IN THE TAX APPEAL TRIBUNAL
IN THE LAGOS ZONE
HOLDEN AT LAGOS

CONSOLIDATED APPEAL NOs:
APPEAL NO: TAT/LZ/040/2013
APPEAL NO: TAT/LZ/041/2013
APPEAL NO: TAT/LZ/042/2013

BETWEEN:

THE SHELL PETROLEUM DEVELOPMENT COMPANY OF NIGERIA LIMITED ..... APPELLANT

AND

FEDERAL INLAND REVENUE SERVICE ..... RESPONDENT

JUDGMENT

INTRODUCTION

The Appellant being aggrieved with the Notices of Additional Assessments numbered PPTBA 52, PPTBA 50 and PPTBA 51 all dated 25th September, 2013 which the Respondent issued on the basis that payments made by the Appellant for gas flaring operations were disallowable expenses for the years 2006-2008 filed these appeals. The three separate Notices of Appeal were consolidated pursuant to the order of this Tribunal dated 15th April, 2014.

STATEMENT OF FACTS

The Appellant made payments in respect of years 2006-2008 as gas flaring fee and sought to deduct same as deductible expenses in its returns for the said years. The Respondent disallowed the deductions and issued additional assessments on the amounts deducted by the Appellant on the ground that such deductions were not allowable deductions. The Appellant brought these Appeals in respect of the expenses incurred.

ISSUES FOR DETERMINATION

The parties formulated three issues for determination.

1. Whether the payments made by the Appellant to the DPR in respect of the gas flared by the Appellant in 2006, 2007 and 2008 constitute a penalty.

2. Whether the Appellant is entitled to make tax deductions on the sums paid for gas flaring activities for the period 2006 to 2008.

3. Whether or not the Respondent was right to have issued the Additional Assessments for the years 2006-2008.

PARTIES' POSITION

ISSUE ONE

Whether the Appellant is entitled to make tax deductions on the sums paid for gas flaring activities for the period 2006 to 2008.

The Appellant contends that the payments it made to DPR in respect of the gas flared in 2006, 2007 and 2008 were not by way of penalty. The Appellant relied on the Black's Law Dictionary 9th Edition definition of penalty as; "A punishment imposed by statute as a consequence of the commission of an offence." The Appellant therefore argues that it is only upon establishing liability or conviction by a court of competent jurisdiction that penalty or punishment can be imposed in accordance with the statute which created the obligation. The Appellant cites the Supreme Court decision in **EFFIOM V C.R.S.I.E.C (2010) 14 NWLR (Pt. 1213) 106 at 131**, where Per Tabai JSC restated and relied on the following statement of the law:

> *"The Courts have consistently maintained that trial and conviction by a court is the only constitutionally permitted way to prove the guilt and therefore the only ground for imposition of criminal punishment or penalty for criminal offence of embezzlement or fraud."*

It should be noted that the authors of the Black Law dictionary did not affix such a limited interpretation to the word. In fact they state that it is "An elastic term with many different shades of meaning" ....

The Appellant further contends that the penalty for flaring gas in contravention of the provisions of AGRA is not in the form of monetary payments but as clearly contained in section 4 of AGRA;

> *"1. Where any person commits an offence under section 3 of this Act, the person concerned shall forfeit the concessions granted to him in the particular field or fields in relation to which the offence was committed.*
>
> *2. In addition to the penalty specified in subsection (1) of this section, the Minister may order the withholding of all or part of any entitlements of any offending person towards the cost of completion or implementation of a desirable re-injection scheme or the repair or restoration of any reservoir in the field in accordance with good oil-field practice."*

The Appellant submits that the penalty for an offence must be in accordance with the law prescribing the offence as the Supreme Court held in the case of ***OGBOMOR V STATE (1985) NWLR (Pt. 2)223 at 233***

The Appellant submits that from the testimony of the Appellant's sole witness that up until December 2005, the DPR, in response to applications by the Appellant, consistently issued certificates to the Appellant which is in evidence as Exhibits 2EA1/08, showing authorization to flare gas, in accordance with which the Appellant flared gas and paid the amounts prescribed by the Minister. The Appellant asserts that fees it paid are royalties and not penalties as is contained in Exhibits 2EA1/07 and 3EAA1/07, which are letters addressed to the DPR notifying the DPR of payments with payment advice attached.

