Tax Bites
Monthly focus on tax related issues

The real cost of fuel subsidy and tax implications

By Taiwo Oyedele

To some extent taxpayers actually subsidise government's subsidy on regulated fuel products, so removal of the subsidy will not result in 100 percent savings.

The recent announcement by the Federal Government of Nigeria to remove fuel subsidy with effect from January 2012 has been generating a lot of interesting debates and mixed reactions from different quarters.

However, not much has been said about the tax implications to government, corporate entities and individuals. This article therefore chronicles the issue, outlines the real cost and highlights the likely tax implications for various stakeholders.

According to OPEC, Nigeria has proven reserve of crude oil of 37.2 billion barrels as at the end of 2010, the tenth largest in the world and the second largest in Africa behind Libya. Nigeria with a daily production averaging about 2.4 million barrels is the 8th largest exporter in the world and number one in Africa.

Crude oil is refined into major products including Premium Motor Spirit (PMS) or gasoline popularly known as petrol which is commonly used for powering small appliances and light road vehicles such as cars; Automotive Gas Oil (Diesel) used to power diesel engines; Aviation / Jet fuel used to power aircraft; and House Hold Kerosene used for heating and lighting purposes. It can rightly be said that crude oil powers the world economy hence its strategic importance.

Nigeria's daily domestic consumption of petrol is estimated at 32 million litres. This is equivalent to about 200,000 barrels of crude oil at 35 imperial gallons or 159 litres per barrel. Assuming Nigeria has adequate capacity for refining locally, the daily consumption will average 8.4 percent of our daily crude oil production. However, due to inadequate capacity to refine crude oil locally Nigeria imports about seventy percent of the country's daily consumption.

Of all the products from crude oil, only petrol and household kerosene are regulated (or subsidized) in Nigeria while others are deregulated thereby selling at prices dictated by market forces. Those who benefit from the current fuel subsidy are private car owners, companies in respect of their light road vehicles, owners of mini buses, tricycles, motorcycles, small businesses and artisans who generate their own power using petrol. Other fuel users such as coaches and buses used for inter and intra city transportation, lorries and truck for transportation of goods, industrial plant and machinery all use diesel which has been deregulated since 2003.

According to the Petroleum Product Pricing Regulatory Agency (PPPRA), the landing cost of petrol as at Friday 28 October 2011 was N124.06 excluding N15.49 margin for transporters and marketers resulting in expected retail price of N139.55. Compared to the regulated price of N65 per litre, there is a subsidy of N74.55 per litre which translates into about N870 billion per annum based on the average daily consumption of 32 million litres of petrol. This is in addition to the subsidy on household kerosene which adds up to about N1.2 trillion per annum compared to only N240 billion allocated to fuel subsidy in the 2011 budget. This subsidy is sourced from the federation account which would otherwise have been shared by the three tiers of government in the ratio of 52.68%, 26.72% and 20.6% respectively by the federal government, 36 states and 774 local governments. The subsidy does not include taxes forgone which is some countries could constitute up to 50 percent of the pump price. This is one issue that is yet to be addressed as to whether taxes especially VAT will be applicable on the price of petrol and kerosene when fully deregulated. This is not currently considered in the PPPRA pricing template notwithstanding that petroleum products are not specifically exempted from VAT.

In the first nine months of 2011, the Federal Inland Revenue Service (FIRS) collected non tax revenue of N1.16 trillion. The breakdown showed a collection of N505.88 billion from Companies Income Tax (CIT); N503 billion from Value Added Tax (VAT) made up of N377.86 billion from local transactions and N125 billion from import, N74.91 billion from Education Tax (EDT), N30.52 billion in Gas Income, N9.19 billion from Capital Gains Tax (CGT); N7.8 billion from National Information Technology Development Fund (IT Tax) and 4.51 billion from Stamp Duty.

