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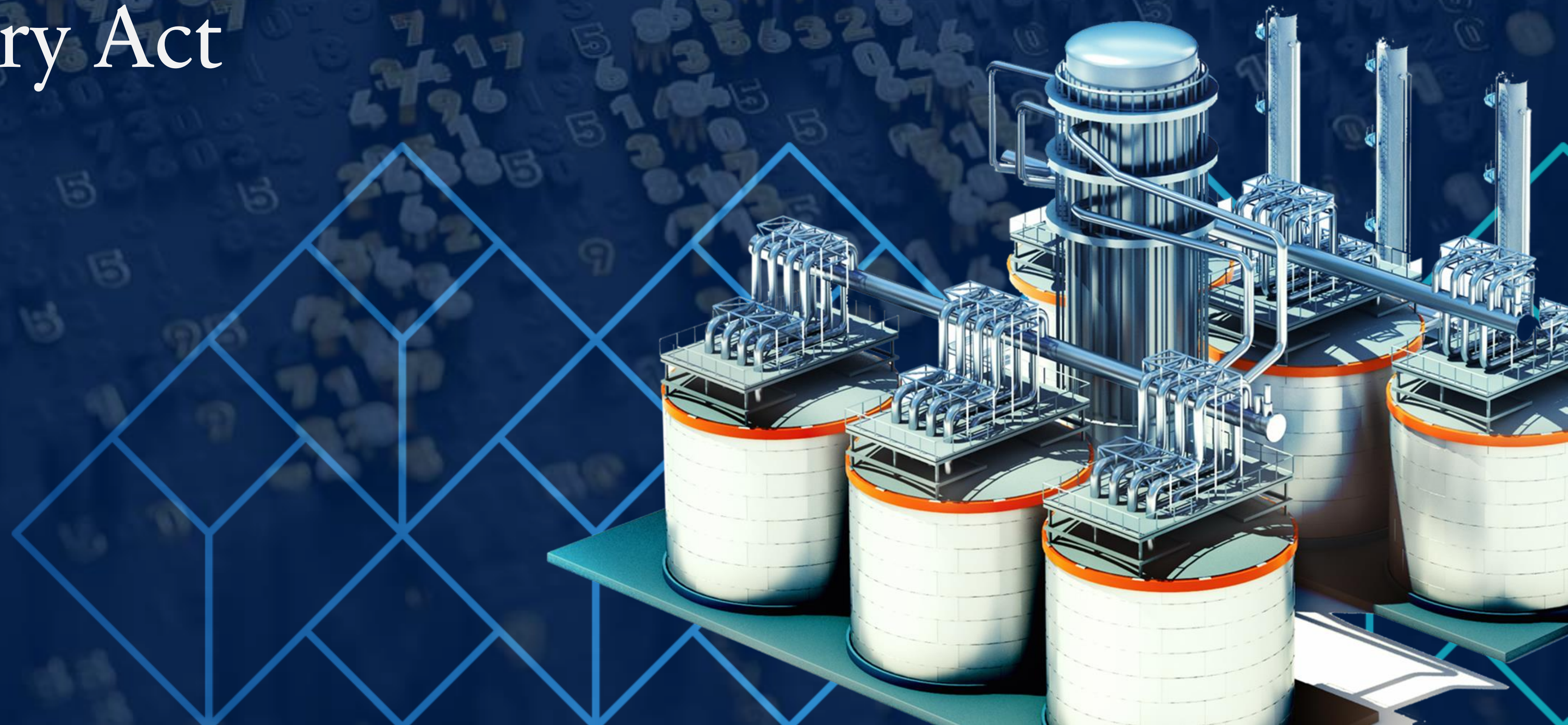
Taxation of the Nigerian Upstream, Midstream and Downstream Petroleum Operation Under the Petroleum Industry Act



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The TEMPLARS Tax team ranked as a Tier 1 firm for Tax Controversy and a leading firm for Tax and Transactional Tax

- The International Tax Review (ITR) World Tax Firm Rankings 2024

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Petroleum Industry Fiscal Framework Under the PIA

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Introduction

The Petroleum Industry Act (PIA) enacted in August 2021, and it introduced significant changes to the taxation of the upstream, midstream, and downstream petroleum operations in Nigeria.

