

**AN EXAMINATION OF ADMINISTRATIVE CHALLENGES INHIBITING THE  
DISTRIBUTION OF PETROLEUM PRODUCTS UNDER THE PETROLEUM  
PROFIT TAX LAWS OF NIGERIA**

**BY**

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**SUPERVISORY COMMITTEE**

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**JUNE, 2016**

## DECLARATION

I, **Nana Aisha USMAN**, declare that the work in the thesis entitled “**An Examination of Administrative Challenges Inhibiting the Distribution of Petroleum Products under the Petroleum Profit Tax Laws of Nigeria**” was written by me in the Department of Commercial Law under the supervision of Dr. A. A. Akume. The information derived from the literature has been duly acknowledged in the text and list of reference provided. No part of this project, report, thesis, dissertation was previously presented for another degree or diploma at any University.

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**Date**

## **CERTIFICATION**

The thesis entitled “**An Examination of Administrative Challenges Inhibiting the Distribution of Petroleum Products under the Petroleum Profit Tax Laws of Nigeria**” meets the regulations governing the award of the degree of Master of Arts Law (MA) of Ahmadu Bello University Zaria and is approved for its contribution to knowledge and literary presentation.

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## **DEDICATION**

This thesis is dedicated to Almighty Allah and my Parents (Alhaji Yunus Ustaz Usman, SAN and Hajiya Amina Ustaz Usman).

Also, my mentor Yusuf Olaolu Ali, SAN and my beloved siblings; Abdulmutallab Usman, Abdullahi Usman, Sa'adiya Usman, Abduljalal Usman, Umar Usman and Ummi Suleiman for all the endless love and support.

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## TABLE OF STATUTES

	<b>PAGES</b>
1999 Constitution, Federal Republic Nigeria (as amended) - - - -	34
Petroleum Profit Tax Act, Cap P13, LFN, 2004 - - - -	9, 14, 21, 45
Companies Income Tax Act (CITA), Cap C21, LFN, 2010 - - - -	31, 47
Laws of the Federation of Nigeria (LFN), 2004 - - - -	21
Oil Pipelines Act, Cap 07, LFN, 2010 - - - -	22
Nigerian Oil and Gas Industry Local Content Development Act - - - -	26

## TABLE OF CASES

	<b>PAGES</b>
Attorney General, Federation v. Attorney General, Abia State & 35 Ors. (No. 2) -	40
Commissioner v. Newman-159 F.2d 848,850 (CA-2,1947) - - - -	5
Famfa Oil Ltd. v. A-G Federation & NNPC [2003] 18 N.W.L.R (Pt. 852) 453 SC -	33
Gulf Oil Company (Nig.) Ltd V. F. B. I. R NOGC 2 [1996-2000] 156 CA. - -	46
Njikonye v. MTN Nig.Communication Ltd (supra) - - - - -	33
Nwadioro & 2 Ors. v. Shell Petroleum Development Company of Nigeria Ltd NOGC 1	
[1961-1995] 205 CA. - - - - -	36
Shell B.P Petroleum Development Company v. Federal Board of Inland Revenue NOGC	
1[1961–1995] - - - - -	43
Southern Atlantic Petroleum Limited v. Minister of Petroleum Resources NOGC 6[2007-	
2008] 245 CA - - - - -	36
United States v. Butler,2279 US (1936) at p.61 - - - - -	1

## **ABBREVIATIONS**

CITA	-	Companies Income Tax Act
FBIR	-	Federal Board of Inland Revenue
FIRS	-	Federal Inland Revenue Service
JV	-	Joint Ventures
MEND	-	Movement for the Emancipation of Niger Delta
7MOU	-	Memorandum of Understanding
NNPC	-	Nigeria National Petroleum Corporation
NWLR	-	Nigerian Weekly Law Report
OML	-	Oil Mining Lease
OPL	-	Oil Prospecting License
PPT	-	Petroleum Profit Tax Act
PPTA	-	Petroleum Profit Tax Act
PSC	-	Production Sharing Contract

## ABSTRACT

*The aim of this paper is to examine the ownership, the legal framework as well as the basic components of the petroleum profits which components are revenue, adjusted profits, assessable profit, chargeable profit, assessable tax and chargeable tax. In Nigeria, the petroleum industry is the bedrock of the economy and is responsible for about 90 percent of her total revenue. Her other sources of revenue include, inter alia, agriculture, solid minerals, goods and services and most importantly taxes collected from various sources including the petroleum industry. Companies and corporations in Nigeria are taxed principally under the Companies Income Tax Act. Cap 60, Laws of the Federation of Nigeria, 1990. While companies engaged in petroleum operations are taxed specially under the Petroleum Profit Tax Act, as amended (PPTA Cap.354, LFN, 1990). Because of the peculiar and complicated nature of the oil industry, the Federal Board of Inland Revenue (FBIR) is saddled with the onerous task of collecting taxes from the various companies including those engaged in the oil business. This project will examine the petroleum profit taxation system established under the PPTA, with a view to assessing whether or not it is effective in dealing with the myriad of problems associated with the financial areas of the oil industry particularly the problem of tax evasion on the part of some companies and deliberate fraudulent and incorrect assessment of the tax due and payable on petroleum profits by others. This paper also focuses on the assessment of the petroleum profit tax under the Petroleum Profit Tax Act. Cap P13, Laws of Federation of Nigeria 2004, as well as judicial authorities' regarding same. Nigeria's economy is totally dependent on oil. It is no doubt that proceeds from the sale of crude oil holds the mainstay of the Nigerian economy since 1970s. Equally not in contention is the fact that oil explorations and exploitation requires enormous amount of money and technological know-how to execute. This paper also concludes that petroleum profit tax is one of the most important components direct taxes in Nigeria that affects the economic growth, therefore should be properly managed to reduce the level of evasion by petroleum exploration companies in Nigeria. The paper recommends among others that companies involved in petroleum operations should be properly supervised by the relevant tax authority (FIRS) to reduce the level of tax evasion, government should show more accountability in the management of tax revenue and finally, the level of corruption in Nigeria and that of government officials should be drastically reduced to win the confidence of tax payers for voluntary tax compliance. More so, government policy should create a conducive-business environment that will attract foreign investors to the country.*

## **TABLES OF CONTENTS**

Title Page	-	-	-	-	-	-	-	-	-	-	i
Declaration	-	-	-	-	-	-	-	-	-	-	ii
Certification	-	-	-	-	-	-	-	-	-	-	iii
Dedication	-	-	-	-	-	-	-	-	-	-	iv
Acknowledgement	-	-	-	-	-	-	-	-	-	-	v
List of Statutes	-	-	-	-	-	-	-	-	-	-	vi
Table of Cases-	-	-	-	-	-	-	-	-	-	-	vii
List of Abbreviations	-	-	-	-	-	-	-	-	-	-	viii
Abstract	-	-	-	-	-	-	-	-	-	-	ix
Table of Contents	-	-	-	-	-	-	-	-	-	-	x

## **CHAPTER ONE**

### **GENERAL INTRODUCTION**

1.1	Background to the Study-	-	-	-	-	-	-	-	-	-	1
1.2	Statement of Problem	-	-	-	-	-	-	-	-	-	4
1.3	Aim and Objectives of the Study	-	-	-	-	-	-	-	-	-	9
1.4	Scope of the Study	-	-	-	-	-	-	-	-	-	10
1.5	Justification of the Study	-	-	-	-	-	-	-	-	-	11
1.6	Research Methodology	-	-	-	-	-	-	-	-	-	11
1.7	Literature Review	-	-	-	-	-	-	-	-	-	12
1.8	Organizational Layout	-	-	-	-	-	-	-	-	-	15

## **CHAPTER TWO**

### **LEGAL FRAMEWORKS OF THE PETROLEUM INDUSTRY IN NIGERIA**

2.1	Introduction	-	-	-	-	-	-	-	-	-	16
2.2	Petroleum Act	-	-	-	-	-	-	-	-	-	16

2.3	Oil Pipeline Act	-	-	-	-	-	-	-	-	18
2.4	Petroleum Profit Tax Act	-	-	-	-	-	-	-	-	21
2.5	Nigerian Oil and Gas Industry Local Content Development Act	-	-							26
2.6	Companies Income Tax Act (CITA)	-	-	-	-	-	-	-	-	31

### **CHAPTER THREE**

#### **PETROLEUM PROFIT UNDER THE NIGERIA'S PETROLEUM PROFIT TAX**

##### **ACT**

3.1	Introduction	-	-	-	-	-	-	-	-	32
3.2	1999 Constitution and the Oil and Gas Sector	-	-	-	-	-	-	-	-	33
3.3	Administration of Petroleum Profit Tax	-	-	-	-	-	-	-	-	35
3.4	Oil Licenses and Fiscal Arrangements	-	-	-	-	-	-	-	-	36
3.5	Fiscal Arrangements	-	-	-	-	-	-	-	-	38
3.6	Ownership of Petroleum Resources	-	-	-	-	-	-	-	-	40
3.7	Assessment of Petroleum Profit Tax	-	-	-	-	-	-	-	-	41

### **CHAPTER FOUR**

#### **OFFENCES AND PENALTIES IN RELATION TO THE PETROLEUM PROFIT TAX**

4.1	Introduction	-	-	-	-	-	-	-	-	53
4.2	Statutory Offences against the Petroleum Profit Tax	-	-	-	-	-	-	-	-	54
4.3	Penalties against Petroleum Profit Tax Avoidance/Evasion	-	-	-	-	-	-	-	-	56

### **CHAPTER FIVE**

#### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

5.1	Summary-	-	-	-	-	-	-	-	-	61
5.2	Findings/Observations	-	-	-	-	-	-	-	-	62
5.3	Recommendations	-	-	-	-	-	-	-	-	64
	Bibliography	-	-	-	-	-	-	-	-	68

## CHAPTER ONE

### GENERAL INTRODUCTION

#### 1.1 Background to the Study

Before a country considers how best to administer its tax system it must first possess a clear picture of its tax system. The quality and quantity of resources required by tax administrations are to a large extent determined by the type of tax system which it is introduced. A nation's tax goals are not achieved by designing a tax system which is fair. Any fair system which is not administered as planned becomes inequitable. Thus, a good tax system is capable of financing the necessary level of public spending in the most efficient and equitable way possible. It should also raise enough revenue to finance essential expenditures without recourse to excessive public sector borrowing, raise the revenue in ways that are equitable that minimized its disincentive effects on economic activities, to do so in ways that do not deviate substantially from international norms.

It is common knowledge that one of the problems plaguing taxation in Nigeria has been the widespread tax evasion and avoidance which in the view of many experts in the tax field which has led to the loss of revenue which can be blamed on our inefficient and inept tax administrative machinery<sup>1</sup>. There's no doubt that the administrative machinery in Nigeria still has a long way to go in terms of delivery and efficiency but it is believed that Nigeria's income tax law could in spite of their low rates and generous allowances, still have yielded much more revenue, but for the inefficient and defective assessment and collection machinery.<sup>2</sup> For no matter how sophisticated and progressive a tax legislation is, it cannot be effective unless it is properly administered with competence and integrity. This is why in this paper we will be examining the problems facing the administration of petroleum taxation.

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<sup>1</sup> A.O.Philips, (1968) "*Nigeria's Companies Income Tax*". The Nigerian Journal of Economics and Social Studies, Vol. 3, at p.333.

<sup>2</sup> United States v. Butler, 2279 US (1936) at p.61

The Nigerian tax system has undergone several reforms geared at enhancing tax collection and administration with minimal enforcement cost. The recent reforms include the Petroleum Industry Bill 2012 which is with the National Assembly, introduction of TIN (Unique Tax Payers identification number which became effective since February 2008), automated tax system that facilitates tracking of tax positions and issues by individual tax payers-payment system which enhances smooth payment procedure and reduces the incidence of tax touts, enforcement scheme (special purpose tax officers), these are special tax officers in collaboration with other security agencies to ensure strict compliance in payment of taxes.

The tax authority now has autonomy to asses, collect and record tax. This enabling environment which came into being on the basis of (Section 8(q) of FIRS Establishment Act 2007) has led to an improvement in tax administration in the country.

Petroleum is no doubt a predominant source of Nigeria's revenue and foreign exchange. The petroleum industry is divided into two main segments. The upstream and downstream sectors. The upstream refers to activities such as exploration, production and delivery to an export terminal of crude oil or gas.

The downstream on the other hand encompasses activities like loading of crude oil at the terminal and its user especially transportation, supply tradition, refining, distribution and marketing petroleum. The Petroleum Profit Tax is applicable to upstream operations in the oil sector. It is particularly related to rents, royalties, margins and profit sharing elements associating with oil mining, prospering and exploration leases. It is the most important tax in Nigeria in terms of its share of total revenue, contributing almost 90 percent of foreign exchange earnings and government revenue. It covered oil and gas sector.<sup>3</sup>

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<sup>3</sup> Ayodele (2006) *Tax Policy Reforms in Nigeria*, Research Paper No. 2004, National centre for Economic Management and Administration, Ibadan, (Nigeria),

The tax system is an opportunity for government to collect additional revenue needed in discharging its pressing obligations. A tax system offers itself as one of the most effective means of mobilizing a nation's internal resources and it lends itself to creating an environment conducive to the promotion of economic growth.

Oil is the dominant source of government revenue, accounting for about 90 percent of total exports, and this approximates to 80 percent of total government revenues. Since the oil discoveries in the early 1970s, oil has become the dominant factor in Nigeria's economy. The problem of low economic performance of Nigeria cannot be attributed solely to instability of earnings from the oil sector, but as a result of failure by the government to utilize productively the financial windfall from the export of crude oil from the mid-1970s to develop other sectors of the economy.

The Nigerian petroleum industry has been described as the largest among all industries in the country. This is probably due to the belief that petroleum is one of the major sources of energy worldwide. The size, international characteristics, and role assumed by the petroleum industry were noted to have originated from the notion that petroleum is versatile as it currently satisfies a wide variety of energy and related needs.

Petroleum is the most vital source of energy, providing over 50 percent of all commercial energy consumption in the world. The revenues obtained from crude oil in Nigeria are of absolute advantage to expenditure commitments on various projects at the local, state, and federal levels. The Nigerian economy relies heavily on the revenue derived from petroleum products, they provide 70 percent of government revenue and about 95 percent of foreign exchange earnings. Apart from this, the contribution of petroleum to national development is many and varied, employment generation, foreign exchange earnings, income generation, industrialization, and improvements in other economic variables. While the major investors in the petroleum industry are the international oil companies

(IOCs), the principal legislation governing petroleum operations in Nigerian is the Petroleum Profit Tax(PPT).under the PPT, the tax rate was set at 67.5 percent for the first five years of operations by the oil company and 85percent thereafter.

