giving the name and address of the defendant. This shall be sufficient authority for the court to give full judgement.[98] While at first sight, this provision may seem unduly favourable to the Board and harsh, this impression is dispelled, when one realises that such proceedings are only taken after the company has had opportunity to exhaust the whole process of appealing the taxed assessed upon it to the Board, through the Appeal Committee and through the Court system.

Where a company has paid excess tax due to excessive assessment made upon it, it may, within 6 years of the accounting period during which the error was made, apply in writing to the Board for relief.[99] The Board, on inquiry into , reasonable and just.[100] The decision of the Board in this respect is final and conclusive.[101] If claimed within 6 years of the accounting period in which it was made, repayment of excess tax paid may be allowed. But if the Board disputes the claim, notice of refusal to admit it shall be given and an appeal will lie to the Appeal Commissioner and from then to the Federal High Court.[102] Where the Board admits the repayment, or a court orders it, the Board shall give a certificate of repayment and upon receipt of the certificate, the Accountant General of the Federation shall cause the amount to be repaid in conformity with the certificate.[103]

---

[94] S.43
[95] S.44
[96] S.45(1)
[97] Ibid
[98] S.45(3)
[99] S.46(1)
[100] S.46(2)
[101] S.46(5)
[102] S.47(1)
[103] S.47

OFFENCES AND PENALTIES

The PPTA contains provisions which were apparently designed to punish the contravention of its rules and to discouraged tax fraud. The major offences created by the Act, are contained in part 10, although other offenses are contained in other parts of the Act. By Section 48(1), where a person is guilty of an offence under the Act for which no penalty is therein provided, the offender is liable to a fine of N10,000. Where the offence is one under section 22(1) i.e. engaging in petroleum operations, either as an individual or a partnership, a further fine of N2,000 is imposed for ever day during which the offense continues, and in default of payments, the offender is liable to imprisonment for six months. The same rate will befall any person who fails to provide returns, particulars, accounts or documents required by the Board or to keep proper books required.[104]

Criminal liability is also imposed in respect of failure to comply with the requirement of notice served under the Act, or to attend in answer to the notice. The penalty for these offences is same as that mentioned above. And where there is falsification of any document required for the computation of tax liability, for the purpose of obtaining a reduction or rebate or defrauding the Board, any person who makes, assists or counsels such falsification, will be liable to a fine of N1,000 and treble the amount of tax liable to be paid under the Act, or to imprisonment of 6 months.[105]

Where without reasonable cause, incorrect accounts or information is prepared, the operator is liable to a penalty of N1,000 and to double the amount of tax which was under-charged due to the false statement or which would have been undercharged, had the document been accepted as correct[106]. This liability ceases, six years after commission of the offence.[107]

Finally, where a member of the Board or a person employed in the administration of the Board, renders false returns, makes excessive demands or is fraudulent, he shall, by section 51, be liable to the tune of N600, or to three years imprisonment, or both.

Though the legislature may be commended for the attempt to curb fraudulent evasion of taxes and defrauding of the revenue and tax payers, one cannot help, but notice the inadequacy of the penalties prescribed, especially as regards the fines. One only hopes these provisions will be reviewed soon, to bring them more in line with economic realities.

DOUBLE TAXATION AGREEMENT UNDER THE PPTA

[104] S.48(1)
[105] S.48(2)
[106] S.49(1)
[107] S.49(2)

Although every company engaged in petroleum operations in Nigeria, must under the present state of the law, obtain a Nigerian incorporation,[107] the reality of the oil, industry is that most of their major Nigerian oil companies are little more than local subsidiaries of foreign multinationals which were established abroad, before incorporating a subsidiary in Nigeria. One major result of this state of affairs, is that profits may be derived by Nigerian companies from foreign countries. If this profit is taxed in the country of origin, and is subsequently taxed under the PPTA, the company could have been subjected to over lapping tax regimes and would therefore have to pay tax twice, on the same income.

To avoid such double taxation, the PPTA makes provisions in sections 56 and 57 for the negotiation of double taxation agreements between the Federal Government of Nigeria and other world governments, whereby relief can be obtained from the effects of double taxation, in relation to tax imposed under the PPTA and any tax of a similar character imposed by the laws of that country.

Under section 56, the Minister may by order, declare that arrangements have been made with another country to afford relief from double taxation in relation to PPTA, or any other tax relief from double taxation is based on reciprocity and it is only when a particular country affords relief from double taxation of income derived from Nigeria, that Nigeria does the same in respect of income derived from that country.

Section 57, provides methods of calculating double taxation relief. Such relief is given in the form of audit against the tax payable in Nigeria. The relief may operate retrospectively,[108] so that where the tax has already been paid, the relief may be offset against the chargeable tax of subsequent accounting periods. However, the tax credit cannot be more than the total tax liability of the company, if no such credit had been allowed. [109]

CONCLUSION

The foregoing represents a brief overview of the fiscal regime governing petroleum profit taxation in the Nigerian Petroleum Industry. The importance of oil to the Nigerian economic survival is underpinned by the finding that over 90 percent of the country's foreign exchange earnings is from this commodity. Thus, it becomes important that the country should be able to evolve a fiscal regime that recognizes the interest of foreign investors, and the host country in the collective effort at keeping the industry working.

---

[107] S.22(1) and see Companies and Allied Matters Act 1990 SS 54 and 56; Petroleum Act Cap 350 LFN 1990, S.2(2)
[108] S.57(9)
[109] S.57(4)