The Appellant submits that section 3(2) of Associated Gas Re-injection Act (AGRA) gives the Minister the discretion to issue a certificate to a company engaged in the production of oil and gas upon having been satisfied that the utilization or re-injection of the gas produced is not appropriate or feasible in any particular field or fields.

Section 3(2) of AGRA stipulates as follows:

"2. Where the Minister is satisfied after 1st January, 1984 that utilization or re-injection of the produced gas is not appropriate or feasible in a particular field or fields, he may issue a certificate in that respect to a company engaged in the production of oil or gas-

(a) specifying such terms and conditions, as he may at his discretion choose to impose, for the continued flaring of gas in the particular field or fields; or

(b) permitting the company to continue to flare gas in the particular field or fields if the company pays such sum as the Minister may from time to time prescribe for every 28.317 Standard cubic meters (SCM) of gas flared:

Provided that, any payment due under this paragraph shall be made in the same manner and be subject to the same procedure as for the payment of royalties to the Federal Government by companies engaged in the production of oil."

The Respondent counters that the payments made by the Appellant to the DPR in respect of the gas flared by the Appellant in years 2006, 2007 and 2008 are by way of penalty. The Respondent therefore submits that even though no statute prescribes a monetary penalty for gas flaring, the Appellant purportedly paid to flare gas and this is an illegal transaction that this Tribunal should not recognize as being legal. The Respondent cites the Court of Appeal decision in the case of **OLOKO –V- UBE (2001)13 NWLR (Pt. 729)161 at 168** ratio 13 where it was held that :

"Once a Court becomes aware of the illegality of a transaction, it is the duty of that Court to stop the case and dismiss the claim for being void and unenforceable. None of the parties to such transaction is entitled to any remedy or relief from the Court..."

The Respondent contends that section 3 (1) of AGRA disallows flaring of gas except the Minister of Petroleum gives permission in writing, and section 3(2) requires that per adventure, the Minister deems it necessary, after a formal application to that effect, the Minister could issue a certificate. The Respondent also referred the Tribunal to Regulation 1 of Cap A25, AGRA (Continued Flaring of Gas Regulation) which provides conditions to be met before a company could be permitted to flare gas, which the Appellant never met. The Respondent asserts that any amount purportedly paid by the Appellant for gas flaring is not backed up by law and hence illegal. The Respondent further argues that Section 10 of PPTA mandates the Respondent to allow for deduction expenses listed under the section that are wholly, exclusively and necessarily incurred and penalty for gas flaring is not on that list.

ISSUE TWO

Whether the Appellant is entitled to make tax deductions on the sums paid for gas flaring activities for the period 2006 to 2008?

The Appellant submits that it is entitled to make tax deductions on the sums incurred as payment for gas flaring activities for the period 2006 to 2008 because the expenses were incurred wholly, exclusively and necessarily for the purpose of petroleum operations in accordance with section 10(1)(i) of the PPTA, which provides thus:

"(1) In computing the adjusted profit of any company of any accounting period from its petroleum operations, there shall be deducted all outgoings and expenses wholly, exclusively and necessarily incurred, whether within or without

Nigeria, during that period by such company for the purpose of those operations, including but without otherwise expanding or limiting the generality of the foregoing-

(i) all sums the liability of which was incurred by the company during that period to the Federal Government, or to any State or Local Government Council in Nigeria by way of duty, customs and excise duties, stamp duties, education tax, tax(other than the tax imposed by this Act) or any other rate, fee or other like charges;"

The Appellant urged the Tribunal to give section 10 (1)(i) of the PPTA the ordinary, strict and narrow meaning as held by the Court of Appeal in the case of ***AHMADU V GOV. OF KOGI STATE (2002) 3 NWLR (Pt. 755) 502 at 522 B-E.***

The Appellant cites section 11(2) of the PPTA which makes it mandatory for a party involved in gas flaring to pay the fees prescribed by the Minister for the gas flared, before it will be entitled to partake of the benefits conferred by section 11(1) of the PPTA. Section 11(1)(2) of the PPTA provides thus:

"(1) The following incentives shall apply to a company engaged in the utilization of associated gas, that is –

(a) investment required to separate crude oil and gas from the reservoir into usable products shall be considered as part of the oil field development;

(b)capital investment on facilities equipment to deliver associated gas in usable form at utilization or designated custody transfer points shall be treated for tax purposes, as part of the capital investment for oil development:

(2) The incentives specified under subsection (1) of this section shall be subject to the following conditions, that is-

(a)condensates extracted and re- injected into the crude oil steam shall be treated as oil but those not re- injected shall be treated under existing tax arrangement;

(b) the company shall pay the minimum amount charged by the Minister of Petroleum Resources for any gas flared by the company...."

The Appellant also submits that section 13 (1) of the PPTA which specifies deductions that are not allowed does not include fees paid for flaring gas as a prohibited deduction. The Appellant therefore submits that the omission of gas flare royalty and gas flare penalty from the list of statutorily non-tax deductible items of expenditure makes it abundantly clear that such payments are tax deductible, which is in line with the Latin maxim *"expressio unius est exclusion alterius."* rightly applied in the case of ***OJUKWU V YAR'ADUA (2008) 4 NWLR (Pt. 1078)435 at 461.***

The Appellant urged the Tribunal to grant the relief sought by the Appellant in the Notices of Appeal.

The Respondent contends that the Appellant is not entitled to make tax deductions of the sums incurred as royalties paid for gas flaring activities for the period 2006 to 2008 because the deductions allowed under section 10 of the PPTA do not include payment of penalty for gas flaring. The Respondent therefore urged the Tribunal to hold that the payment it made for gas flaring is an illegal payment.

ISSUE THREE

Whether or not the Respondent was right to have issued the Additional Assessments for the years 2006-2008.

The Appellant submits that the Respondent was wrong to have issued the Additional Assessments for the years 2006-2008, because section 3 (2) of the AGRA gives the Minister discretion whether or not to issue the Appellant a certificate to evidence the Minister's approval for the Appellant to continue to flare gas, where the Minister is satisfied that it is not appropriate or feasible in a particular field or fields if the company pays such sum as the Minister may from time to time prescribe for every 28.317 Standard cubic metres (SCM) of gas flared.

The Respondent asserts that it was right to have issued the Additional Assessments for the years 2006-2008 because the Appellant flared gas during the period under review without obtaining a certificate before flaring gas, contrary to Regulation 1 of Cap A25 (LFN) AGRA(Continued Flaring of Gas Regulation). The Respondent submits that the Appellant has not tendered any certificate of gas flaring for the period under review in this appeal.

ANALYSIS AND CONCLUSION

It is not in dispute that the unrestrained flaring of gas has a negative impact on the host community and constitutes a waste of a depleting resource which the country can ill afford. For this reason AGRA was enacted by the legislative in the following terms:

> *"2. Where the Minister is satisfied after 1st January, 1984 that utilization or re-injection of the produced gas is not appropriate or feasible in a particular field or fields, he may issue a certificate in that respect to a company engaged in the production of oil or gas-*
>
> *(a) specifying such terms and conditions, as he may at his discretion choose to impose, for the continued flaring of gas in the particular field or fields; or*
>
> *(b) permitting the company to continue to flare gas in the particular field or fields if the company pays such sum as the Minister may from time to time prescribe for every 28.317 Standard cubic meters (SCM) of gas flared:*

A close reading of the above provisions reveals the intention of the legislative to prevent gas flaring "without the permission in writing of the Minister."

Sub-section 2 of section 3 allows the Minister to fulfill that discretion in writing by the issuance of a certificate of 2 types.

[a] "specifying terms and conditions" or

[b] "if the company pays such sums as the Minister may from time to time prescribe…"

The consent of the Minister is manifested in a certificate stipulating either of the above terms.

Once the Minister issues his permission for a period such sanction ends at the end of the given period as it is not permission in perpetuity.In strict technical terms it can be argued that the express provisions of AGRA stipulate a written consent before gas flaring. In practical terms the bureaucratic inefficiency may work hardship on the operator due to the less than efficient bureaucracy particularly as the ongoing oil production releases the gas byproduct which will need immediate attention and there may be silence from DPR as in the instant case notwithstanding that an application for such certificate may have been made timeously.