The petroleum industry is the largest and main generator of Gross Domestic Product (GDP) in Nigeria which is the most populous in African nations. Since the British discovered oil in the Niger Delta in the late 1950s;the oil industry has become the main stay of the Nigerian economy. Agriculture was the mainstay of the country's economy. However, the regulatory regime, since its enthronement in the industry has not been without challenges.

## **1.2 Statement of the Research Problem**

It is obvious that petroleum income be it revenue from the sale of crude oil, petroleum profit tax, royalties etc. can cause an increase or a decrease in economic growth and development of a nation, depending on the type of policy and practical implementation the government in power adopts. Nigeria with all its oil wealth has performed poorly, with GDP per capita today.

The problems with Nigerian economy have been traced to failure of successive governments to utilize oil revenue and excess crude oil income in the development of other sectors of the economy effectively and efficiently. overall, there has been poor performance of national institutions such as power, energy, road, transportation, politics, financial systems and investments environment have been deteriorating and inefficient.

There are problems affecting the Petroleum Profit Tax (PPT) in general. These include the problems relating to the PPT administration, the complexity of PPT/MOU calculation, and the problems of PPT avoidance and evasion.

The Corporate Tax Act has provided various offences and penalties, and the reason for these penalties are to discourage companies from evading or avoiding the payment of taxes as and when due.

Therefore even if tax avoidance strategies are legal, the question is whether they are ethical. In 1947 in the United States of America, a Federal Judge, Learned Hand answered this question in the following way:<sup>4</sup>

Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.

There is no doubt that about the significance of strong, able and effective administration in any system. It is widely agreed that one of the main aims of taxation is to raise revenue for the government to meet its needs of providing necessary services to the public. It is also agreed that tax evasion/avoidance cause government to lose huge amount of money. Consequently, there is the opinion that the loss of revenue as the result of widespread tax evasion/avoidance in Nigeria is due to the weak, inept and inefficient system of tax administration.<sup>5</sup>

In the oil sub-sector, the Federal Board of Inland Revenue (FBIR) is vested with the power to administer the petroleum Profit tax. It is also responsible for carrying out all acts deemed necessary and expedient for inter-alia the assessment of petroleum profits tax.<sup>6</sup>

Another problem that may affect petroleum Profit Tax as well as its assessment is the tax evasion/avoidance. An oil company can evade tax by deliberately delivering false returns, refusal to pay the tax at the right time or refusal to pay the tax at all. It can also avoid tax by manipulating some provisions from the petroleum Profit Tax Act. In other words, some oil companies may look for any lacuna in the PPT provisions so that they will make use of it to avoid tax. This also a serious matter that may render a significant amount of revenue coming

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<sup>4</sup> See *Commissioner v. Newman*-159 F.2d 848,850 (CA-2,1947)

<sup>5</sup> Ayua, I.A. (1996) *Nigerian Tax Laws*, Spectrum Law Publishing, Ibadan, 1<sup>st</sup> edition, p.165

<sup>6</sup> *Ibid.* P.150

from this sector to reduce. Subsequently, the government may not have enough money to use for public services; it is also a critical problem that has to be tackled.

Also, theft and illegal oil bunkering of oil by supposed criminal syndicates also reduces the country's revenue, possibly by several billion dollars every year.<sup>7</sup> In March 2003 for example, political turmoil resulted in force majeure declarations by Chevron, Texaco and Shell, the major oil producers in the country.

There is also the problem of the crises in Niger Delta area gives negative effect on the petroleum Profit Tax and subsequently affects its assessment. For example, on January 19, 2006, a group called the Movement for the Emancipation of the Niger Delta (MEND) grabbed four oil workers and also attacked pipelines and platforms of Royal Dutch Shell Company(which was the biggest oil producing company in the Niger Delta).the MEND was always behind the bombing of pipelines and kidnapping of oil workers. The group has also warned that it will drive oil companies like Shell, Chevron and Exxon-Mobil out of the area,<sup>8</sup>

Presently, Nigerian has been hit by growing unrest in the country's oil producing south by a new militant group calling itself the Niger Delta Avengers, this group attack on Shell's Forcados underwater flow line in February used divers, showing they have the skills and knowledge of oil infrastructure to target areas that will significantly halt production. Other attacks include the sabotage of Chevron's offshore okan gas valve platform, and bombings of Eni's infrastructure and Nigerian National Petroleum Corporation (NNPC) pipelines, which provide gas to Lagos for power generation.

Nigeria has budgeted for production of 2.2 million barrels per day this year but the attacks have cut output to 1.4 million barrels per day according to the petroleum minister Emmanuel Kachikwu. The sabotage couldn't have come at a worse time, with Nigeria, which

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<sup>7</sup> Mahatni, (2006) D, Financial Times Reporter, "*Fight over oil money percolates in Nigeria*" Retrieved July 20,2006 from <http://www.npr.org>

<sup>8</sup> Opele,S. (2006) "*Oil and Youth Restiveness in Niger Delta*". Retrieved September 10,2006 from <http://www.nigerdeltacampaign.com>

normally depends on oil export sales for 70 percent of government revenue, on the brink of a recession. The daily production output of the oil companies in the Niger Delta drops and so Nigeria loses revenue. Indeed, this is a tremendous problem of which an urgent solution should be provided.

Another major problem existing within the tax administration of the upstream oil sub-sector lies essentially on the design of the tax administrative system and the capability of the institution. This consequently leads to low efficiency and effectiveness of not only the assessment of petroleum profit tax, but also the collection of the tax.

The first need of any modern government is to generate enough revenue which is indeed ‘the breadth of its nostrils’. There is high incidence of tax evasion and avoidance by tax payers. This may affect the amount of revenue collectible by the government for the running of the administration furthermore, it is hoped that people were wrongly assessed and the assessment sometimes result to regressive taxation. Thus, taxation is by far one of the most significant sources of revenue for the government .Nigerians regard payment of tax as a means through which government raises revenue at herself on the expense of their sweat. Operators in the Nigerian Oil and Gas industries have in recent times expressed concern over excessive taxes which have impeded their ability to operate at optimal level as well as achieve the desired level of growth. In contracts, government has rolled out various incentives to investors in these sectors to facilitate a favourable business environment and enhance international competitiveness.

It is good to note that no taxation succeeds without the tax payers’ co-operation. Here, we can ask some thought provoking questions such as:

- i. What makes taxation such a difficult issue?
- ii. Why do people feel cheated when it comes to tax?
- iii. Is government making judicious use of tax payers’ money?

iv. What are the problems affecting the successful operation of tax system in Nigeria?

In view of the above questions this study is going to be carried out to offer solutions to them. There is high incidence of tax evasion and avoidance by tax payers. This may affect the amount of revenue collectible by the government for the running of administration.

Furthermore, it is hoped that people were wrongly assessed and the assessment sometimes result to regressive taxation.

Tax as a whole has been the most dependable government revenue source. This is because of the certainty of revenue to be derived data at a particular time. Despite these there have been some problems on the part some taxation authority in ensuring the smooth and efficient use of machinery of collection of taxes.

Taxation in petroleum industry is not a simple task especially in Nigeria where voluntary compliance is lacking in effecting the problems of tax collection constitute area ban to the achievement of target the peculiar problems which prompted this research viz.

The rate of taxes have several implication for taxation in petroleum industry if the rates are high, people will reject them and if they are low the government will lose large revenue . How then will the board reconcile these two interest? What rate should it charge?

Most of the tax law are outdated and are being subjected to different need of amendment which makes it difficult to identify the real law. What then is the government doing to prevent saboteurs from taking advantage of these poor legal systems.

In recent years there had been increase of sharp malpractices and practices and mismanagement of tax revenue, by issuing of duplicated receipt and forged certificate and collecting revenue and not paying it into government treasury, who is responsible for such malpractices? Does it mean the collection machinery is ineffective? Or are the staff purity treated? If they are, how does the board intend to solve it?

Another problem is the conflict between government policies and the objectives, so how does government intend to harmonize these two issues? Despite these problems it does not mean problem taxation was bad, but it will perform better if these problems are solved.

Empirical studies like those of (Sanni 2002) and (Dotun 1996) have reported different views on tax incentives as a catalyst for economic growth and development. A school of thought believes that tax incentive encourages economic growth and development while another believes that it reduces revenue to the government. As a result of this , it does not stimulate economic growth and development .It must be noted that some of the measures taken so far by the government to improve the economy has not produced good results. The Naira exchange rate has not been able to stimulate the economy. The poverty alleviation program aimed at reducing the rate of poverty among Nigerians was introduced. This program covered provision of jobs for able and unemployed youths, provisions of loans to small and medium scale enterprises at a minimum lending rate.

With all these measures and policies Nigerian economy has not shown any appreciable progress. Nigeria still remains one of the developing nations. Given this gap, the study seeks to examine the nature of tax incentives that are extended to deserving companies and the interactions that exists between tax incentives and the economy. Also, it is will be important to examine the impact of petroleum profit Tax (PPT) on economic growth in Nigeria.

### **1.3 Aim and Objectives**

The research mainly aims at examining the problems and identifying any loophole in the provisions relating to the tax assessment of the upstream oil sector, under the Petroleum Profit Tax Act.<sup>9</sup> Also, to examine the impact of petroleum profit tax on economic growth in Nigeria.

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<sup>9</sup> Cap.P.13 Laws of the Federation of Nigerian,2004.

The general objective of this study is to assess the effect that taxation has towards the development/growth of Nigerian economy. Taxation is known to be one of the most important sources of revenue to government, the efficiency and effectiveness of its management is therefore very important. Unfortunately, this is not what is operative and so the main objectives of this study are stated below;

- i. To examine the extent the Government has been using revenue generated by tax
- ii. To examine the causes and reasons for high tax evasion and avoidance, and the effect on economy.
- iii. To determine the reaction of people towards payment of tax.
- iv. To study and analyze the machinery of collection of taxes available
- v. To examine the revenue collection in the form of taxes for the past years from available records and to highlight areas of weakness and to make necessary recommendation on how to improve on it.
- vi. To find out the various internal and external problem confronting the petroleum industry taxation revenue service in the administration of tax with a view to suggesting possible solutions.

#### **1.4 Scope of the Research**

The scope of this study covers critical examinations on the impact of taxation on Nigerian economy. It will also analyze other related issues such as structure and administrative machinery of tax in Nigeria and their associated problems. The essence of this digression is to possibly find out the obstacles if any, that hinder the effective collection and administration of tax in the country.

This research work shall also cover the following areas:

- i. An evaluation of petroleum tax administration in Nigeria;
- ii. The offences and penalties in Nigerian tax law.

- iii. Critical tax administration challenges in the 21st century Nigeria and;
- iv. Measures required by tax authorities and practitioners to meet these challenges

This work shall focus mainly on the issues and problems that are specifically related to the petroleum profit tax of the upstream sector. These issues shall be traced and examined based on the petroleum Profit Tax Act.

### **1.5 Justification**

The justification for embarking on a research work in this area is inspired by the fact that petroleum industry is currently one of the most important industries in the economic life of Nigeria and yet no adequate and well researched literatures that covers the law and practice of the petroleum industry activities and operations together is readily available for those looking for information or those that want to acquire knowledge in this area. This work will therefore contribute to the knowledge by providing an insight to the laws, practice and regulations available in the petroleum industry in Nigeria. Students and lecturers in the faculties of laws in the Nigerian universities, particularly, (students and lecturers of oil and gas law), legal practitioners, other professionals in the petroleum industry and the general public will find this work very useful.

### **1.6 Research Methodology**

The methodology employed in this research is purely doctrinal and it makes use of both primary and secondary legal materials. It will therefore depend on the research from textbooks written by scholars and legal sages. In order to buttress relevant points, legal statutes shall be quoted. Nigerian or foreign cases would be cited to explain or support any point deemed necessary. Journals and articles related to the research topic shall be used. Newspapers may also be used. Reports and conference papers on the topic or any other topic related to it would also be utilized. Relevant materials available on the internet website shall be used.

Finally solutions to the problems of the research shall be proffered by way of recommendations.

## 1.7 Literature Review

Notwithstanding the inadequacy of literatures authored by local writers in the field of petroleum law in Nigeria, there are however few Nigerian authors who have written extensively and have made meaningful contributions as far as Petroleum Law in Nigeria is concerned.

For instance Etikerentse<sup>10</sup> who is the first author to have written a comprehensive text on Petroleum Law in Nigeria as far back as 1984 has yet published another work titled Nigerian Petroleum Law<sup>11</sup> which is very comprehensive in nature as far as petroleum law in Nigeria is concerned.

Abdulrazaq M.T in his book titled Nigerian Tax Offences and Penalties<sup>12</sup> provided a comprehensive and detailed analysis of 'Offences and Penalties' and therefore, highly commendable. However, the following are some of the researcher's observations and comments. At page 37-38 of the book, Nigerian Tax Offences and Penalties, it is stated that:

“In Nigeria there are some monetary penalties and criminal sanction in connection with tax evasion, including the Revenue Boards power to sell off defaulting tax payers goods or other chattels, bonds or securities as well as his premises so that the amount owed can be recovered.”

One is therefore, bound to ask questions in view of the above comments of Prof Abdulrazaq M.T., does the Federal Board of Internal Revenue (FBIR) have the absolute power to sell off defaulting tax payers property (s)?

With due respect to the learned Professor Abdulrazaq M.T, it is submitted by the writer that the revenue Board do not have the absolute power to sell off defaulting taxpayers

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<sup>10</sup> Etikerentse. G.(2005) *“Petroleum Law Nigeria”*, (2<sup>nd</sup> edition) Dredew Publishers, Lagos

<sup>11</sup> *Op.cit.*

<sup>12</sup> Abdulrazaq. M. T. (1993) *“Nigerian Tax Offences and Penalties”*, Batay Law Publications Limited, 1993.

goods or other chattels, bonds or securities and where such power exist, recourse must be made to the courts. For instance the Act<sup>13</sup> provides that; “nothing in this section shall be construed so as to authorize the sale of any immovable property without an order of a High court, made on application”

That is to say where the court fails to make an order the Revenue Board cannot proceed to sell any defaulting tax payer’s property (s) that is, his premises. This provision is considered to be of very important in order to protect the defaulting tax payer from the hands of overzealous tax officials and more so where the payment of tax is being contested in court by the tax payer.

