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The Petroleum Industry Act and the attempt at addressing Host Community Restiveness

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Introduction

Host communities play an important role in the success of the operations in the petroleum industry in Nigeria. The relationship could make the difference in realising profitable returns from the highly capital-intensive investments. Over the years however, the relationship between host communities and oil companies have not been cordial (to put it mildly). Distrust and restiveness have disrupted oil operations. The hostilities may also have contributed partly to the massive theft of crude oil, vandalization of pipelines and the incessant shutdown of major oil fields. The magnitude of the problem is evident in the inability of the government to meet its OPEC crude oil production quota of about 1.8 million barrels per day with production averaging 1.3 million to 1.4 million barrels per day in recent times.

The hostile relationship can be partly attributed to the lack of (or slow pace) of development in these communities. The Nigerian government has at various times sought to address this issue with initiatives which have had varying degrees of success. We highlight some of these initiatives below:

- the setup of the Derivation Fund - Funded with 13% of oil revenue from the Federation Account and paid to oil-producing states.
- the creation of the Niger Delta Development Commission (NDDC) in 2000 - Funded with NDDC Levy of 3% of total annual budget of oil producing companies.
- creation of the Ministry of Niger Delta Affairs in 2008, with the total budget allocation of N584.6 billion between 2008 and 2022.[1]
- the Amnesty (to Niger Delta Militants) Programme in 2009.

In another attempt at addressing the frosty relationship between host communities and petroleum companies, the Petroleum Industry Act (PIA) introduced the requirement for specified petroleum industry operators to establish a Host Communities Development Trust (HCDT)[2].

Host Communities Development Trust (HCDT)

The HCDT is a fund to be set up for the benefit of communities that are situated in or appurtenant to the area of operation of petroleum companies or operators. The fund will cater to the infrastructural development and economic empowerment of host communities. In designating host communities, the PIA permits operators to exercise discretion to expand the coverage of the HCDT to include other communities which may indirectly impact on its successful operation even if these other communities are not 'appurtenant' to the area of operation of the operator[3].

The concept of the HCDT is not totally new to the Nigerian petroleum industry. There is an earlier iteration in the Global Memorandums of Understanding (GMoUs) used by some international oil companies (IOCs) to execute projects within host communities under their corporate social responsibility (CSR) initiative. What the PIA has done is to standardise the CSR initiative and make it mandatory. Thus, operators that operate the GMoU may find it easier to transition to the HCDT by transferring the CSR initiative to the HCDT. Contributions made by operators under the CSR initiatives within 12 months after the effective date of the PIA would be deemed as a contribution to the HCDT[4].

The operators within scope of the HCDT are those in the upstream sector and owners of designated facilities[5] in the midstream sector of the petroleum industry. The holders of Petroleum Prospecting Licence/Oil Prospecting Licence, Petroleum Mining Lease/ Oil Mining Lease, holders of licence to operate petroleum crude oil and natural gas transportation pipelines, bulk storage tank farms, refineries and gas processing plants in the midstream petroleum operations and petrochemical plants, are currently obligated to incorporate the HCDT. In the case of a collective of operators under a joint operating agreement with respect to upstream operations, the operators are to appoint an operator who would be responsible for complying with the requirement to incorporate the HCDT.

Failure to incorporate the HCDT is grounds for the revocation of a licence[6].

Incorporating the HCDT

The PIA generally requires operators with existing operations or facilities under construction to incorporate the HCDT within 12 months of the effective date of the PIA. For other operators the HCDT is to be incorporated prior to the application for field development plan for OPL/PPL and PML holders, and prior to commencement of commercial operations for licensees of designated facilities granted under the PIA.

In incorporating the HCDT, the operator is to consult with the host communities to appoint a board of trustees and apply to the Corporate Affairs Commission (CAC) for registration of the HCDT. The PIA does not specify the corporate vehicle to be adopted. However, the corporate structure of the HCDT[7] in the PIA and its funding pattern[8] suggests that the more suitable corporate vehicle for the HCDT is an incorporated trustee.

The management of the HCDT is the responsibility of the board of trustees, management committee, and the advisory committee. However, the operator is required to oversee the activities of the board of trustees and committees of the HCDT, the funds and expenditures of the HCDT[9]. The operations of the HCDT is to be governed by the provisions of the PIA, the Companies and Allied Matters Act, regulations issued by the regulators and the constitution of the HCDT.

