Fiscal regime under the new Petroleum Industry Bill: Revolutionary or business as usual?

By Taiwo Oyedele

From sports to entertainment, tourism to technology, infrastructural development to industrialisation, and the list goes on - Nigeria is a country that is often celebrated more for her potentials than real achievements. Quite so with over 160 million people we struggle for medals to no avail at the ongoing London 2012 Olympics. The same is our experience in the area of natural resources; we are one of the largest producers of petroleum in the world, with one of the largest proven oil reserves of over 35 billion barrels and over 185 trillion cubic feet of proven natural gas. No doubt that the country is rich but unfortunately her people are poor.

The major issues with the all important petroleum sector have been corruption, poor institutions, weak regulations, and lack of transparency. In order to address these issues the Petroleum Industry Bill (PIB) was initiated during the Obasanjo regime but the Bill suffered a lot of setbacks and hence the negative impact on the much needed local and foreign direct investment in the sector. The inability to pass the previous versions of the PIB was due to vested interests pulling in opposite directions and lack of will by the political class.

Following the nationwide outcry particularly arising from the partial fuel subsidy removal earlier in the year, the federal government constituted a special task force to harmonise the various versions of the PIB which has now been re-introduced to the National Assembly on 18 July 2012.

The key objectives of the PIB include the creation of a conducive business environment for petroleum operations to enhance exploration and exploitation of petroleum resources in Nigeria for the benefit of the Nigerian people, optimise domestic gas supplies particularly for power generation and industrial development. The PIB is also to establish a progressive fiscal framework that encourages further investment in the petroleum industry while optimising revenues accruing to the Government, to deregulate and liberalise the downstream petroleum sector, promote transparency and openness in the administration of the sector and promote Nigerian content through efficient and effective regulatory framework.

The midstream operation in the earlier versions of the PIB has been removed hence the existing upstream and downstream stratification will be sustained. However, upstream is now specifically and exclusively to do with crude oil and gas production. Upstream is defined as “all activities entered into for the purpose of finding and developing petroleum and includes all activities involved in exploration and
in all stages through, up to the production and transportation of petroleum from the area of production to the fiscal sales point or transfer to the downstream sector”.

All other activities in the sector are classified as downstream including oil transportation and gas transmission, gas processing, liquefied natural gas, derivative productions and processing, oil refining, petroleum product distribution and storage, construction and operation of facilities, product pipelines and so on.

From the fiscal regime viewpoint, all companies engaged in upstream petroleum operation to pay Companies Income Tax (CIT) at 30% and the introduction of Nigerian Hydrocarbon Tax (NHT) at either 50% for onshore and shallow area of not more than 200 metres depth or 25% for bitumen, frontier acreages or deep water areas. Where petroleum operations fall in geographical areas that are subject to different tax rates, NHT shall be levied on the proportionate parts of the profits arising from such operations.

Deductions allowed for tax purposes are expenses wholly, exclusively, necessarily and reasonably incurred for the purpose of upstream petroleum operations. The introduction of “reasonability” as one of the conditions will lead to more subjectivity in dealings with the tax authorities. Deductions allowed now include sums set aside in a fund for decommissioning and abandonment expenditure, interest upon any loans, including intercompany loans as long as the tax authorities are satisfied that the interest payable is on capital employed in upstream petroleum operations except interest incurred under a Production Sharing Contract. Disallowed deductions include all general, administrative and overhead expenses incurred outside Nigeria in excess of 1% of capital expenditure and 20% of any expenses incurred outside Nigeria except for goods or services not available domestically in the required quantity or quality. Also legal and arbitration costs related to cases against the tax authorities or the Federal Government except awarded to the company during the legal or arbitration process will not be tax deductible. Others include costs incurred in organising or managing any partnership, joint venture or other arrangement between or among companies, gas flaring charges, insurance costs payable to an affiliate of the company, any signature or production bonuses and costs of obtaining and maintenance of a performance bond under a PSC.

Tax incentives available to upstream gas operations will be limited to only the tax holiday under the Companies Income Tax Act provided the gas supply destination is solely to the domestic market. Dividend distribution by upstream companies will not suffer any withholding tax in so far as such profits have been subject to NHT and CIT to be computed and paid on an actual year basis monthly from the end of February of every year. The final installment is payable not later than 21 days after filing of the self-assessment for the accounting period which is due for filing within 5 months of the end of the accounting period, that is, May of the subsequent year.

Although capital allowances for petroleum companies will no longer be restricted, annual allowances will be claimed at 20% per annum except 5th year and after at 19%. It is unclear whether the intention is to claim more than 100% given that the tax written down value will be only 1% after the 5th year. Production Allowance (PA) will be introduced to replace Investment Tax Credit (ITC) or Investment Tax Allowance (ITA) as may be applicable. The PA is to encourage investment in crude oil and gas production with specified rates per barrel either as a fixed amount per barrel or a percentage of Official Selling Price (OSP) subject to cascading thresholds. This is to reward result in form of production rather than effort in terms of capital expenditure.

Every company will be responsible for filing its own tax returns unlike the current arrangement where the NNPC files tax returns on behalf of PSC partners. Each party will own and be able to claim capital allowances on cost of equipment. Any appeal against tax assessments are to be made directly to the Federal High Court rather than to the Tax Appeal Tribunal as provided under the FIRS (Establishment) Act. This needs to be resolved also in terms of potential conflict with CITA given that upstream companies will be liable to tax under the Act.

Each upstream petroleum company to remit on a monthly basis 10% of the net profit (adjusted profit less NHT and CIT) to host community fund. Any act of vandalism or sabotage that occurs in a community will lead to a forfeiture of the community’s portion of the Fund up to the amount sufficient to repair and
remediate the damage caused. Contributions made to the Fund will be available as credit against fiscal rent obligations being royalty, NHT and CIT although no order of offset is provided for. Downstream companies are largely unaffected by the provisions of the PIB.

Overall the PIB introduces some positive developments including moves to address host community concerns, promotion of local content, removal of minimum tax, removal of restriction on capital allowances claimable, tax deduction for abandonment provision. However contentious issues include dispute resolution and potential conflicts with the existing provisions of CITA, conflicts with other laws such as NDDC Act and insufficient distinction regarding the roles of other agencies not mentioned in the Bill.

Stakeholder must consider all aspects of the PIB including transfer pricing, regulatory compliance, possible structuring, tax efficiency, project economics, financial reporting, contracts/covenants etc. The proposed changes may not really be revolutionary, but the PIB if passed in its current form will mean that fiscal issues are no longer business as usual.

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