In a similar vein the Act,<sup>14</sup> also provides that “for the purpose of levying any distress under this section an officer duly authorized by the Executive Chairman may apply to a judge of the Federal High Court sitting in chambers under oath for the issue of a warrant under this section”. That is to say where the court is of the opinion not to grant the application, the duly authorized officer cannot proceed to levy or distain the tax payer’s goods, chattels bonds or other securities, not to talk of even selling them off.

Also Professor Ayua. I. A also touched some issues in his book entitled the “Nigerian Income Tax Laws”<sup>15</sup>, Chapter 12 extensively discussed petroleum profit tax.

The book entitled “Income Tax Law and Practice in Nigeria”<sup>16</sup> has also treated some issues related to assessment of PPT. The issues like peculiarities of assessment of petroleum profits, administration of the tax, persons liable to pay tax as well as assessment of petroleum tax are all discussed.

According to Ayodele Odusola 2006, PPT is a tax applicable to upstream operations in the oil industry. It is particularly related to rents, royalties, margins and profit sharing elements

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<sup>13</sup> Section 33(6) FIRS Act 2007.

<sup>14</sup> Ibid Section 33(3).

<sup>15</sup> Ayua, I. A. (1996), Spectrum Law Publishing. Ibadan Nigeria

<sup>16</sup> Ola, C.S. (2001), “Income Tax Law and Practice in Nigeria”, Heinemann Educational Book(Nigeria)Plc Ibadan, pp.534-544.

associated with oil mining,prospecting and exploration leases.it is the most important tax in Nigerian in terms of its share of total revenue contributing 95 and 70 percent of foreign exchange earnings and government revenue respectively.

A petroleum operation as defined in the PPTA essentially involves petroleum exploration, development,production, and sale of crude oil. The Petroleum Profit Tax is regulated by the Petroleum Profit Tax Act of 2007.although the initial law was passed in 1959 to capture the first oil export made in that year.

Section 8 of the Petroleum Profit Tax Act (PPTA) states that every company engaged in petroleum operations is under an obligation to render return, together with properly annual audited accounts and computations, within a specified time after the end of its accounting period, Petroleum profits tax is charged, assessed and payable upon the profits of each accounting period of any company engaged in petroleum operations during any such accounting period, usually one year ( January to December).

Another text worthy of review is a book written by Olisa entitled Nigerian Petroleum Law and Practice<sup>17</sup> which focuses more on the activities and services that are cantered on the petroleum industry.

The books fail to pinpoint the loopholes in the provisions governing the taxation of oil producing companies. Furthermore, theproblem of tax evasion/avoidance has not been specifically pointed out. Most of the books are out-dated; they are therefore devoid of discussing contemporary problems in the oil upstream sub-sector. Most of these books reviewed have failed to address key issues and challenges in the petroleum industry arising from implementation of the regulatory laws. For these reasons there is need to make research specifically on this topic.

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<sup>17</sup> OLISA,M. M. (1997) *"Nigerian Petroleum Law and Practice"* (2<sup>nd</sup> edition) Jonia Ventures Limited Lagos.

## **1.8 Organizational Layout**

This research work is made up of five chapters with sub-headings discussed there under; This research work is made up of five chapters with sub-headings discussed there under.

Chapter One provides a general introduction and the usefulness of the research. It also discusses a vivid literature review of some existing literatures on the subject matter.

Chapter Two deals with the governing legal frameworks of the Petroleum Industry in Nigeria.

Chapter Three examines generally the petroleum profit under the Nigeria's Petroleum Profit Tax.

Chapter four will examine the criminal offences and penalties provided under some federal laws in Nigeria in relation to Petroleum Profit Tax in Nigeria.

Chapter five draws the curtain to this research work with summary/conclusion, findings/observations and the recommendations.

## CHAPTER TWO

### LEGAL FRAMEWORKS OF THE PETROLEUM INDUSTRY IN NIGERIA

#### 2.1 Introduction

The laws regulating the Petroleum Industry clearly provides a striking example of the use of statutory intervention as an instrument of regulation, administration, management and enforcement of laws relating to the Petroleum Industry, It is however instructive to note that Petroleum laws did not gain momentum until late 1970's following the aftermath of oil boom in Nigeria. This chapter will therefore attempt to analyse these laws with the view of finding out whether or not they have kept their promise since their enactment.

#### 2.2 Petroleum Act

The Petroleum Act (The Act) and the regulations issued pursuant to it is the main legislation governing matters relating to petroleum exploration and production in Nigeria. The statutory intent of this Act<sup>1</sup> is to provide for the exploration of petroleum from the territorial waters and continental shelf of Nigeria and to vest the ownership of all on shore and off-shore including the revenue from the petroleum resources derivable there from, in the Federal Government and for all other matters incidental thereto. Section 2 (1) (a)-(c) of the Act<sup>2</sup> provides that the Oil exploration licence, Oil prospecting licence, and Oil mining lease may be granted by the Minister subject to this Act. Sub-section (2)<sup>3</sup> of the same section gave a condition upon which such licences can only be granted, which is to the effect that a licence can only be given to a company registered under Companies and Allied Matters Act. What the section stated above attempted to do, is to first of all leave the power to issue licences and mining leases, a sensitive and probably the most important

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<sup>1</sup> Petroleum Act, Cap P. 10, LFN, 2010

<sup>2</sup> Ibid at Section 2

<sup>3</sup> Ibid

license in an oil and gas industry to the hands of an individual without any checks from any arm of government or institution. Secondly the section did not provide any due process that might be followed by a prospective applicant of the licence to ensure transparency in the issuance of such licences. It is expected that there should be an organization, an institution or a body separate from the office of the Minister that deals with the issue of compliance from the prospective, applicants of the licence in the way Bureau of Public Procurement BPP ensures transparency and due process in the supply chain management public sector of oil and gas industry and other public organisations. From the wordings of the section particularly the sub-section (2)<sup>4</sup> the only requirement for the qualification for such licence is that the company must be registered under Company and Allied Matters Act. So by implication, giving the section a literary meaning any company whether or not it has the manpower, financial viability, technical skills, equipment and expertise can simply apply and probably be granted a license So long as it is registered under the Companies and Allied Matters Act. Section 4 (1)<sup>5</sup> of the Act<sup>6</sup> provides that; “Subject to this section, no person shall import, store, sell or distribute any petroleum product in Nigeria without a licence granted by the Minister. Section 4 (2) went further to say that subsection (1) of this Act shall not apply in respect of:-

- a) Storage, sale, or distribution of not more than **500 litres** of and such other categories of petroleum products as may be exempted from the application of subsection (1) of this section by the Minister by order published in the Federal Gazette.
- b) Storage of petroleum products undertaken otherwise than in connection with the importation, sale or distribution of petroleum products.

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<sup>4</sup> Ibid

<sup>5</sup> Petroleum Act, CAP, P10, LFN, 2010

<sup>6</sup> Ibid

Apart from the impracticability of enforcing this particular provision of this Act, the Act did not even provide for the mode or ways of enforcing this provision. For instance which agency, Parastatals, or institution is responsible for uncovering the offenders and bringing them to book? Essentially, the Act does not address the environmental effect of petroleum exploratory activities. Most of the regulations are concerned with the safety of the personnel working in the oil wells and the safety precautions to be observed in the course of oil exploration activities and the Department of Petroleum Resources DPR, under the Ministry of Petroleum Resources which is charged with the power to enforce the Petroleum Regulations.

The Petroleum Act and Regulations created offences and imposed penalties for non-compliance, which include short term imprisonment and payment of meager amount as fine. It is submitted that these penalties were not deterrent enough as it is cheaper, economical and desirable for defaulting company to violate these regulations and pay the necessary the imposed fine as specified by the Act than to comply with these regulations.<sup>7</sup>

### **2.3 Oil Pipeline Act**

The Oil Pipeline Act<sup>8</sup> was enacted to make provision for licenses to be granted for the establishment and maintenance of pipelines incidental and supplementary to oil fields and oil mining for purposes ancillary to such pipelines. Section 4 (1) of the Act<sup>9</sup> made provisions for the grant of a permit to survey the route for an oil pipeline for the transport of mineral oil, natural gas or such other products.<sup>10</sup> Although not expressly stated, the Act<sup>11</sup> has as part of its set goals the protection of the environment. Principally, the holder of a permit to survey is expected to take all reasonable steps to avoid damage to any land

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<sup>7</sup> Ibid

<sup>8</sup> Oil Pipeline Act, Cap 07, LFN, 2010

<sup>9</sup> G. DEINDUOMO (2009) In: I .EV11RI and G.DK1NDUOMO, "Law and Petroleum Industry in Nigeria" Malthouse Publication, Lagos,

<sup>10</sup> ETIKERENTSE G. (2nd Edition) "Petroleum Law in Nigeria", Lagos Nigeria

<sup>11</sup> S. EABILA and D. KDERRL In: F. EMIRI and G. DHINDUOMO, Law and Petroleum Industry in Nigeria. Malthouse Publication, Lagos, 2009

entered upon. Where there is any damage done, the holder is expected to compensate the owner, objection can be made by any person whose land or interest in land may be injuriously affected by the grant of a license but, where a licensee is granted, the holder is expected to pay compensation to any person whose land or interest in land has been injuriously affected or any person suffering damage by reason of or as a consequence of the holder's negligence to make good a damage. Additionally, the Act<sup>12</sup> prohibits the alteration in the flow of water in a navigable waterway, or the construction of works, in, under or over any navigable waterway that might obstruct or interfere with the free and safe passage of vessels, canoes or other craft, by an oil pipeline licensee. A licensee is also prohibited from making any construction in, under or over, or depositing materials in or altering the flow of water required for domestic, industrial or irrigational use, thereby diminishing or restricting the quantity of water available for these purposes, or constructing works or making deposits in any waterways that would cause flooding or erosion without the prior permission in writing of the Minister. There are restrictions on vested land while there are also specific Provisions allowing access to government officials to inspect and be sure things are being done in accordance with the licence. In addition, subsection 4 of section 17 of the Act<sup>13</sup> also made every oil pipeline licenses granted under the Act subject to the provisions of the Act and any regulations in force concerning the prevention of pollution of land and waters. Much as it can be said that the Act made adequate provisions for the protection of individual interests and concerns, its weakness, lies in its failure to make the restoration of land upon which compensation is paid mandatory<sup>14</sup> in a way that is commendable, the Act made provision for courts to play roles that would ensure just assessment of compensation not only for damage done to buildings,

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<sup>12</sup> Ibid

<sup>13</sup> G. DEINDUOMO In: F. KMIRI and G. DEINDUOMO, *Law and Petroleum Industry in Nigeria*. Malthouse Publication, Lagos, 2009

<sup>14</sup> FAGBOHON O (2010) *The Law of Oil Pollution and Environmental Restoration*. Odadu Publishers, Lagos.

profitable trees or crops, disturbance, or damage suffered by reason of or as a consequence of a holder's negligence, but also for loss in value of the land or interests in land. The grant of a licence is also deemed to include among others a condition to indemnify the Minister against any claims arising from injury to any person or damage to any public or private property as a result of any act or thing done by the holder of the licence or his agents, servants or workmen in accordance with the licence.<sup>15</sup> The problem, however, is the faith in and the assumption that man is capable of fulfilling his responsibilities towards nature without much prompting. Thus, a provision like section 21 of the Act<sup>16</sup> which provides that where the interest injuriously affected are those of a local community, the court may order the compensation to be paid to any chief, headman or member of that community on behalf of such community or that it be paid in accordance with a scheme of distribution approved by the court or that it be paid into a fund administered by a person approved by the court on trust for application to the general, social or educational benefit and advancement of that community or any section thereof.<sup>17</sup> The above approach, for failing to provide a clear guide as to how compensation received would mandatorily be applied to the respective heads of claim under which it is received is too simplistic an approach to tackle the challenges on ground. To start with, the low standard of living of Nigerians is such that restoration of land from harm done to it is the least of a land owners' priority when compensation is paid. Furthermore, the widespread ignorance of many land owners and communities is such that technical data and detailed evaluation of natural system (which is usually complex) cannot easily be undertaken.<sup>18</sup>

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<sup>15</sup> OMOROGBE Y (2001). *Oil and Gas Law in Nigeria*, Malthouse Publication, Lagos.

<sup>16</sup> Oil Pipeline Act, CAP O23 LFN, 2010

<sup>17</sup> FAGBOHUN O. *The Law of Oil Pollution and Environmental Restoration*, Odade Publishers, Lagos, 2010

<sup>18</sup> F. EMIRI, O In: F. EMIRI and G. DEINDUOMO, *Law and Petroleum Industry in Nigeria*. Malthouse Publication. Lagos. 2009

## **2.4 Petroleum Profit Tax Act (PPTA)**

The PPTA is the principal legislation which governs the taxation of companies engaged in petroleum operations in Nigeria. All companies engaged in petroleum operations are subject to tax under the PPTA. The PPTA imposes tax upon the profits from the winning of petroleum in Nigeria, provides for the assessment and collection of PPT in Nigeria. The Law took effect from 1<sup>st</sup> January, 1958 and has had several amendments. Government came up with a consolidated version of the PPT as Cap P13 of the Laws of the Federation of Nigerian 2004 as amended.

Petroleum Profit Tax (Amendment) Bill 2005 (PPT Bill 2005) forms part of the government tax reforms but is yet to be passed into law.

Their income is liable to tax at 85% (subject to incentives contained in the MOU (as relevant), or 65.75% within the first five years of operating during which they are recovering their capitalized pre-production expenditure.

This Act was enacted in 1958 when the activities in the petroleum industry began to increase and the government then under the colonial administration saw the need to tax petroleum activities differently from companies engaged in other enterprises. Taxation or tax as usually understood, is the compulsory levy on a person's or a subject's property (including income) by an appropriate governmental authority.<sup>19</sup> This understanding of the nature of a tax does not differ much from its legal definition or meaning. See Black's Law Dictionary 7th Edition in which taxation is defined as "a monetary charge imposed by the government on persons, entities or property to yield public revenue". Taxation in its broader sense includes governmental impositions like duties, excises, levies and rates. The sources from which incomes are derived under the Petroleum Profit Tax Act as follows;

- a) Direct Tax: on the Profits of the Oil Company, This is levied in accordance with

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<sup>19</sup> OL15A M. M. (2003) Nigerian Petroleum Law and Practice (2nd edition) Jonia Ventures Limited Lagos.

the provisions of the PPTA

- b) Signature Bonuses: Paid upon grants of Oil Prospecting Licences, Production Sharing and Service Agreements as well as marginal fields allocation.
- c) Fees: These include those charged and paid in connection with the application, grant, assignment, etc. in respect of the following:
  - i. Oil Exploration and Oil Prospecting Licences;
  - ii. Oil Mining Leases;
  - iii. Permits to Survey the route of proposed oil pipelines;
  - iv. Oil Pipeline Licences;
  - v. Production Sharing and Service Agreements,
  - vi. Marginal fields allocations.
- d) Rents: In respect of concessions and grants made to oil companies under the Petroleum Act.<sup>20</sup>
- e) Premiums: Paid (if not waived) in respect of approved assignments of Oil Prospecting Licences and Oil Mining Leases or of interest therein.<sup>21</sup>
- f) Revenue from Royalties: Paid on crude oil, casinghead petroleum spirit and gas produced from on-shore and off-shore concessions.
- g) Payments: made under the provisions of the Oil Terminal Dues Act.<sup>22</sup>
- h) Bank Charges or Commissions: Paid to the Central Bank of Nigeria in connection with petroleum profits tax, royalties and concession rentals.