1. https://budgetoffice.gov.ng/nbi/app/index.php/budget-documents
2. Section 235, PIA
3. Sections 318 and 235(3), PIA
4. Section 316(3), PIA
5. Section 236, PIA
6. Section 238, PIA
7. Sections 242, 247 and 249, PIA
8. Section 240, PIA
9. Section 234(4), PIA

Utilisation of the HCDT funds

For upstream operations, the HCDT is to be funded with 3% of the operator's annual operating expenditure of the preceding year. The PIA is silent on the amount to be contributed by midstream operators to the HCDT. It is expected that the Nigerian Midstream and Downstream Petroleum Regulatory Authority (the Authority) will issue regulations to prescribe the amount to be contributed. Funds made available by operators to the HCDT are deductible in respect of hydrocarbon tax and companies income tax. Other sources of funds for the HCDT include donations, grants or honoraria, and any profit and interest accruing on reserve funds of the HCDT.

Funds made available to the HCDT are to be used exclusively for the development of the host communities in accordance with the Host Community Development Plan (HCDP) prepared by the operator and approved by the Nigerian Upstream Petroleum Regulatory Commission (the Commission) or the Authority as the case may be. In preparing the HCDP, the operator is required to conduct needs assessments in the host communities and determine the effect of the petroleum operations, the strategy to be adopted and the projects to undertake to meet the communities' needs.

HCDT funds are to be utilised as follows:

- 75% to be allocated to execution of projects,
- 20% to be reserved for investment, and
- no more than 5% is to be allocated for the administrative cost of running the HCDT.

Funds spent on projects are to be accounted for by the operator and the board of trustees of the HCDT. The allocation ratios for the funds of the HCDT, should provide sustainability for the HCDT and prevent administrative costs from outpacing the intended objectives of the HCDT.

Mid-year and annual reports and audited accounts are to be prepared for the HCDT; the annual report and audited accounts are to be submitted on or before the 31st May to the Commission or Authority as the case may be.

The PIA further provides that where there is sabotage or vandalism to petroleum installations or designated facilities within a host community, that community shall forfeit, to the extent of the cost of the repairs, its entitlement under the HCDT[10]. It is expected that the above provision will create a sense of responsibility for the safety of petroleum installation and designated facilities within host communities. However, disputes could arise where there is no clear nexus or attribution for the damage.

10. Section 257(2), PIA

Analysis

The PIA initiative is commendable and should foster harmonious coexistence between host communities and operators in the petroleum sector of the Nigerian economy. How the HCDT will fare in addressing host community restiveness will only be evident in the future. There may be indications in the fact that despite the use of GMoU by some IOCs, there are continuing disruptions to the operations of those IOCs. Accountability remains a common thread that runs through these initiatives. With the HCDT, we hope that the funds will be better managed and utilised in host communities given that its administration will be by the operators.

Notwithstanding the above, the government must continue in its efforts to improve the economic prospects of host communities as it bears the primary responsibility for such development from the tax and royalties it collects.

From our review of the PIA, there are some gaps in the operation of the HCDT, including:

a. The absence of a dispute resolution mechanism between host communities and operators. The PIA identifies that this would be issued by the regulators. With barely 3 months to the deadline for the implementation of the HCDT, it is important that these regulations are issued so that operators may incorporate them into the constitution of the HCDT.

b. The PIA does not address the contribution to be made by the specified midstream operators to the HCDT. However, the Authority may define the contribution through regulations.

c. No clear mechanism for partnership amongst operators who may have the same host community within their coverage to prevent the duplication of projects in such a community and gain synergy in terms of overheads.

Conclusions

To achieve the laudable objectives, the Funds need to be properly managed and some of the gaps identified should be plugged.

The government should collaborate with the sector and provide an enabling environment while continually improving the legislation guiding the industry. Administratively, operators should be allowed to discharge their duties with minimal interference while the regulators maintain proper oversight.

Authors

Ayo Akinduyite
Associate Director
Tax Reporting and Strategy

Kelechi Anugwa
Manager
Tax Reporting and Strategy

Russel Eraga
Senior Associate
Regulatory Compliance and Advisory