The PIA introduces new tax and fiscal provisions that are different from the Petroleum Act ("PA") and Petroleum Profits Tax Act ("PPTA") regimes. The tax and fiscal provisions under the PIA apply to licenses and leases granted under the PIA, as well as licenses and leases either renewed or converted from the PA regime to the PIA regime.

Some of the changes include, introduction of a new tax – the Hydrocarbon Tax (HT), imposition of Companies Income Tax (CIT) at a rate of 30%, new allowable and disallowed deductible expenses, new production allowances, new royalty rates etc.

Fiscal Framework for Upstream Operations

1. Royalty:

- Prior to the PIA, price-based royalties were applicable to crude oil and condensates produced from deep offshore acreages when the price of crude oil **exceeds US$20 per barrel.**
- Under the PIA, the price-based royalty is payable on crude oil and condensates produced from ***all forms of acreages*** where the price per barrel **exceeds US$50.**
- Royalties unpaid after 30 days from the due date will be considered a debt to the Commission and subject to interest at prevailing CBN rate.
- Under the PIA, both the production based royalty and price based royalty are subsisting and the rates are as follows:

Fiscal Framework for Upstream Operations Contd.

Production based Royalty	Price based royalty
Production exceeding 10kbopd • Onshore: 15% • Shallow water up to 200m water depth: 12.5% **Production between 5k1-10kbopd** • Onshore and shallow water (including marginal fields): 7.5% **Production between 1bopd-5kbopd** • Onshore and shallow water (including marginal fields): 5% **Deep offshore** • Production above 50kbopd: 7.5% • Production below 50kbopd: 5% **Frontier Basin: 7.5%**	• Below $50 per barrel – 0% • At $100 per barrel- 5% • Above $150 per barrel – 10% • Between $50 and $100 per barrel and between $100 and $150 per barrel – to be determined by linear interpolation. N/B: The price based royalty is not applicable to frontier acreages.
Natural Gas and Natural Gas Liquids • Export: 5% • Domestic Utilisation: 2.5%	
Royalties unpaid after 30days from the due date will be considered a debt to the Commission and subject to interest at the prevailing CBN rate.	

Fiscal Framework for Upstream Operations Contd.

2. Dual Income Tax Regime:

- The PIA introduced a dual income tax regime for upstream petroleum companies, i.e., Hydrocarbon Tax (HT) and Companies Income Tax (CIT). Therefore, companies engaged in petroleum operations in the upstream sector will now pay Hydrocarbon tax and CIT. (s. 260(1)(b)).

3. Hydrocarbon Tax (HT):

- Section 262 of the PIA introduces the Hydrocarbon Tax (HT) which applies to **companies engaged in upstream petroleum operations**. Specifically, HT is charged only to crude oil, field condensates, and liquid and natural gas liquids produced from associated gas at a maximum rate of 30%.
- Hydrocarbon tax is not applicable to associated gas produced which is not upstream of the measurement point and any frontier acreage until it is reclassified.
- Deep offshore acreages are not subject to the payment of Hydrocarbon Tax.
- All hydrocarbon tax computation is to be in United States Dollars.

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Fiscal Framework for Upstream Operations Contd.

4. Deductible Expenses

- The PIA includes "reasonableness" as a yardstick for the deductibility of an expense – thereby increasing the threshold of deductibility under the PA regime from wholly, exclusively and necessarily to include reasonable. (s. 263 (1))

- The PIA introduced a list of deductible items in addition to existing deductible expenses some of which includes. However, the PIA makes certain expenses deductible for Hydrocarbon tax computation and other deductible for CIT computation.