In ascertaining a company's profit in a fiscal year under the PPTA, the computation must be done within 12 calendar months beginning on 1<sup>st</sup> January and terminating on 3<sup>rd</sup> December of the same year.<sup>23</sup> Be this as it may, the first taxable period of a

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<sup>20</sup> CAP P10 LFN, 2010

<sup>21</sup> Paragraph 15 of the 1st Schedule to the petroleum Act

<sup>22</sup> Cap T16, LFN, 2010

<sup>23</sup> ETIKERENTSE G. Petroleum Law in Nigeria, Lagos 2005

company could be shorter than one year, commencing from the date it makes its first bulk sale of chargeable oil or liquefied natural gas.<sup>24</sup> It means therefore, that a company whose first bulk sale was effected after 1<sup>st</sup> January, its accounting period would commence from the date of such first bulk sale and end on 31<sup>st</sup> December of the same year of such first bulk sale. In the illustrative case where the accounting period covered is less than twelve months, such period would be regarded under the law as the accounting period of such a company. However, such a company's accounting period thereafter must match the statutory twelve months' period of 1<sup>st</sup> January to 31<sup>st</sup> December.<sup>25</sup>

For a company that ceases its petroleum operations before the end of the year (December) its accounting period is adjudged to terminate on the date of such cessation. It should be noted here that such operative date is the date of the cessation of its operations and not the date of its last bulk sale of chargeable oil or gas.<sup>26</sup> Should the effective date of the cessation of petroleum operations as regards the determination of an accounting period be in dispute, the decision of the Director of the Department of Petroleum Resources in the matter would be final.<sup>27</sup> In this connection, the submission is made that the issues involved are those of fact and that not much difficulty would be encountered in leading evidence that would satisfactorily establish such dates. As regards the accounting period of a "reconstituted company" that is to say, a company, which is incorporated locally to carry on the petroleum operation of a foreign company, which had such business in Nigeria, the provisions of section 16(2)(a)<sup>28</sup> would apply to it. As earlier pointed out, the principle applied in the determination of the actual taxable profits of a company engaged in petroleum operations is the same as with other companies namely, that certain items of expenditure are permitted to be deducted from the company's gross profits. The general

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<sup>24</sup> Ibid

<sup>25</sup> OMOROGBE Y. (2001) Oil and Gas law in Nigeria, Malthouse Publication, Lagos.

<sup>26</sup> OLISA M.M (2003) Nigerian Petroleum Law and Practice, Jonia Ventures Limited Lagos.

<sup>27</sup> ETIKERENTSE G. Petroleum Law in Nigeria, Lagos 2005

<sup>28</sup> Petroleum Profit Tax Act, CAP P13, LFN, 2010

guide for identifying an expense or outgoing which qualifies for such allowable deduction is to ascertain if it meets the criteria that it is wholly and exclusively incurred during the subject accounting period for the direct purposes of the petroleum operations, that is to say, in directly generating the income to be taxed. Such expenditure must also have been a necessary one. It is immaterial that the expenditure was incurred outside Nigeria<sup>29</sup>. The deductible expenses are enumerated under section 10 (1) (a)-(e) of the Petroleum Profit Tax Act. Every company engaged in petroleum operations is required by section 28<sup>30</sup> to "make up accounts of its profits and losses arising from those operations," for each accounting period. Under section 31(1),<sup>31</sup> it is stipulated that not later than two months after the commencement of each accounting period of a company, the company shall deliver to the Federal Inland Revenue Service (in the form prescribed by the FIRS) the company's estimated tax for the period. Section 35 (1)<sup>32</sup> authorizes the FIRS to make assessments of the tax (in the form and manner provided by it) of a company for its accounting period based on the amount of chargeable profits, assessable tax and chargeable tax. None of the foregoing provisions or in any other provisions of the PPTA is the currency in which the account estimates, returns or computations are to be made, stipulated.<sup>33</sup> However, arising from certain problems associated with currency gains and losses experienced by the Federal Government and the oil companies in the fulfillment of the oil companies financial obligation, an agreement was finally executed in 1992<sup>34</sup> that these computations, estimates and returns be made in U. S. dollar currency, since this currency features prominently and generally in most transactions in the industry.

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<sup>29</sup> ETIKERENTSE G. Petroleum Law in Nigeria, Lagos 2005

<sup>30</sup> Petroleum Profit Tax Act, CAP P13, LFN, 2010

<sup>31</sup> Ibid

<sup>32</sup> Ibid

<sup>33</sup> Ibid

<sup>34</sup> Ibid

One of the problems associated with the efficient implementations of the PPTA is that section 10 (1) (a)-(i)<sup>35</sup> provides a very long list of deductible expenses while ascertaining the company's profit for the purposes of computation of the Petroleum Profit Tax due to the company under the Act. It was observed that by the time the company had completed its deductible expenses as outlined in the section mentioned above, there might be little or nothing that is taxable from the company's profit. So at the end of the day the amount a company may remit to the Federal Government through FIRS might just be something little in comparison with the company's turnover after all the deductions.

Cooking of company's audited account is one of the major problems of taxations generally in Nigeria. Before any company can be assessed for the purposes of taxation, such a company must submit its audited account in a financial year (January-December). It is the audited accounts submitted by the companies that guides the tax authorities in the assessment of chargeable taxes due to the company. Under the PPTA particularly section 9<sup>36</sup> thereof, which is to the effect that any company engaged in petroleum operation must submit its audited accounts showing its profits and losses to the FIRS to enable them assess chargeable taxes due to the company. The simple interpretation of this provision is that whatever is submitted to the FIRS by the company is presumed to be correct. So, for the purpose of taxation under the PPTA there is a presumption of regularities in the audited accounts as presented by the companies and the FIRS not being an audited form may not deem it fit to re-audit the already presumed audited accounts submitted to them but rather merely assess the chargeable taxes due to the company from the information they have before them whether or not the information contained therein is true or false.

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<sup>35</sup> Ibid

<sup>36</sup> Ibid

The PPTA understandably did not specify the currency in which the petroleum profit tax should be paid but ordinarily the tax being a Nigerian statute it is expected that the currency should be in Naira. However, the practice is that the assessment of the profit tax for companies engaged in petroleum operations is done in US Dollars on the possible reason that most of the companies engaged in petroleum operations in the upstream sector of the petroleum industry are foreign companies mostly referred to as International Oil Companies (IOCs). The originators of this practice did not however avert their minds to the deductible expenses which are usually done in Naira. Because it is believed that some of the items under the deductible expenses are local transactions of which such transactions are paid for in Naira. For example, rents, customs and excise duties, tenement rates and any other tax other than the tax imposed by this Act are all remitted in Naira.

The penalty prescribed under sections 51-55 of the PPTA are so insignificant, 11 the modern day Nigeria to a company engaged in petroleum operators. Although these sanctions as at the time of promulgation this Act<sup>37</sup> in 1958 might have been a weighty sanction on the defaulters but with the passage of time these amounts mentioned in the Act is nothing to go by this days. So the need to review this sanctions in pertinent to the enforcement of this Act.

## **2.5 Nigerian Oil and Gas Industry Local Content Development Act**

The main thrust of the NOGIC ACT is to increase the Nigerian content in the country's oil and gas.

‘Nigerian content has been defined as:

The quantum of composite value added in the Nigerian economy by a systematic development of capacity and capabilities through the deliberate utilization of Nigerian

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<sup>37</sup> Petroleum Profit Tax Act, CAP P13, LFN, 2010

human, material resources and services in the Nigerian Oil and Gas industry.

Most African countries, at post-independence, recognized the need for their indigenes to take ownership and control of their natural resources for exploitation and transformation into economic growth.<sup>38</sup> In order to achieve this goal various policies and laws have been pursued by the Governments.<sup>39</sup> Petroleum industry in Nigeria was not immune from these Government policies. Some laws enacted in Nigeria include the Petroleum(Drilling & Production) Regulations<sup>40</sup>, Industrial Training Fund,<sup>41</sup> Petroleum Technology Development Fund<sup>42</sup> and National Office of Technology Acquisition Act.<sup>43</sup> The Nigerian Petroleum industry was originally the exclusive domain of the International Oil Companies (IOCs) in areas ranging from exploration to production, refining and trading. Even the downstream operations were initially controlled by expatriate companies. Intervention by the Federal government resulted in the nationalization of assets of the major oil players in 1991,<sup>44</sup> the Federal Government sought to demystify the oil industry by awarding onshore and offshore oil blocks to Nigerian entrepreneurs through competitive bidding. Despite the seeming progress narrated above, the “Nigerianization” process in the lucrative process in the lucrative upstream has been comparatively negligible.<sup>45</sup> The primary reason is the absence of legal or statutory frameworks for Nigeria to harvest the technological industrial and economic intangible capital assets being generated by oil and gas activities for diffusion into the local economy. The enactment

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<sup>38</sup> <http://www.akindelano.com> accessed on the 15<sup>th</sup> of December, 2013

<sup>39</sup> Ibid

<sup>40</sup> Schedule 1 of the Petroleum Act, Cap P10, LFN, 2010

<sup>41</sup> 1971

<sup>42</sup> 1973

<sup>43</sup> Cap N123, LFN, 2010

<sup>44</sup> <http://www.akindelano.com> accessed on the 15<sup>th</sup> of December, 2013

<sup>45</sup> Ibid

of Nigerian Oil and Gas Industry Content Development Act<sup>46</sup> seeks to increase indigenous participation in the Oil and gas industry by prescribing minimum thresholds for the use of local services and materials and to promote transfer of technology and skill to Nigerian staff and labour in the industry.

The Act<sup>47</sup> is comprehensive in nature, running into 107 sections and applies to all operators, contractors and other entities involved in any project in the oil and gas industry. It takes precedence over all other existing enactments and laws in respect of all matters and operations industry pertaining to Nigerian content carried out in the oil and gas. A Nigeria Content Development and Monitoring Board (the Board) has been established and vested with the responsibility to implement the provisions of the Act, make procedural guidelines and monitor compliance by operators within the oil industry. The Act set out general obligations which are applicable either by reference to the operators and participants in the Oil and Gas Industry or activities taking place in the Oil and Gas industry. The overall local content policy objective and obligation imposed in respect of transactions within the oil and gas industry are set out in Section 3(1) of the Act<sup>48</sup> which provides that Nigerian independent operators shall be given first consideration in the award of oil blocks, oil field licences, oil lifting licenses and all projects for which contract is to be awarded in the Nigerian oil and gas industry subject to the fulfillment of such conditions as may be specified by the Minister. Sub-section (2)<sup>49</sup> of the same section state that there shall be exclusive consideration to Nigerian Indigenous service companies which demonstrate ownership of equipment, Nigerian personnel and capacity to execute such work to bid on land and swamp operating areas of the Nigerian oil and gas industry for contracts and services contained in the schedule of this Act, Sub-section (3)<sup>51</sup> is

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<sup>46</sup> CAP N125, LFN, 2010

<sup>47</sup> Ibid

<sup>48</sup> CAP, N124, LFN, 2010

<sup>49</sup> Ibid

with regards to the compliance with the provisions of this Act and promotion of Nigerian content development shall be a major criterion for award of licenses, permits and any other interest in bidding for oil exploration, production, transportation and development or any other operations in Nigerian oil and gas industry. In furtherance of this objective, the Act<sup>50</sup> gives prudential treatment to all Nigerian companies operating in the industry. As a basic principle, the Act requires that promotion of Nigerian content development shall be a major concern in all projects and operations in the oil industry. It then goes to say that Nigerian independent operators shall have first consideration in the award of oil blocks, lifting licenses etc and in all projects for which contracts are to be awarded. This principle applies to all sphere of the industry not only “contracting” but also employment of staff and labour, staff training and procurement of goods, materials and services etc. By Section 3 (2),<sup>51</sup> exclusive consideration is given to Nigerian indigenous service companies which demonstrate ownership of equipment, Nigerian personnel and capacity to execute such work on land and swamp. This section incorporates a significant pre-condition for getting the coveted exclusive preferential treatment. It stipulates “demonstrate capacity to perform as a key criterion for preferential award of jobs. Supporting provisions for the policy objectives of Section 3 and for Nigerian companies are contained primarily in Section 11, 15 and Section 16. The main support granted in favour of Nigerian companies is contained in Sections 15 and 16 which deals with the bidding process. Other benefits to be enjoyed by Nigerian companies under the Act are technology transfer as contained in Sections 44 and 45 of the Act. Section 44 stipulates that operators are required to have a program of incentives to promote transfer of technology and Section 45 encourages the formation of joint ventures and other forms of alliances. Section 3(2) is developed further in Section 11 of

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<sup>50</sup> Nigerian Oil and Gas Local Content Development Act CAP N124, LFN, 2010

<sup>51</sup> Ibid

the Act which sets out the minimum level of Nigerian Content required for various activities carried out in the Oil and gas industry. Section 11 of the Act states that the "minimum Nigerian content in any project to be executed in the Nigerian Oil and Gas industry shall be consistent with the level set out in the Schedule to the Act" The promotion of "Nigerian human material" as an aspect of Nigerian Content is dealt with in Section 28 to 35 of the Act. The general clause in this regard is Section 28(1) of the Act which stipulates that "Nigerians shall be given first consideration for employment and training in any project executed by any operator or project promoter". Based on the above foundation the Act requires that the Nigerian Content Plan submitted by operator or project promoter shall include an employment and training Plan which complies with Section 29 of the Act. Section 30 and 31 also make it an obligation on operators to provide training to Nigerians where Nigerians are not employed because of lack of training and to provide a succession plan for a Nigerian to understudy to an expatriate for a maximum period of 4 years. By Section 32 the expatriate workforce for an operator or project promoter is limited to a maximum of 5% of its management positions as may be approved by the Board. Further in this regard, Section 33 requires that all applications for expatriate quota must first be referred to the Board. The Act requires in Section 34 that a "Labour Clause" be inserted in "projects or contracts" mandating the use of a minimum percentage of Nigerian workers as may be stipulated by the board. Finally all operators and companies operating in the Nigeria oil and gas industry shall employ only Nigerians in their junior and intermediate cadre. With regards to legal and financial services Section 51 provides that the operators and other investors in any operations, business or transaction in Nigeria oil and gas industry can only retain a Practitioner or a firm of Legal Practitioners located in Nigeria, whereas Section 52 provides that all operators and investors in need of financial services can

only retain the services of Nigerian financial institutions expect in situations to the satisfaction of the Board it is impracticable to do so. Section 53 on the other hand provides that all operators and investors engaged in Nigerian oil and gas industry must carry out all fabrications and welding activities in the country.