Put differently, the cost of fuel subsidy is the equivalent of removing CIT for all companies in Nigeria, and VAT on all local transactions extrapolated for 12 months. Many analysts have questioned the veracity of the N1.2 trillion annual fuel subsidy and whether it really gets to the poor people who need to be subsidised or it is being used to subsidise inefficiencies, the middle class and the rich.

If the fuel subsidy is removed, government is not likely to save the N1.2 trillion currently being spent on subsidy in the short to medium term as a result of the tax implications which may not have been considered. In the short to medium term the savings will be less than the subsidy removed. The reason for this is that to some extent taxpayers actually subsidise government's subsidy on regulated fuel products, so removal of the subsidy will not result in 100 percent savings.

For instance, the removal will result in higher cost for companies and individuals. This means lower profit for companies and less disposable income for individuals. Hence companies will pay less companies income tax, education tax and IT tax. Also companies and individuals will consume less and therefore pay less VAT. If the savings from subsidy removal is not well utilised to develop infrastructure, and create employment, then the lower consumption by individuals would mean less income for businesses with the attendant effect on further productivity, profitability and income taxes.

Individuals and households will experience reduction in their disposable income, which will in turn result in a drop in savings and funds available for lending to businesses. This could lead to higher cost of funds for businesses further resulting in lower taxable profit for CIT purposes. Also firms may cut down on jobs, which will further result in reduction in personal income tax. Under extreme pressures on disposable income and profitability, tax avoidance and evasion would likely intensify resulting in further loss of tax revenue to the government and higher cost of enforcing compliance.

On the positive side, if the fuel subsidy is applied in fixing power supply and other infrastructures as the government has promised, then there will be a drop in the cost of doing business, cost of production and prices of goods and services. The increase in public spending on infrastructural development and social palliatives designed to ameliorate the harsh effect of subsidy removal will result in improvement of living standard and employment generation. It is important to ensure that Nigeria is able to refine crude oil locally at least to meet local demand otherwise fuel importation means export of jobs, in addition to loopholes, inefficiencies and avoidable cost associated with importation of refined products. It could also provide the impetus required for public transportation thereby reducing congestion on the road especially in cities like Lagos. By refining locally many oil producing countries are able to subsidise the price of fuel products on a sustainable basis. For instance the price per litre of petrol is about N5.84k in Venezuela, N15.95k in Libya, Saudi Arabia N17.52k; Kuwait N30.66k; Qatar N32.12k; Bahrain N39.42k; Egypt N46.72k; UAE N54.02k; Iran N58.40k; Malaysia N73.00; Mexico N81.76k; Indonesia N81.14 and Russia N90.52k.

To show sincerity and demonstrate good faith, government must look at other areas where savings can also be made especially the high cost of running government, due process in the award of contracts and diligence in monitoring of implementation. What makes fuel subsidy removal good or bad is what we do with the savings. If government must withdraw fuel subsidy, then the savings must be productively utilized to improve the economy with palliative measures for the poor. Every effort should be made to create employment, ensure local refining and address the power sector challenge to serve as catalyst for economic development and widen the tax base for further growth.

***Taiwo Oyedele is a Partner in the Tax and Corporate Advisory Services Unit of PwC Nigeria and a regular paper presenter on professional tax matters -* taiwo.oyedele@ng.pwc.com.**

About PwC

PwC firms help organisations and individuals create the value they're looking for. We're a network of firms in 158 countries with close to 169,000 people who are committed to delivering quality in assurance, tax and advisory services. Tell us what matters to you and find out more by visiting us at www.pwc.com

In Sub-Saharan Africa, we're the largest provider of professional services with firms in 31 countries and 7,700 people. In the Africa Central sub-region, our nine firms operate in Angola, Ghana, Kenya, Mauritius, Nigeria, Rwanda, Tanzania, Uganda and Zambia and we offer services in Burundi, Djibouti, Eritrea, Ethiopia, Liberia, Seychelles, Sierra Leone, Somalia and Sudan. Combining global expertise with local know-how, our 1,950 people in Africa Central can help you grow and manage change.