- Some of the items deductible in computing Hydrocarbon Tax (HT) are : (s. 263 (1))

i. rent incurred by the company for the period pursuant to the lease or licence;
ii. any amount contributed to a fund, scheme or arrangement and approved by the Commission for the purpose of decommissioning and abandonment;
iii. costs of gas reinjection wells, which are re-injecting natural gas that otherwise would be flared, subject to ratification by the Commission; and
iv. any amount contributed to any fund, scheme or arrangement approved by the Commission pursuant to the Host Community Development Trusts, Niger Delta Development Commission; and other similar contributions.
v. all royalties the liabilities for which was incurred and were paid by the company during that period in respect of crude oil and associated gas and where a petroleum mining lease includes payments to the Federation Account related to production sharing, profit sharing, risk service contract or other contractual features under a model contract and the company has incurred liability for such payment in kind or cash. (s. 263. (1) (a) – (h)) (*Notably, in order to be deductible under the PIA, **royalties** must now be incurred and paid within the period – as opposed to simply being "incurred" under the PPTA.*)

Fiscal Framework for Upstream Operations Contd.

5. Non-deductible expenses:

- Some of the items non- deductible in computing Hydrocarbon Tax (HT)include: (s. 264 (1))

i. expenditure and fees incurred as a penalty for flare of natural gas.

ii. amounts incurred in respect of tertiary education tax, companies income tax, any income tax, profits tax or other similar taxes, whether charged within Nigeria or elsewhere

iii. Financial or bank charges, arbitration and litigation costs, bad debt, interest on borrowing. (*Prior to the PIA regime, bank charges and litigation/arbitration costs although not expressly stated as deductible expenses under the PPTA, were treated as deductible expenses if they meet the WEN test. However, the PIA expressly treats them as non-deductible expenses.*)

iv. head office costs or affiliate costs, shared costs, research and development costs or any like shared indirect costs.

v. tax inputted in a contract or an agreement on a net tax basis and paid by a company on behalf of the vendor or contractor ;

vi. amounts incurred in respect of tertiary education tax, company income tax or any other income similar taxes;

vii. production bonuses, signature bonuses paid for the acquisition of, or of rights in or over, petroleum deposits, bonuses or fees paid for renewing petroleum mining lease or petroleum prospecting licence or marginal field or fees paid for assigning rights to another party;

viii. all custom duties.

Fiscal Framework for Upstream Operations Contd.

6. Production Allowances:

For converted OMLs and renewals, the production allowance is the lower of US$2.50 per barrel and 20% of the fiscal oil price.

For leases granted after the commencement of the PIA, the production allowance is as follows:

- Onshore areas: the lower of US$8.00/barrel and 20% of the fiscal price- up to $50million barrels after which it is the lower of US$8.00/barrel and 20% of the fiscal price.
- Shallow water areas: the lower of US$8.00/barrel and 20% of the fiscal price - up to $100million barrels after which it is the lower of US$8.00/barrel and 20% of the fiscal price;
- Deep offshore and frontier basins: the lower of US$8.00/barrel and 20% of the fiscal price - up to $500million barrels after which it is the lower of US$8.00/barrel and 20% of the fiscal price.
- The PIA does not provide for ITCs or ITAs or petroleum investment allowances.

Sixth Schedule to the PIA.

Fiscal Framework for Upstream Operations Contd.

7. Rendering of Estimated Returns

- Upstream petroleum companies are required to submit an estimated return of its profits or losses, in respect of crude oil only, for that accounting period for the purpose of HT not later than two months after the commencement of each accounting period.
- Defaulting companies are required to pay N10,000,000 on the first day of default and N2,000,000 for every other subsequent day default continues.
- Where during the accounting period, there is a change in price, cost or volume, the company is required to submit on a monthly basis a further return containing its revised estimated tax for such period
- Where a company fails to make the further estimated returns it will be liable to interest equal to LIBOR or any successor rate plus 10% points for the differential of the revised tax over the estimated tax paid.
- Where a company fails to submit estimated HT returns and revised estimated returns, FIRS may determine the estimates and revisions based on its best of judgment and assess the defaulting company to tax accordingly. (s. 280)

8. Consolidation of costs and Taxes

- Upstream companies holding PPLs and PMLs across terrains are allowed to consolidate costs and taxes for the purpose of hydrocarbon taxes across the two categories of chargeable tax. Such consolidation shall be allowed only across assets in which it holds licenses and leases .