## **2.6 Companies Income Tax Act (CITA):**

Companies operating in all other segments of the oil and gas sector are assessed to Companies Income Tax at 30% of taxable profit under CITA. Also non-crude oil related income/profits earned by petroleum operations are liable to CIT, separately.

In practice, nonresident companies are taxed on a deemed profit basis at an effective tax rate of 6% of total revenue (i.e. 30% of 20% deemed profit).the FIRS have indicated its intention to begin to assess them to tax on actual profits basis (based on audited accounts), like a typical Nigerian company.

## CHAPTER THREE

### PETROLEUM PROFIT UNDER THE NIGERIA'S PETROLEUM PROFIT TAX ACT

#### 3.1 Introduction

Taxation can simply be described as a compulsory sum levied by a sovereign Power on the incomes, profits, goods and services or properties of individuals or corporate bodies. In most countries of the world the primary objective of taxation is essentially to generate money for government expenditures on social welfare. The rationale for imposing taxes in a market economy includes provisions of basic amenities for the people, defence, redistribution of incomes, etc. In the past, Nigeria boasts of its resources from export of cocoa, cotton, rubber and groundnut. Before independence in 1960, agriculture was the mainstay of Nigeria economy, providing cash crops as well as food to the entire economy<sup>1</sup>. The history of oil production in Nigeria dates back to 1908 when an affiliate of a German Exploration Company, the Nigerian bitumen company came to present day Ondo State to venture for Bitumen (tar sand)<sup>2</sup>.

By 1971, a year after the Civil War, oil had started becoming more important to the economy. With the boom in the late seventies of oil, attention shifted completely from the agricultural sector to the oil sector of the economy. The structure of Government's participation, as well as its impacts on the entire sector of the economy, changed from been a mere 'supportive' sector it was in 60s to the predominant source of foreign exchange earnings and development finance as well as a viable access to international development opportunities.

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<sup>1</sup>Afolabi Khadijat, *Impact of Oil export on Economic Growth in Nigeria from 1970- 2006*. from: <http://www.abdulhamidmustapha.wordpress.com/2011/12/29> Retrieved on Saturday 22nd June, 2013

<sup>2</sup>Olanrewaju Fagbohun (2010), *The Law of Oil Pollution and Environmental Restoration: A Comparative Review*, Odade Publishers, Nigeria, p. 153. See also Online Nigeria, *Petroleum Exploration and Production*. Retrieved on Tuesday 6<sup>th</sup> August, 2013 from : <http://onlinenigeria.com>

The very vital importance of oil to Nigeria dictates government's involvement in the regulation of the Nigerian oil sector. It is noteworthy that prior to 1971, all of the multinational companies were wholly owned by their foreign parent companies. In that same year, government started acquisition of participating interest in the operation of these companies while citizens also acquired varied shareholding interests in the assets of these companies<sup>3</sup>. To strengthen Government control in the sector, the Nigerian National Petroleum Corporation (NNPC) was established by a decree in 1971<sup>4</sup>. Petroleum is a generic name for combustible hydrocarbon compound found in the earth, and occurring in nature in the gaseous, liquid and solid state<sup>5</sup>. Taxation of petroleum profit started in 1959 with the enactment of the Petroleum Profit Tax Act 1959 which was meant to have a retrospective effective date of 1st January, 1958.

This Act serves as a foundation for the present Petroleum Profit Tax Act, 2004; which was further amended in 2007. The objective of this Act can be gleaned from its preamble which reads:

An Act 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 line with its objective, the Act in Section 3 thereon establishes a body known as the Board and saddled with the responsibility of assessment and collection of the petroleum profit tax.

### **3.2 1999 Constitution and the Oil and Gas Sector**

In Nigeria, like in any other countries, Constitution is the organic law from which all other laws derived their validity. **Njikonye v. MTN Nig. Comm. Ltd.; Famfa Oil Ltd. v. A-**

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<sup>3</sup>Olanrewaju Fagbohun, op. cit. p. 156.

<sup>4</sup>*Performance of Economic Growth in Nigeria (1979-2000): Impact of Oil Industry*. Retrieved on Saturday 22nd June, 2013 from: <http://www.doubleglist.com/economicgrowth-nigeria-impact-oil-industry>

<sup>5</sup>Williams & Meyers (2007)*Oil and Gas Law*, Lexis Nexis, vol.1 p.1.

**G Federation & NNPC<sup>6</sup>; Attorney-General, Federation v. A-G Abia State & 35 Ors.**

(No. 2).<sup>7</sup>In other words, it is the basis upon which the existence of other laws rest. The Court of Appeal, per Omoleye, JCA, put the position as:

“The Constitution of the Federal Republic of Nigeria, 1999, is the organic law from which all other laws flow and derive International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013 3 their validity”<sup>8</sup>.

In the oil and gas sector of the economy, the 1999 Constitution (as amended) is the supreme law in relation to Nigeria’s oil and gas sector.

Section 1 (1) of the Constitution provides for its supremacy as follows: “This Constitution is supreme and its provisions shall have binding force on all authorities and persons throughout the Federal Republic of Nigeria.” The Constitution further provides that if any other law is inconsistent with the provisions of the constitution, the constitution shall prevail and that other law shall to the extent of its inconsistency be void<sup>9</sup>.

Section 44 (3) of the Constitution vests the ownership and control of mineral oil and natural gas in the Federal government of Nigeria. The Constitution provides:

“Notwithstanding the foregoing provisions of this section, the entire property in and control of all minerals, mineral oils and natural gas in, under or upon any land in Nigeria or in, under or upon the territorial waters and the Exclusive Economic Zone of Nigeria shall vest in the Government of the federation and shall be managed in such manner as may be prescribed by the National Assembly.”

In line with these provisions of the Constitution, the National Assembly, through its Standing Committees on Oil and Gas Matter, has as one of its constitutional duties, the responsibility to monitor the activities in the Nigeria’s oil and gas sector<sup>10</sup>. This oversight

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<sup>6</sup>[2003] 18 N.W.L.R (Pt. 852) 453 SC

<sup>7</sup>[2002] F.W.L.R (Pt. 102) 1

<sup>8</sup>*Njikonye v. MTN Nig .Communication Ltd (supra)*

<sup>9</sup>Section 1 (3) of the 1999 Constitution

<sup>10</sup>See Section 62, 88 and 89 of the 1999 Constitution (as amended)

function has helped the Federal Government in saving several billions of naira in the oil and gas sector alone<sup>11</sup>.

### 3.3 Administration of Petroleum Profit Tax

The administration of petroleum profit tax is vested in the Federal Inland Revenue Service (formerly Federal Board Inland Revenue). The FIRS<sup>12</sup> is statutorily responsible for the assessment and collection of taxes in the oil and gas sector of the economy. Section 3 of the Petroleum Profit Tax Act vests the Board with the following powers, among others;

Due administration of the Act;

Acquisition, holding and disposal of any property taking as a security for or in satisfaction of any tax or any judgment debt due in respect of any tax, etc.

The service may by notice in the Federal Gazette direct that any information, returns or documents required to be supplied, forwarded or given to the revenue service be supplied to such other person as the service may direct<sup>13</sup>; Specify from time to time, form of returns, claims, statement and notices under the Act<sup>14</sup>, etc.

The scope of FIRS<sup>15</sup> power over tax administration and enforcement covers three types of companies in the oil and gas industry, namely:<sup>16</sup>

- i. Crude Oil and natural Gas producing Companies;
- ii. The Petroleum Marketing Companies; and
- iii. Servicing Companies<sup>17</sup>;

The Act regulates upstream activities as opposed to downstream.<sup>18</sup> Upstream operation involves all activities carried out in the exploration,<sup>19</sup> drilling, extraction, development,

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<sup>11</sup>Udo Jude Ilo, *Oil Subsidy Report: A Chance for New Democracy in Nigeria*. Retrieved on Tuesday 2nd July, 2013 from: <http://www.opensocietyfoundations.org/voices/oilsubsidy-report-chance-new-democracy-Nigeria>

<sup>12</sup>The Service is established by virtue of Section 1 of the Federal Inland Revenue (Establishment) Act, 2007

<sup>13</sup>Section 3 (d) of the Petroleum Profit Tax Act

<sup>14</sup>Section 6 (2) Ibid

<sup>15</sup>The powers and functions of the Service are also being regulated by Sections 7 and 8 of the Federal Inland Revenue (Establishment) Act, 2007.

<sup>16</sup> International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013 4

<sup>17</sup>Such services include drilling, seismic survey, logging, data interpretation from oilfields, etc.

production, transportation and sale of crude oil. Downstream operations on the other hands involve conversion of crude oil into usable form such as premium motor spirit, diesel, kerosene, gas utilization project etc. In the exercising the duties and power conferred on it by the Act, the Service shall be subject to the authority, direction and control of the Federal Minister of Finance<sup>20</sup>. Consequently, any written direction, order or instruction given by the minister, after consultation with the Chairman of the Service, shall be carried out by the Service.

### 3.4 Oil Licenses and Fiscal Arrangements

The Petroleum Act provides for three (3) classes of Oil Licenses that can be granted by the Minister to a company<sup>21</sup>. Section 2 of the Act vest the Minister, charged with the responsibility for petroleum, with the power to grant three categories of interest from the absolute ownership of the Federal Government<sup>22</sup>.

The law provides that a lease or licence under the Act may be granted only to a company incorporated in Nigeria under the Companies and Allied Matters Act or any corresponding law<sup>23</sup>.

The Nigerian Court of Appeal in *Nwadioro & 2 Ors. v. Shell Petroleum Development Company of Nigeria Ltd*<sup>24</sup> held that the Petroleum Decree No. 51 of 1969 (now Petroleum Act) empowersthe Minister or government to grant an oil exploration license, oil prospecting license and oil mining license to a citizen of Nigeria or a company incorporated in Nigeria under the Companies Decree, 1968 or any other corresponding law. In any of the three

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<sup>18</sup>Downstream operations, which are not subject to petroleum profit tax, include marketing and refining activities.

<sup>19</sup>By oil exploration it means a search for reservoir traps. See Williams & Meyers op. cit.p. 6

<sup>20</sup> Section 3(1)(f) Of the Act

<sup>21</sup>Section 2(1) of the Petroleum Act

<sup>22</sup>See the case of *Southern Atlantic Petroleum Limited v. Minister of Petroleum Resources NOGC 6[2007-2008] 245 CA.*

<sup>23</sup>Section 2 (2) of the Petroleum Act, Law of Federation of Nigeria 2004.

<sup>24</sup>NOGC 1 [1961-1995] 205 CA.

licenses, whatever right is granted to a company, the reversionary right is retained in the grantor, which is the Federal Government of Nigeria. The licenses that can be granted are:

#### **3.4.1 Oil Exploration License (OEL)**

An oil exploration license is granted to a company to explore for petroleum. An oil exploration license does not confer any exclusive license over the area of the license, and the grant of an oil prospecting license in respect of any area shall not preclude the grant of another oil exploration license or of an oil prospecting license or oil mining lease over the same area or any part thereof<sup>25</sup>. An oil exploration license shall terminate on 31st December next following the date on which it was granted, but the licensee shall have an option to renew the license upon the fulfillment of certain conditions.

#### **3.4.2 Oil Prospecting License (OPL)**

This license confers exclusive right on the holder of the license to explore, carry away and dispose of petroleum discovered and won in the area of operation<sup>26</sup>. The area covered by an oil prospecting license must be compact but not being an area in excess of 2590km<sup>2</sup> (1000 sq. Miles). The award of oil prospecting license creates a contractual relationship between the parties which is statutory in nature. The duration of an oil prospecting license shall be determined by the Minister, but shall not exceed five years (including any period of renewal). The holder of an oil prospecting license may carry away and dispose of petroleum won during prospecting operations, subject to the fulfillment of obligations imposed upon him by or under the Act. These obligations include any special conditions imposed under paragraph 34 of the First Schedule to the Petroleum Act or by the Petroleum Profit Tax Act or any other

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<sup>25</sup>See paragraph 2 to the First Schedule to the Petroleum Act, 2004

<sup>26</sup>Oil Prospecting Licence is defined in section 2 of the petroleum profit tax Act as a lease granted to a company, under Minerals and Mining Act, for the purpose of winning

law imposing taxation in respect of petroleum<sup>27</sup>. The oil prospecting license can be converted to an oil mining license<sup>28</sup>.

### **3.4.3 Oil Mining License (OML)<sup>29</sup>**

This type of license is issued to a holder of oil prospecting license that has satisfied all the conditions with daily production of not less than 10,000 barrels. This license confers exclusive right on the holder to explore, carry away and dispose of petroleum discovered and won in the area in excess of 1295km<sup>2</sup> (500 sq. miles). The life of an Oil Mining License is usually for a maximum of 20 years but renewable in accordance with the Act, and the leases of the license is expected to apply for a renewal of the license not less than twelve month before the expiration of the lease<sup>30</sup>. A holder of an oil mining license may, with the consent of and on such terms and conditions as may be approved by the President, farm out any marginal field which lies within the leased area. One half of the area granted under an oil mining lease shall be relinquished after 10 years.

## **3.5 Fiscal Arrangements**

### **3.5.1 Joint Venture**

This is an arrangement under which the Federal Government through the Nigerian National Petroleum Corporation (NNPC) enters into a joint operating agreement with multinational companies as joint venture partners. The foreign technical partners are usually designated as “Operators”. The operators’ duties include the implementation of the work program and budget. Each partner is expected to make contribution to cash calls through exploration, development and production activities, and separately lift and dispose of its share of crude oil based on their equity contribution, usually in the ratio 60:40, and also separately

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<sup>27</sup> See paragraph 7 of the First Schedule to the Petroleum Act, 2004

<sup>28</sup> Ayoola-Daniels Niyi (2008), *“Nigerian Laws, Cases and Materials on Oil and Gas”*, Petgas Global Consulting Limited, vol. 1, P. 16. See also the Court of Appeal decision in case of *Southern Atlantic Petroleum Limited v. Minister of Petroleum Resources NOGC 6 [2007-2008] 245*.