In order to meet the justice of the case, this tribunal in TAT/LZ/035/2013, TAT/LZ/037/2013 and TAT/LZ/038/2013 between Total Oil Nigeria Limited v. FIRS delivered on 17th March, 2015 held as follows:

> *"It is a notorious fact that an intolerable amount of gas flaring has persisted for far too long in the Nigerian territory. This carries along with it health, environmental and financial costs. For this reason the legislature enacted the Associated Gas Re-injection Act (AGRA) which is intended to discourage the practice of gas flaring. The requirement for ministerial permission in writing is not satisfied by the unilateral payment of fees by an oil and gas company. Having said this, the Petroleum Profit Tax Act (PPTA) and the Associated Gas Re-injection Act (AGRA) do not expressly require that a company must obtain gas flare certificate before expenses incurred can be tax deductible. The NEITI report which states that gas flare fee paid by the Appellant for the said years of assessment is not deductible is not based on any provision of the law. NEITI report which the Respondent relied on cannot overrule either the PPTA or the AGRA.*
>
> *Section 3(2) of AGRA which theAppellant relies on, means that a company which applies for permission to continue to flare gas is not bound by the provisions of section 3(1), provided the Minister is satisfied that the utilization or re-injection of the produced gas is not appropriate or feasible, the Minister may if he so wishes, issue a certificate to the company engaged in petroleum operations.*
>
> *By this subsection 2, the Minister has a discretion to issue a certificate to a company to continue to flare gas. Section 4 of AGRA contains provisions for penalty whenever gas is flared illegally.*
>
> *The Appellant proved by Exhibits CEP1, CEP2 and CEP3 (the gas flaring certificates for 2005) that the Minister issued the Appellant gas flaring certificates in 2005. The Appellant applied for gas flaring certificates and made requisite payments for the period 2006, 2007 and 2008, to continue to flare gas. The Minister did not issue certificate nor sanction the Appellant for illegal gas flaring. The Respondent has not provided proof of sanction on the Appellant for illegal flaring of gas from 2006 to 2008. In the circumstances, we believe that the Minister did not consider the gas flared by the Appellant illegal. If the Minister had sanctioned the Appellant, then, the gas flare fee paid by the Appellant would be considered an illegal payment which would disqualify the Appellant from benefiting under section 10(1)(l) of the PPTA."*

This conclusion was arrived at because for the catalogue of reasons stated in the decision was tantamount to substantial compliance in the circumstances of that case. See also Mobil Producing Nigeria Unlimited v. FIRS TAT/LZ/033/2013 delivered on the same 17th March, 2015 to the same effect.

In those cases the DPR receipts obtained by the companies for their gas flaring activities were accepted as evidence in writing under the auspices of the Minister's. The additional assessments seek to write back these payments into the books of the taxpayer and derive the additional tax on the sum in question while another agency of the same executive keeps the payment at the same time. Quite a curious and incongruous outcome.

Affixing an inscription of "penalty" on the receipt, a label without statutory foundation does not have much impact on the complexity of the issues brought about by the role of the office of the Minister in the circumstance.

In the result, we hold as follows:

(i) that the payments made by the Appellant to DPR in respect of the gas flared by the Appellant in 2006,2007 and 2008 do not constitute a penalty;

(ii) that the Appellant is entitled to make tax deductions of the sums incurred as royalties paid for gas flaring activities for the period 2006 to 2008 and

(iii) that the Respondent was wrong to have issued the additional assessments for the years 2006- 2008.

We hereby grant the reliefs sought by the Appellant in its Notices of Appeal and set aside the additional assessments.

LEGAL REPRESENTATION

Chukwuka Ikwuazom Esq. with Shehu Mustafa Esq. and O. Ogunrinde (Mrs) for the Appellant

A. A. Iriogbe (Mrs) for the Respondent.

DATED AT LAGOS THIS 27TH DAY OF OCTOBER 2015

KAYODE SOFOLA, SAN (Chairman)

CATHERINE A. AJAYI(MRS)
Commissioner

D. HABILA GAPSISO
Commissioner

MUSTAFA BULU IBRAHIM
Commissioner

CHINUA ASUZU
Commissioner