- Upstream companies with operations across terrains (onshore, shallow-water) are allowed to consolidate costs across terrains in computing CIT .

- Companies who hold multiple upstream concessions may take benefit of cost consolidation in computing HT and CIT.

Fiscal Framework for Upstream, Midstream and Downstream Operations

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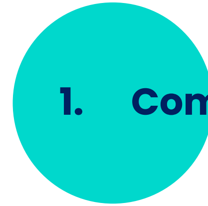
The PIA provides fiscal provisions applicable to upstream, upstream and downstream operations. Some of these include:



1. Companies Income Tax (CIT)

- **Upstream, Midstream and Downstream petroleum operations are subject to CIT.**
- Petroleum profit of upstream companies will be assessed to CIT on actual year basis period (as applicable under HT) while midstream and downstream companies will be assessed to CIT on a preceding year basis period.
- However, in determining CIT the hydrocarbon tax under the PIA is not be deductible (s. 302 (5))
- Capital allowance for CIT purposes for upstream assets is in accordance with the Fifth Schedule to the PIA while capital allowances for midstream and downstream assets is in accordance with the Second Schedule of the PIA. (s. 302 (10) (a)).
- In addition to the deductions allowed under CITA, the following are allowable under the PIA in determining the taxable profit for CIT:

I. Rent and royalties incurred in respect of crude oil sold/delivered/disposed in a commercial manner and other payments made to the Federal Account.

II. Amount contributed to a statutory fund for host communities, environmental remediation, and abandonment and decommissioning.

III. Other deductions as may be prescribed by the Minister of Finance in an order published in the Gazette of the FGN (s. 302 (11)).

Fiscal Framework for Upstream, Midstream and Downstream Operations Contd.

- In addition to the non-allowable deductions, the following are also non-deductible under the PIA in determining the taxable profit for CIT:

i. Purchase costs for information on petroleum deposits.
ii. Gas flare fees or penalties.
iii. Production and signature bonuses or fees paid for assigning rights to third party for marginal fields
iv. Tax gross-up costs in contracts or agreements psid on behalf of vendors or contractors (s. 302 (12))

2. Gas Investment Incentives

- The PIA introduced an incentive for investors in gas pipelines in addition to the erstwhile incentives under the CITA.

- Under the PIA, all companies engaged in midstream and downstream petroleum operations, downstream gas operations, and large-scale gas utilisation industries are entitled to benefit from the incentives provided in Section 39 of the CITA, i.e.,

i. an initial tax-free period of three years which may be renewed for an additional two-year period – with accelerated capital allowances after the tax-free period (viz: annual allowance of 90% with 10% retention and an additional investment allowance of 15% which shall not reduce the value of the asset), or
ii. an investment allowance of 35% which shall not reduce the value of the asset.
iii. Accelerated capital allowances after the tax-free period – 90% annual with 10% per cent retention
iv. Tax-free dividends during the tax-free period – where the investment is in foreign currency or imported machinery was not less than 30% of equity.

- Investors in gas pipeline shall be granted an additional tax-free period of five years at the expiration of the tax free period granted in **the CITA** . (s. 302 (6))

General Fiscal Provisions under the PIA

Other general fiscal provisions under the PIA include:

1. Tertiary Education Tax (TET)

- As prescribed in the Tertiary Education Trust Fund Act (TETFA) as amended by the Finance Act 2023, TET is calculated as 3% of a company's assessable profits determined under the PPTA and/or CITA, as the case may be.
- On the basis that TETFA does not reference PIA, *assessable profit computed under the PIA for HT purpose is not expected to be subject to TET, only assessable profit computed based on CITA rules is subject to TET.* This also avoids the potential for double taxation.