<sup>29</sup> Oil Mining Licence is defined in section 2 of the petroleum profit tax Act as a lease granted to a company, under Minerals and Mining Act, for the purpose of winning petroleum or any assignments of such lease.

account for petroleum profit tax and royalty. The royalty rate for Joint Venture Operation is as follows:

Onshore	-	-	-	-	-	-	20% <sup>31</sup>
Offshore less than 100m water depth	-	-	-	-	-	-	18%
Offshore 100 – 200 water depth	-	-	-	-	-	-	62%

### 3.5.2 *Product Sharing Contract*

Under this arrangement, the NNPC, who is the owner of the mineral right (concession) enters in to a contract with a foreign technical partners designated as contractors. The contractors bear all the risks and when oil is discovered in commercial quantity, they recover their cost and share profit on a predetermined ratio with NNPC. The ownership of the concession remains with NNPC. Under this arrangement royalty is payable as follows:

201 – 500 meters water depth	-	-	-	-	-	-	12%
501 – 800 meters water depth	-	-	-	-	-	-	8%
801 – 1000 meters water depth	-	-	-	-	-	-	4%
Beyond 1000 meters water depth	-	-	-	-	-	-	0%
Inland basin water depth	-	-	-	-	-	-	10%

### 3.5.3 *Marginal Field Operators*

Under this arrangement fields discovered by the multinational companies but left unattended to for a period not less than 10 years is compulsorily acquired and reallocated to indigenous concession holders to boost local participation in the oil and gas industry.

### 3.5.4 *Service Contract*

Under this scheme, contractors undertake exploration development and production activities for and on behalf of NNPC, the concession owners. The contractors provide the

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<sup>31</sup> International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013 6

capital and technical expertise and are reimbursed from the fund obtained from the sale of oil produced. However, profit of a company engaged in service contract is not subject to petroleum profit tax, but rather companies income tax.

### **3.6 Ownership of Petroleum Resources**

The entire ownership and control of all petroleum resources in Nigeria is vested in the Federal Government of Nigeria<sup>32</sup>. The Constitution provides that ownership of mineral resources shall be vested in the Federal Government of Nigeria<sup>33</sup>.

Section 1 (1) of the Petroleum Act<sup>34</sup> provides as follows:

“The entire ownership and control of all petroleum in, under or upon any land to which this section applies shall be vested in the state.”

Although the section provides that ownership is vested in the state, the word ‘state’ used refers to the Federal Government of Nigeria as opposed to components states. The Supreme Court in the case of *Attorney General, Federation v. Attorney General, Abia State & 35 Ors. (No. 2)*<sup>35</sup> put the position succinctly as follows:

By virtue of section 315 of the Constitution the four enactments mentioned above are existing laws of the national Assembly and by virtue of Section 4 (2) and (3) of the Constitution, National Assembly has the power to make laws for the peace, order and good government of the Federation of Nigeria or any part thereof with respect to any matter included in the Exclusive Legislative List set out in Part 1 of the Second Schedule to the Constitution. Item 26 of the said Exclusive List is external affairs and each of the aforementioned enactments is concerned with external affairs, one of the items in the Exclusive Legislative List which the State Houses of Assembly are banned from legislating upon. In the circumstances, the federal Government alone and not the littoral States can lawfully exercise legislative, executive and judicial powers over the maritime belt or territorial waters and sovereign right over the exclusive economic zone subject to universally

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<sup>32</sup>Ayoola-Daniel, op. cit. at p. 10. International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013 17

<sup>33</sup>Section 44 (3) of the 1999 Constitution (as amended)

<sup>34</sup>Cap P10, Laws of Federation of Nigeria, 2004.

<sup>35</sup>(supra)

recognized rights. The validity of the four aforementioned enactments has not been questioned<sup>36</sup>.

The legal implication of this is that no state government, local government or any group or group of persons other than Federal Government can exercise any sovereign right, claim, control or ownership over oil and gas resources within, upon or underlying all lands, sea bed and sub-oil including lands under the territorial waters of Nigeria or that forms part of the Continental shelf or exclusive Economic Zone of Nigeria.<sup>37</sup> The Federal Government, however, permits the involvement of private and public interest in the development, production, marketing and export of discovered associated gas. Although, the Petroleum Profit Tax Act provides a framework for the understanding of the Nigerian petroleum tax regime, there are other various contractual agreements, memorandum of understanding and side letters that provide information on the incentives made available by the Federal Government to the operators in the oil and gas sector. All these are additional provisions of the Act and are usually applied as if they are part of the Act.

### **3.7 Assessment of Petroleum Profit Tax**

The Government of Nigeria, like in any other countries of the world, has legislative power to impose on its citizens, any form of tax and at whatever rates it deems appropriate. The taxation of petroleum profit is governed by Petroleum Profit Tax Act<sup>38</sup>. The tax is levied on the profits of a company engaged in petroleum operations during an accounting period. The chargeable persons under the Act are companies engaged in petroleum operations as

International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013

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<sup>36</sup>Ogwuegbu, JSC at p. 243, paras. B – E.

<sup>37</sup> Exclusive Economic Zone is defined in Article 55 of the United Nations Conventions on the Law of the Sea, 1982 as an area beyond and adjacent to the territorial sea, subject to the specific legal regime established in this Part, under which the rights and jurisdiction of the coastal state and the rights and freedom of other states are governed by relevant provisions of this Convention. The zone shall not extend beyond 200 nautical miles from the baselines from which the breadth of the territorial sea is measured.

<sup>38</sup> Cap P.13, Laws of Federation of Nigeria, 2004. This Act was amended in 2007.

8 opposed to individuals who are not permitted to go into petroleum operations<sup>39</sup>. Petroleum, for the purpose of tax, is defined as:

“Mineral oil (or related hydrocarbon) and natural gas as it exists in its natural state, and does not include coal or bituminous shales or other stratified deposits from which oil can be extracted by destruction distillation<sup>40</sup>.”

Petroleum Operation is defined as:

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 or on behalf of the company.<sup>41</sup>

In the case of *Shell Petroleum Development Company (Nig.) Ltd v. Federal Board of Inland Revenue*<sup>42</sup> it was held by the Supreme Court that petroleum operation for the payment of profit tax by companies engaging in petroleum operations includes not only winning or obtaining petroleum oil by drilling, mining, etc. but all operations that are incidental to such operation. The legal implication of this is that activities such as refining of crude oil, marketing, sold minerals, oil field services, etc., are not subject to petroleum profit tax. These activities are rather subject to companies' income tax under the Companies Income Tax Act. Petroleum profit tax is imposed on the profit derived from petroleum operations. The legal basis for imposition and payment of petroleum profit tax by companies engaged in petroleum operations in Nigeria is contained in section 8 of the Act. The Act provides as follows:

“There shall be levied upon the profits of each accounting period of any company engaged in petroleum operation during that period, a tax to be charged, assessed and payable in accordance with the provisions of this Act.”

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<sup>39</sup>See section 24 of the Act.

<sup>40</sup>Section 15, Petroleum Act, Cap. P.10, Laws of Federation of Nigeria, 2004.

<sup>41</sup>Section 2 of Petroleum Profit Tax Act

<sup>42</sup>NOGC 2 [1996-2000] 80 SC. Also reported in (1996) 8 N. W. L. R (Pt. 466) 256

The above provisions have received judicial blessing in a number of authorities<sup>43</sup>. The Supreme Court in Shell's<sup>44</sup> held that by virtue of section 8 of the Petroleum Profit Tax Act, any company engaged petroleum operations is liable to pay profit tax and such tax is to be deemed as debt due to the Federal Government. In order to ascertain the petroleum profit tax payable by a company under the Act, the computation of the following is necessary. The Act provides for the computation of the petroleum profit tax as follows.

### **3.7.1 Revenue**

This can simply be described as the proceeds of the company. For the purpose of ascertaining tax payable by a company engaged in petroleum operation, all the revenue accruing to the company during the accounting. The International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013 9 revenue is taken to be the aggregate of:

- a. Proceeds of all chargeable oil sold by the company during that period;<sup>45</sup>
- b. Value of all chargeable oil disposed by the company during the period<sup>46</sup>;
- c. Value of chargeable natural gas sold;<sup>47</sup>

All income incidental to and arising from one or more petroleum operations, e.g. interest on fixed deposit, rent/hire of equipment, income from services provided to another petroleum company, etc.

The aggregate of what constitute chargeable oil sold for the propose of item “b” is defined in Section 9(2) to include value of oil as determined, cost of extraction of that oil

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<sup>43</sup>See Shell Petroleum Development Company (Nig.) Ltd v. Federal Board of Inland Revenue

<sup>44</sup>Supra

<sup>45</sup>It was held by the then Federal Revenue Court in the case of *Shell B.P Petroleum Development Company v. Federal Board of Inland Revenue NOGC 1[1961–1995]*

<sup>46</sup>In relation to chargeable oil owned by a company, ‘disposed of’ connotes delivery, without sale, of chargeable oil to a refinery or to an adjacent tank for refining by the company. See Advance Taxation, ICAN Study Park of the debt which is proved to have become doubtful during that accounting period.

<sup>47</sup>Section 9(1) of the Petroleum Profit Tax Act.

deducted as well as any cost incurred by the company in transportation and storage of that oil between the field of production and the place of its disposal.

### **3.7.2 Adjusted Profit**

The adjusted profit of a company in any accounting year means the profit for that period after the deductions of allowable expenses as contained in section 10(1)<sup>48</sup>. The nature of petroleum operations necessarily require that certain expenses will have to be incurred for the business that could not be tied directly to the income produced. It is clear that such would have been incurred for the petroleum operations but have not produced income/profits. Consequently, section 10(1) of the Act allows a company engaged in petroleum operations to make some deductions before calculating its profit payable by it. These are regarded as allowable expenses, and they include.

- a. Rent incurred by the company;
- b. All non-productive rents, the liability of which was incurred by the company during that period;
- c. All royalties;
- d. Sums incurred by way of interest up money borrowed by the company;
- e. Expenses incurred for repair of premises, plant, machinery or fixtures;
- f. Debts directly incurred by the company and proved to the satisfaction of the Board to have become bad or doubtful in the accounting period<sup>49</sup>
- g. Exploration and drilling costs, including costs relating to the drilling of the first two appraisal wells in a particular field;
- h. All sum incurred by way of interest on any inter-company loans under terms prevailing in the open market;

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<sup>48</sup>Section 9 (3) Ibid

<sup>49</sup>The deduction to be made in respect of a doubtful debt shall not exceed that portion of the debt which is proved to have become doubtful during that accounting period.

- i. Any contribution to pension, provident or other society, scheme or fund as may be approved; etc.

Bank charges and scholarships are, ordinarily, not deductible as allowable expenses. However, where the charges arose or were imposed by the Federal Government in the course of the company's operation relating to petroleum operation, such charges will be allowed. In other words, they International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013 10 (charges) will be allowed once they are incidental to petroleum operations. It was held by the Supreme Court in the case of *Shell Petroleum Development Company (Nig.) Ltd V. F.B.I.R*<sup>50</sup> that scholarship expenses incurred by a company will qualify as allowable expenses under section 10(1) of the Act. In that case, one of the issues in contention was whether or not the scholarship expense incurred by the company was deductible as an allowable expense or not. Uwais, C.J.N that case succinctly put the position as follows:

It seems to me obvious that in computing the adjusted profit of the appellant, bank charges cannot be deducted under the provisions of section 10 subsection (1) (G). This is because the Central Bank of Nigeria, as rightly held by the Court of Appeal (per Awogu, J.C.A) is neither the Federal Government of Nigeria, nor Government of any State no a Local Authority. However, the situation differs with regard to the provisions of section 10 (1) simpliciter. What needs to be determined there under is the question whether the payment of bank charges arose in the course of the operations of the appellant as defined under the definition of 'petroleum operations' in section 2 of the Petroleum Profit Tax Act<sup>51</sup>

The Court went further:

In my respective opinion, the bank charges qualify for deduction under the general provisions of section 10 subsection (1) of the Petroleum Profit Tax Act<sup>52</sup>.

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<sup>50</sup>(supra)

<sup>51</sup>P.104, paragraphs. c – e.

<sup>52</sup>P.105, paragraph H.

This decision was followed by the Nigerian Court of Appeal in the case of *Gulf Oil Company (Nig.) Ltd V. F. B. I. R*<sup>53</sup>The deductions allowed by virtue of the provisions of section 10 (1) are however limited<sup>54</sup>. The following expenses are not allowed for the purpose of calculating adjusted profit;

- i. Any disbursement or expenses not been money wholly and exclusively laid out or expended, or any liability not being a liability wholly or exclusively incurred, for the purpose of those operations;
- ii. Any capital withdrawn or any sum employed or intended to be employed as capital;
- iii. Any capital employed in improvement as distinct from repairs;
- iv. Any sum recoverable under an insurance or contract of indemnity
- v. Rental of or cost of repairs to any premises or part of premises not incurred for the purpose of those operations; etc.

The Act also allows some adjustments to be made in accordance with the provisions of section 14 of the Act. Section 14 excludes the inclusion of certain profit in the computation of petroleum profit tax.

International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013 11, the section provides thus;

Where a company engaged in petroleum operation is engaged in the transportation of chargeable oil by ocean going oil-tankers operated by or on behalf of the company from Nigeria to another territory then such adjustments shall be made in computing an adjusted profit or loss as shall have the effect of excluding therefrom any profit or loss attributable to such transportation.

The income derived from the transportation of crude oil by an ocean-going tanker is not an income derived from petroleum operation. Consequently, such income is not

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<sup>53</sup>(supra). Also reported in NOGC 2 [1996-2000] 156 CA.