2. Tax Loss

- Companies are entitled to carry their tax losses forward indefinitely. The PIA, however, provides that the Company may carry forward its tax losses indefinitely and can elect (in writing to the FIRS) to defer the deduction of tax losses to a later period. (s. 265 (3) & (4))

3. Cost Ratio Limit

- Under the PIA, all deductible operating and capital allowances, excluding those related to rents, royalties, and contributions to statutory funds and schemes, are subject to a cost price ratio limit of 65% of gross revenues. The costs that are subjected to the CPR limit are those that are eligible for deduction under HT, except for the following costs and allowances.

i. Rent incurred by the company on PPLs & PMLs
ii. Royalty incurred and paid.
iii. Host Community Fund contribution incurred.
iv. Environmental Remediation Fund contribution
v. Niger Delta Development Commission Fund (paragraph 2(1) of the Sixth Schedule)

General Fiscal Provisions under the PIA

4. Additional Financial Outlay

- NDDC: 3%
- Host Community Development Fund: 3% of actual annual operating expenditure of the preceding financial year.
- Environmental Remediation Fund: amount of contribution not stated
- Decommission and abandonment fund – operators are required to establish a decommissioning and abandonment fund ("**D&A Fund**") to be held by a financial institution that is not an affiliate of the lessee in the form of an escrow account which is accessible by the Commission, contribute monies which have accrued in relation to decommissioning and abandonment costs prior to the effective date of PIA, into the D&A Fund, and subsequently, make annual contributions to the D&A Fund. Section 240 of the PIA.
- The amount of the contribution is not stated. However, the PIA in Section 103 provides that the NUPRC shall take into consideration the size of the operations and the level of environmental risk that may exist in determining the amount.

General Fiscal Provisions under the PIA

5. Segregation Requirement

A company which intends to operate in more than one stream or sector of the oil and gas industry will be required to incorporate separate companies for each stream of petroleum operations. In complying with this requirement, no stamp duties or capital gains tax shall be levied.

Companies engaged in strategic upstream projects to produce oil and gas to be processed or refined to finished petroleum products and supplied in wholesale domestically can be established as an "Integrated Strategic Project" and may consolidate the associated midstream operations with the upstream operations for tax purposes – with the condition of (i) imposing arms-length transfer prices, and (ii) excluding the midstream company from claiming capital allowances on the consolidated costs.

6. Cost Consolidation

Upstream companies holding PPLs and PMLs across terrains shall be allowed to consolidate costs and taxes for the purpose of hydrocarbon taxes across the two categories of chargeable tax. Such consolidation shall be allowed only across assets in which it holds licenses and leases.

Upstream companies with operations across terrains (onshore, shallow water) shall be allowed to consolidate costs across terrains in computing CIT. Section 272 of the PIA.

Tax Administration under the PIA

- The FIRS administers and regulates the assessment and collection of Hydrocarbon Tax, Companies Income Tax, and Tertiary Education Tax due under the PIA. (S. 259)
- The Nigerian Upstream Petroleum Regulatory Commission regulates the determination and collection of royalties, signature bonuses, rents, and related payments under the PIA. (S. 259)