<sup>54</sup>Section 13 Ibid

chargeable to tax under the provisions of the Petroleum Profit Tax Act. The position of the law is that such income should be subject to tax under the provisions of the Companies Income Tax Act. Thus, any expenses incurred to earn the income from the transportation of crude oil shall be treated as a non-allowable expense under the Petroleum profit Tax Act. It follows then that the profit of the company will be adjusted in such a way as to exclude that portion of the profit relating to transportation of oil outside the shores of the country. The profit so excluded shall be subject to tax under the Companies Income Tax Act. Apart from this, there are other incomes which are regarded as non-taxable incomes, and for which adjustments must be made. These include:

- i. Income from refinery operations;
- ii. Any reversal into income of a previously disallowed expenses
- iii. Any profit on the disposal of fixed asset;

There is no provision under the Act, unlike the Companies Income Tax Act, relating to allowable donations. It is therefore correct to say that any donation made by a company engaged in petroleum operations shall be regarded as a non-allowable expense. It should also be noted that before expenses can be regarded as incidental to petroleum operation such expenses must wholly, exclusively and necessarily be incurred by the company. The Supreme Court held that such must be;” expenses wholly, exclusively and necessarily be incurred for the purpose of petroleum operation<sup>55</sup>, which phrase been interpreted to mean solely or entirely. Where a deduction has been allowed to a company under section 10 in respect of any liability or any part thereof corresponding to such part of the liability, shall, for the purpose of subsection (1) (d) of section 9, be treated as income of the company of the accounting period in which such waiver or real ease was made or given.

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<sup>55</sup>Per Uwais, CJN in *Shell Petroleum Development Company Ltd. v. Federal Board of Internal Revenue* (supra) at p. 109, paragraph f.

### **3.7.3 Assessable Profit**

This refers to adjusted profit less the loss incurred by the company during the previous accounting year in accordance with section 16<sup>56</sup>. International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013 12 Section 16 (1) provides:

Subject to the provisions of this section, the assessable profit of any company for any accounting period shall be the amount of the adjusted profit of that period after the deduction of – a) The amount of any loss incurred by that company during any previous accounting period; and (b) In a case to which section 18 of this Act applies, the amount of any loss which under that section is deemed to be a loss incurred by that company in its trade or business during its first accounting period.

Losses incurred by a company engaged in petroleum operation may be carried forward indefinitely. Thus, for a company subject to tax under the Petroleum profit Tax Act, it is possible for the relief of the loss to be deferred to the succeeding accounting period upon a formal application to the relevant tax authority. This application can only be made not later than five months after the year end.<sup>57</sup>

### **3.7.4 Chargeable Profit**

This is the amount of assessable profit of the accounting period less the sum total of capital allowances provided in the Second Schedule to the Act. In other word, it the amount of assessable profit after deduction of any amount allowed as capital allowance. In calculating the amount to be deducted for the accounting period, it is provided that the limitation imposed by subsection (4) shall apply to ensure that the amount of any tax chargeable on the company for the period shall not be less than fifteen per cent of the tax which would be chargeable on the company. Section 20 (4) provides as follows:

The amount to be allowed as a deduction under subsection (1) in respect of the said allowances shall be – a) the aggregate amount computed under subsection (2) of this section; or b) a

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<sup>56</sup>Section 9 (4) of the Petroleum Profit Tax Act.

<sup>57</sup>See Section 16 (3) of the Petroleum Profit Tax Act.

sum equal to 85% of the assessable profit of the accounting period less 170% of the total amount of the deduction allowed as petroleum investment allowance computed under the second Schedule to this Act for that period, whichever is the less.

Capital allowance is granted to a company engaged in petroleum operations in lieu of depreciation. This includes acquisition of right in or over petroleum deposits, searching for and discovery and testing of petroleum deposits and winning access thereto or the construction of any work or buildings which are likely to be of little or no value when the petroleum operations for which they were constructed ceased to be carried on. Capital allowance may be claimed on the following qualifying capital expenditure, which can be classified into four headings:

International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013

#### Qualifying Plant Expenditure

- i. Qualifying Pipeline and Storage Expenditure
- ii. Qualifying Building Expenditure
- iii. Qualifying Drilling Expenditure

Capital allowance on capital expenditure is claimed on a straight-line basis over a period of five years at the following rates:

Year 1 -	-	-	-	-	-	-	20%
Year 2 -	-	-	-	-	-	-	20%
Year 3 -	-	-	-	-	-	-	20%
Year 4 -	-	-	-	-	-	-	20%
Year 5 -	-	-	-	-	-	-	19%

The balance of 1% represents the residual value of the qualifying capital expenditure. This must be retained for as long as long as the asset has not been sold. It must also be noted that even where the asset is sold, approval must be obtained from the Minister of Petroleum

Resources before the residual can be expunged from the book. Allowances are also granted at varying rates on the cost of the assets. One of such is the Petroleum Investment Allowance. A company is allowed to deduct Petroleum Investment Allowance. The Petroleum Investment Allowance is an allowance granted in the first year a qualifying capital expenditure is incurred for the purpose of the company's operation. The applicable rate depends on the fiscal regime under which the company operates. Petroleum Investment Allowance shall be added to the annual allowance. Where the expenditure is incurred in respect of an asset that has been disposed of by the company before the beginning of its first accounting period, then any loss suffered by the company on the disposal of such asset shall be deemed to be qualifying drilling expenditure incurred by the company on that day, and shall be deemed to have been brought into existence an asset owned by the company in use for the purpose of the petroleum operations carried on by the company.

The petroleum investment allowance is calculated as follows:

Onshore	-	-	-	-	-	-	-	-	5%
Offshore up to and including 100 meters above Continental Shelves									10%
Offshore between 100 – 200meters	-	-	-	-	-	-	-	-	15%
Offshore above 200 meters	-	-	-	-	-	-	-	-	20%

### 3.7.5 Assessable Tax

This refers to the tax arrived at using the appropriate tax rate on the chargeable profit. In other words, it is the amount of assessable tax less certain tax offset. Up to the end of 1994 year of assessment, the provisions of the PPTA is that tax offset should be used to reduce the assessable profit to obtain chargeable profit. Tax offset items include:

- i. Non-productive rent International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013 14
- ii. Royalties on local sales

- iii. Investment tax credit, etc.
- iv. Customs duty on essential items, etc.

The assessable tax of a company engaged in petroleum operation in any accounting period is the amount equal to 85% of its chargeable profit for that period. Where, however, a company has not yet commenced to make sale or bulk disposal of chargeable oil under a program of continuous production and sale, its assessable tax for any accounting period during which it has not fully amortized all pre-production capitalized expenditure shall be 65.75 per cent of the chargeable profits for that period.

### **3.7.6 Chargeable Tax**

This is calculated as the amount of assessable tax less the certain tax offset<sup>66</sup>. Section 22 (3) provides that in computing the tax payable, the Investment Tax Credit shall be applicable in full to petroleum operations in the contracts such that chargeable tax is the amount of assessable tax less the Investment Tax Credit. The investment tax Credit rate for a company operating Product Service Contract with the Nigerian National Petroleum Company (NNPC) is 50% flat rate for the contract area, regardless of the duration of the contract. The Investment Tax Credit allowance shall be offset against the chargeable tax in accordance with the provisions of the production sharing contract.

An oil exploration company files two types of returns under the Petroleum Profit Tax Act; Estimated Petroleum Profit Tax Returns and Annual Petroleum Profit Tax. In respect of the estimated petroleum profit tax, tax for any accounting year is payable in twelve (12) equal installments commencing from March of the accounting year and ending in February of the following accounting year. In other words, the first installment is payable not later than the third month of the accounting period. Subsequent installments will be due and payable not later than the last day of each month<sup>58</sup>. The estimated petroleum profit tax shall be submitted

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<sup>58</sup>Section 45 (3) of the Petroleum Profit Tax Act

to the Board not later than two (2) months after the commencement of the accounting period<sup>59</sup>. The audited account is expected to be finalized and the actual tax return filed by May of the subsequent year.

The annual petroleum tax returns, also known as the 13th installment, is payable in July of the following accounting year. Where the total amount paid in advance exceeds the tax computed per account, the excess is granted as a tax credit against future installment. If any installment due and payable is not paid within the appropriate time limit, a sum equal to five (5) per cent of the amount due as installment shall be added to amount due<sup>60</sup>. Any company disagreeing with the assessment served on it by the Board has a right of appeal under the Act<sup>61</sup>

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<sup>59</sup>Section 33 Ibid

<sup>60</sup>Section 46 Ibid

<sup>61</sup>Section 41 Ibid

## CHAPTER FOUR

### OFFENCES AND PENALTIES IN RELATION TO THE PETROLEUM PROFIT TAX

#### 4.1 Introduction

Another issue in connection with the assessment of petroleum profit tax is that of enforcing the payment of PPT. It is clear that one of the obstacles that face the payment of any tax is the problem of tax avoidance and evasion. It is a widespread problem not only in the Nigerian tax system, but also in every tax system. For instance the Nigerian government has repeatedly complained of widespread incidence of tax avoidance/evasion in the country. Taxpayers use different devices in order to escape or minimize their tax liability.<sup>1</sup> Companies deliberately employ fraudulent means of evading tax. Moreover the tendency of some corrupt tax officials does not help the matter. It is with connivance with them that the tax defaulters perpetrate the PPT offence or tax avoidance/evasion.

It is important to note that the two terms "tax avoidance" and "tax evasion" are not the same in meaning. However none of them has a statutory definition. In other words, neither the PPTA nor any tax law provides for the definition of the terms in general not to talk of the PPT avoidance/evasion.

The Oxford Advance Learners Dictionary defines tax avoidance as "the ways of paying only the smallest amount of tax that you legally have to."<sup>2</sup> It also defines the terms "tax evasion" as the crime" of deliberately not paying all the taxes that you should pay.<sup>3</sup> Ayua defines tax avoidance as the minimization of tax liability by so arranging one's affairs as to take advantage of provisions in the tax law. In the same vein, he stated that tax evasion is usually defined to mean the failure to pay one's tax or

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<sup>1</sup> See Ayua, I. A. Op. Cit.

<sup>2</sup> Hornby A.S., Op. Cit.

<sup>3</sup> Ibid

the reduction of one's tax liability through illegal or fraudulent returns or failure to make a return or even failure to pay tax on time.<sup>4</sup>

Therefore the PPT avoidance can be 4<sup>e</sup> fined as crafty and dubious ways which could be employed by the oil producing companies, through the manipulation of taxing provisions in order to minimize their tax liability. While the PPT evasion could be defined to mean any of the followings:

1. Illegal means of limiting the tax liability of oil producing companies by delivering false returns.
2. Refusal of oil producing companies to pay the tax at the right time.
3. Refusal to pay the PPT at all.

#### **4.2 Statutory Offences against the Petroleum Profit Tax**

In accordance with the provision of the Petroleum Profit Tax Act, a person is guilty of an offence against the Act if he is found to have committed any of the following statutory offences:-

- i. Failure to comply with the requirement of any notice served to him under the Act.<sup>5</sup>
- ii. Failure to render returns or deliver account and particulars.<sup>6</sup>
- iii. Failure to attend or answer to a notice or summon served on a person under the Act; or having attended, failure to answer question lawfully put.<sup>7</sup>
- iv. Failure to submit any returns of estimated tax.<sup>8</sup>
- v. Making or causing to be made, incorrect accounts by omitting or understating any losses.<sup>9</sup>
- vi. Preparing any incorrect schedule by overstating any expenditure or by

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<sup>4</sup> Ayua, I. A. Op. Cit,

<sup>5</sup> Section 51 (2) (a) PPTA

<sup>6</sup> Section 51 (2) (b) Ibid

<sup>7</sup> Section 51 (2) (c) Ibid

<sup>8</sup> Section 51 (2) (d) Ibid

<sup>9</sup> Section 52 (1) (a) Ibid

overstating any royalties or other sums or by omitting or understating any amounts repaid, refunded, waived, or released.<sup>10</sup>

- vii. Giving or causing to be given any incorrect information in relation to any matter affecting a person's tax or liability to tax.
- viii. In order to obtain any deduction, making any false return, account, particulars or statement with reference to tax or false representation or forges or fraudulently leads or allows to be used by any by any other person any receipt or token evidencing payment of tax under the Act.
- ix. Aiding, abetting, assisting, counseling, inciting or inducing any other person to:
  - a. Make or deliver any false return or statement
  - b. Keep or prepare any false accounts and particulars affecting the tax.
  - c. Refuse or neglect unlawfully to pay tax.
- x. Being a member of FBIR:
  - a. Demands from any person an amount in excess of the authorized assessment of the tax payable.
  - b. Withholds for his own use or otherwise, any portion of amount of tax collected.
  - c. Renders a false return, whether verbal or in writing, of the amount of tax collected or received by him.
  - d. Defrauds any person, embezzles any money or otherwise uses his position so as to deal wrongfully either with the Board or any other individual.
- xi. Not being authorized under the Act to do so, collect or attempt to collect the tax under the Act.
- xii. Engaging in petroleum operation on own or, in partnership with any other

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<sup>10</sup> Section 52 (1) (b) Ibid

person with a view to sharing profits arising from the operations, not being a company so regarded.

#### **4.3 Penalties against Petroleum Profit Tax Avoidance/Evasion**

Penalties of various offences have been stated under the Petroleum Profit Tax Act. Specifically the Act provides that every person, who - without any reasonable excuse - makes up or causes to be made up any incorrect accounts, by omitting or understating any profits or overstating any losses..., shall be guilty of an offence and shall be liable to a fine of one thousand naira, and double the amount of tax has been or would have been undercharged as the result of such account.<sup>11</sup> The same penalty applies to any person or company that prepares or causes to be prepared an incorrect schedule by overstating-any expenditure. So also the person who prepares any incorrect statement required by the Act through means of overstating any royalties or understating any amount repaid, refunded, waived or released.<sup>12</sup> Additionally, if a person guilty of giving any incorrect information in relation to any matter affecting his tax liability he shall also be guilty of an offence. He shall also be liable to the same penalty as the above.<sup>13</sup>

It can be understood that the aim of the above provision is to deter the officers in charge of signing returns on behalf of a company from being responsible for under declaration of profits. This is because; it can easily implicate them and subsequently incur personal liability. But the question here is whether this penalty can effectively serve as deterrent for curtailment of the offence or not.

It should be noted that this part of the Act has never been amended since the enactment of the PPTA of 1959 which was the principal Act. Therefore it might have previously served the purpose considering the value of the amount of One Thousand Naira

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<sup>11</sup> Section 52 (1), Ibid

<sup>12</sup> Ibid

<sup>13</sup> Ibid

by then. But nowadays the amount is too small particularly when looking at the huge amount which the oil companies pay their officers. To tell this kind of officers that they are liable to a fine of one thousand Naira if they are found guilty of under declaration of profit of their companies is absurd.

It is worthy of note that no person shall be liable to the above penalty unless the complaint on such offences was made within six years after the end of the accounting period in which the offence was committed;<sup>14</sup> However, the Board has right to compound any offence or proceedings as long as it is before judgment.<sup>15</sup>

It is also provided under the Act that making of false statements and returns for the purpose of obtaining any deduction, rebate, reduction or repayment in respect of tax constitutes another offence. Likewise aiding, abetting, assisting, counseling, inciting or inducing any person to make false statements and return, prepare false account and particulars or to unlawfully refuse to pay the tax. Any person found guilty of committing any of the above, shall be liable to a fine of one thousand naira and the amount of tax for which the person assessable is liable for the accounting period in which the offence was committed, or to six month imprisonment or both the fine and imprisonment.<sup>16</sup>

This takes care, inter alia, of lawyers and accountants who may be hired by oil producing companies to give them advise on how to evade or avoid tax in any of the above mentioned ways. The company also has another discretion here to decide on whether to not to compound any of the offences under the Act

Failure to withhold tax also attracts penalty. It is pertinent to understand that withholding tax is not a particular different tax. Rather it is a scheme of advance payment of tax introduced in Nigeria under Decree No. 4 of 1985. Under this scheme, the

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<sup>14</sup> Section 52 (2) Ibid

<sup>15</sup> Section 52 (3) Ibid

<sup>16</sup> Section 53 (1) Ibid

taxpayer is legally required to claim credit later when completing his tax return for the year.<sup>17</sup> According to the provision of the Act, any person who is required to deduct withholding tax and fails to deduct & remit the deducted amount to the FBIR within thirty days from the time of deduction, shall be guilty of an offence. On conviction, he shall consequently be liable to a fine of 200% of the tax not withheld or remitted plus interest at the prevailing commercial rate.<sup>18</sup> The relevant tax authority shall cause to be served on or sent by registered post, to any person fails to withhold or remit, a -notice stating the amount of tax not withheld or not remitted, and the place at which payment should be made.<sup>19</sup>

It should be observed that the Board has a number of discretions to exercise in connection with the offences and penalties. It has the power to compound offence. It also has a power in its discretion to stay proceeding as well as compounding it. This may create an avenue for the tax officials to abuse the power. Bribery and corruption and undue exploitation of influence can be spread among the tax officials of the Board. In order to discourage these, PPTA provides that:

Any person who:-

- (a) being a member of the Board charge with the due administration of this Act, or any assistant employed in connection with the assessment and Collection of the tax who:
  - i. Demands from any person an amount in excess of the authorized assessment of tax payable;
  - ii. Withholds for his own use or otherwise any portion of the amount of tax collected;
  - iii. Renders a false return, whether verbal or in writing, of the amount of tax collected or received by him;
  - iv. Defrauds any person, embezzles any money, or otherwise uses his position so as to deal wrongfully either with the Board or any other individual;

Or

- (b) not being authorized under this act to do so, collects or

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<sup>17</sup> Nigerian Tax Reform, Op. Cit.

<sup>18</sup> See Section 54 (1), PPTA, Op. cit

<sup>19</sup> See Section 54 (2), Ibid

attempts to collect the tax under this Act; (Any person perpetrates any of the above) shall be guilty of an offence and be liable to a fine of six hundred naira, or imprisonment for three years or both.

The above fine of six hundred naira is too small. Hardly can it deter the officials from committing such offence. It necessary for the tax officials to understand that total and complete honesty is demanded from them. An effective way of getting that honesty is to apply a severe punishment on dishonesty. Each tax official, especially in the assessment and collection section of the Board should be required to submit a net worth statement at his employment. The statement should be checked periodically especially when suspicion arises about him or his life style has changed beyond that which his salary and previous wealth can afford.

Generally, any person guilty of an offence under the PPTA or any rule made there under, for which no other penalty is specifically provided, shall be liable to a fine of ten thousand naira. In addition to this, the offender shall be liable to a further sum of two thousand naira for each and every day during which any of the following offences continues:

- (1) Where a person, other than a company, engages in petroleum operations, either on his own or jointly with any other person with a view to sharing the profits arising from those operations.
- (2) Failure to submit a return of estimated tax.
- (3) Failure to deliver account, particulars, information or kept records required by the Act.

The liability for such further sum of two thousand naira commences from the day following the day for conviction or any day thereafter as the court may order.<sup>20</sup> But where the person defaults to pay the fine he shall be liable to imprisonment for six months.

It appears from the above that the main objective of the provision is to compel the staff of the company such as accountants that play a key role in determining the actual

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<sup>20</sup> Section 51, Ibid

tax liability to cooperate with the Board officials. This is to avoid facing any negative consequence of such acts. Furthermore the amount of fine is inadequate compare to the huge amount of money they earn from the oil companies. The amount must be increase so that the desired goal could be achieved.

## CHAPTER FIVE

### SUMMARY, CONCLUSION AND RECOMMENDATIONS

#### 5.1 Summary

The provisions of the PPTA have revealed a legal framework for taxation of petroleum profits of companies engaged in petroleum operations as distinct from taxing of other companies under the general tax regime in Nigeria. It is obvious that the Act has made far-reaching provisions with respect to the assessment and computation of profits and tax payable by oil producing companies and stipulated methods of collecting such tax under the management of the FIRS. It has also tried, but failed to tackle the incidence of tax evasion prevalent in the Nigerian economy. The provisions of the Act leave some ambiguities under which some companies hide to evade tax, and have failed to set a workable enforcement machinery to detect and punish violation of its provisions. Nevertheless, the Act is a piece of legislation that holds great potentials for effective taxation.

The dwindling fortunes of the industry had been affected by several factors like, pipeline vandalism, oil theft, militancy, poor maintenance, ageing assets, operational challenges and volatility of oil prices as key challenges.

In spite of Nigeria's huge human and material resources, the national economy has not experienced meaningful progress. With about 83 percent of the total Federal Government revenue coming from oil and gas exports and a burgeoning labor force of about 57.2 million, the economy should ordinarily be buoyant.

The slow pace of economic growth is blamed on poor infrastructure, insecurity, inconsistency in government policies and corruption. The World Bank estimates that 80 percent of energy revenues are benefiting only one percent of the population due to corruption.

## 5.2 Findings/Observations

This paper has observed that the consumption related policies appear to have done more harm than good. The fuel subsidy for instance, had generated economic problems ranging from scarcity of petroleum products to loss of man hours due to labor unrest and related problems. There were also other observed economic costs, there were confusions among social activists, economists, and politicians on the actual beneficiaries of fuel subsidy in Nigeria. Annual government expenditures have been enormous.

The Act, as it is presently, gives a lot of room for tax evasion and many companies have exploited it to their own advantage. Despite the generous tax incentives offered; by the Act, a lot of companies still defraud the Nigerian government by paying much less than they should. The Petroleum Profit Tax Act lays out an elaborate system of computing the profits and tax payable by a company but fails to establish the method of ascertaining whether what is actually computed by affected companies reflects the true picture. How many companies has the FBJR actually accused and prosecuted for the offences stated under the Act? How does the Board determine who is guilty of what? How does the Board know whether or not there have been false statements and accounts? How does the Board know which members of staff are guilty of corruption and dishonesty?

However, this paper finds that:

- i. **Lack of Staff Training, Poor Remuneration, Technological Know-How and Knowledge:** A significant number of tax officials in the petroleum sector lack sufficient knowledge of the PPT Laws and its provisions which is responsible for ineffective tax administration in the upstream sector of the petroleum industry in Nigeria. Also, obtaining accurate data for this exercise is a challenging task due to poor data management resulting from inadequate technology. There is disparity between the remuneration and incentives between government tax officials and their

counterparts in the petroleum industry. The oil companies are known to engage highly qualified, highly motivated and highly remunerated officials to deal with their tax matter with the tax authorities. The FIRS utilizes principally its own employees who are mainly civil servants to deal with the tax matters of oil companies. Civil servants are known to be poorly paid when compared with oil company officials. It is seen that government tax officials lack adequate exposure and training on petroleum tax related matters due to poor inadequate budgetary allocation, there is also the issue of the quality of technical knowledge, educational qualifications and educational opportunities of government tax officials.

- ii. **Lack of Awareness on Taxation and Lack of Sufficient Infrastructure:** Taxpayers should have a good understanding of the PPT law .The understanding of PPT law by tax payers is no more than fair, such tax payers may not be complying with the tax law, as there is likelihood that they may not fully understand what needs to be done. it is widely believed that oil executives should ordinarily have deep knowledge of the PPT law as oil companies engage experienced and well-motivated specialist to deal with their tax matters. Oil companies utilize modern day technology to stimulate and prepare their PPT liability, for the purpose of tax planning. But where a taxpayers understanding of PPT law is not good, the company may not be doing things right, and the level of compliance with the tax law may not be as required by the law. Also, because some tax payers in the oil industry do not have a good understanding of PPT law, it gives credence to tax payers not to comply with the PPT law.
- iii. **Corruption and Lack of Transparency:** The Oil and gas (exploration and production) companies in Nigeria deliberately minimize their monthly installmental payments of PPT to improve their cash flow situation. In addition, administrative corruption in the oil and gas industry is a major area that limits the positive impact

and efficacy of proposed measures. The level of transparency of oil companies to FIRS: operators In the oil industry in Nigeria is expected to be transparent not only in their dealings with the regulators but with the FIRS. The transparency level of oil companies to the FIRS may assist in measuring transparency level of the FIRS. A company with high transparency level will provide full and adequate information on its tax matters. But a company with poor transparency level may supply inadequate and incomplete information to FIRS. Consequently, incomplete and inadequate information may lead to tax payers not fully complying with the PPT law.

- iv. **Inadequate Penalties:** Some amount of money provided as fine in the PPTA to serve as penalty against PPT offences are not adequate.
- v. **Oil Theft and Niger-Delta Crises:** A major challenge facing the Government is the problem of pipelines vandalism by criminal elements. I found that the issue of sabotage and vandalism are not carried out by ordinary Nigerians, ordinary Nigerians cannot just go and vandalize pipeline, it is an organized crime by cabals who seem untouchable in the government. This makes illegal oil bunkering, pipeline vandalism and selling of petroleum products above pump price being carried on in full public glare.
- vi. **Government Underfunding:** it was observed and found in the course of the study that there is a recurring problem in the upstream sector of the inability of the NNPC to meet its funding obligations to Joint Venture (JV) Operations.

### **5.3 Recommendations**

Based on the findings made in the course of this study, the following recommendations are hereby suggested:

- i. **Staff Training, High Remuneration, Technological Know-How and Knowledge:** Tax officials should be lectured, well trained, and the investigative and intelligence

unit of the revenue authorities should be empowered and made vibrant and effective. Officials should be made to understand clearly that complete honesty is demanded of them. Government expenditures of the tax department include outlays for formal programs of staff training and such programs should be strengthened and expanded. The concept of human capital which enhances productive capacity resulting from education, experience and specialized training improves tax administration. Tax officials must have the political will and a degree of technical competence to implement it. There is need for greater administrative coordination of the collection of revenue from the oil sector. It is expected that the more effectively revenue is utilized by Government to create growth, employment opportunities and wealth in the economy, the more willing taxpayers would meet their obligations to the Government and discharge their duties in the over-riding goal of achieving National Development. The proposed use of forensic audit to investigate process of all the agencies involved in the oil and gas inflows and outflows is a welcome development. Government should allocate more money to the board of internal revenue for training of their officers and recruit more workers and tax agents and set up at least one tax office in every state and community, also a special tax force on tax collection should be set up to check tax avoidance and evasion.

- ii. **Awareness on Taxation and Provision of Infrastructures:** There has to be a way of bringing in private capital and private sector skills in project management to be able to get our infrastructure right, because as long as we do not get the infrastructure right we will still have the problem. This challenge can be tackled by putting proper reforms in place. Tax payers should endeavor to provide tax education and also create awareness with regards on what to pay as tax, how to pay it and where to pay it, as the system we have today does not make payment of taxes easy for tax payers. Tax laws

must be understandable to all; they should be expressed simply, clearly and intelligibly. The annual amendments that are incorporated into the yearly budgets should be aligned with the principal legislation to avoid confusion.

- iii. **Eradication of Corruption and High-level of Transparency:** Government should ensure that those who plunder or misappropriate public funds are prosecuted, as well as the Government providing basic amenities to the people, the anti-corruption drives must not be selective or be done for favor. It is hereby recommended that Government should transparently and judiciously account for the revenue it generates through PPT by investing in the provision of infrastructure and public goods and services. It is expected that the more effectively and efficiently revenue is utilized by Government to create growth, employment opportunities and wealth in the economy, the more willing taxpayers would be to meet their obligations to the Government and discharge their duties in the overriding goal of achieving National Development. Government should make a policy that will ensure justification of payment of taxes, unless and until taxpayers are able to see that the money at the disposal of Government is not unduly and unjustly confiscating their property, tax evasion and avoidance is bound to be in the increase. Corruption has eaten deep into the fabric of our system. If we can reduce corruption to the barest minimum, we will be on the right track. The salary of the staff of the operational arm of the Board should be reviewed. Professionals of high quality should be attracted with sufficient salary that will make the content and not to think of conniving with tax payers to perpetrate the offence of tax avoidance/evasion. Training programs for the staff of the operational arm of the board must be emphasized to enable them perform effectively.
- iv. **Provision of Stiffer Penalties:** There is the need for amendment of PPT laws to strengthen tax administration and to provide adequate penalties for the offences. The

present penalty provisions in our tax statutes overlap and are in some places mutually inconsistent especially in terms of the severity of penalties and are thus defective in form the present situation certainly call for a thorough review and re-arrangement of the penalty provisions on a more rational basis. Imposition of stiff penalties for the various offences as prescribed in the tax Acts. As seen no one has been convicted and imprisoned for giving incorrect information, for aiding, abetting, assisting, counseling, inciting or inducing a taxpayer to make or deliver false returns even when such fraudulent intent is established. Therefore, it is recommended that, to solve the problem of corrupt practices mentioned, government at all levels ensure the enforcement and implementation of stiff penalties and punishments provided by the provisions of the relevant tax laws against any person caught and such person shall be exposed and publicized through media stations.

- v. **Curtailling Oil Theft and Niger-Delta Crises:** It is recommended that the Government should create a department vested with the responsibility of curtailing illegal bunkering, and pipeline vandalism. Such a department should be charged with the duty of protecting oil pipelines from the unscrupulous acts of the oil bunkers. NNPC should also work closely with the Nigerian navy to deal with the problem. The government must deal with offenders without political interference.
- vi. **Provision of Funds:** The issue of self-assessment has worsened the ability of FIRS to collect PPT revenues because FIRS will only tax what the company files. The issue of DPR allowing upstream oil to use parameters that suited them to pay what they deemed fit as royalty to government thereby making underpayments should be stopped. The oil companies are using sophisticated practices and loopholes to avoid tax liability. Qualified tax officials in terms of strategy, power, level of authority, technical knowhow and specialization should be sent to oil companies for tax matters.

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