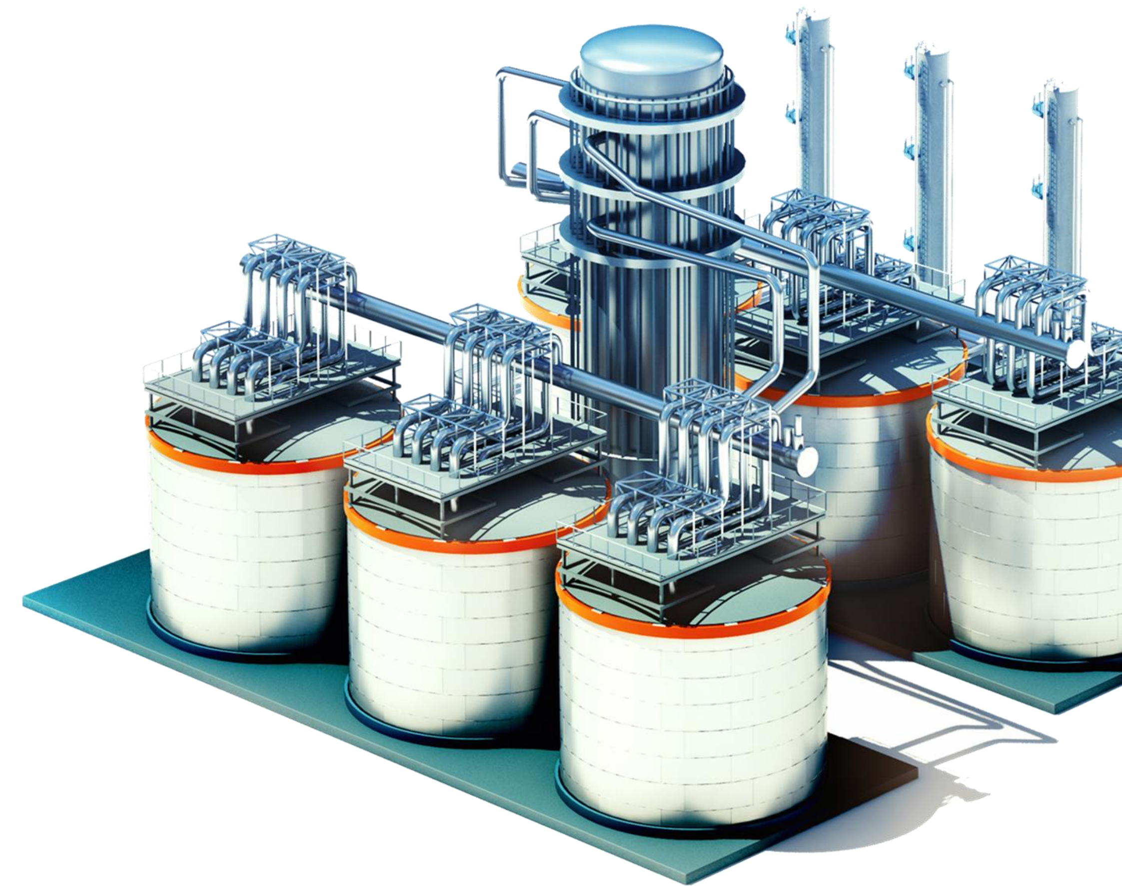
Penalties

- A person which fails to file appropriate returns shall be liable to penalty of N10,000,000 on the first day of occurrence, and N2,000,000 for each day in which the failure continues. (S. 277)
- Where any tax is unpaid as due, the tax due shall incur penalty at 10% of the payable amount, and interest at the prevailing LIBOR.
- A company which makes incorrect accounts in order to understate the payable tax shall be liable to an administrative penalty of N15,000,000 or 1% of the undercharged amount. (S. 298)
- A person which fails to comply with a provision for which no penalty was prescribed shall be liable to penalty of N10,000,000 on the first day of occurrence, and N2,000,000 for each day in which the failure continues.
- A person who is found guilty of an offence under a provision for which no penalty was prescribed shall, upon conviction, be liable to penalty of N20,000,000 and where the offence continues, an additional fine of N2,000,000 shall be imposed, or imprisonment for a term of six months (S. 297).

Appeals

- A person who is dissatisfied with an assessment may challenge the assessment by issuing a letter of objection to the FIRS.
- Where the FIRS refuses to amend the assessment, the person may appeal to the Tax Appeal Tribunal.

Q & A Session



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