IN THE TAX APPEAL TRIBUNAL
IN THE LAGOS ZONE
Holden AT IKEJA

APPEALNO. TAT/LZ/017/2014
APPEAL NO. TAT/LZ/018/2014

Between

NIGERIA AGIP OIL COMPANY LIMITED Appellant

And

FEDERAL INLAND REVENUE SERVICE Respondent

Judgment

Introduction:

The Appellant challenged the Respondent's Petroleum Profits Tax Notice of Additional Assessment No.PPTBA 103 dated 25 October 2013 and Education Tax Notice of Additional Assessment No. PPTBA/ED 92 dated 28 October 2013 for the 2011 year of assessment by filing two separate Notices of Appeal on 31 January 2014. The Notices of Appeal were later amended and consolidated on 20 May 2014.

The Appellant requests the Tribunal to set aside the two Notices of Additional Assessments.

Issues for determination:

1. Whether the Appellant's Participating Interests in OMLs 26 and 42 sold in 2010 and 2011 respectively consisted of a bundle of assets on which different types of qualifying capital expenditure had previously been incurred and if so, whether pursuant to Paragraph 3 of the Second Schedule to the PPTA, the total consideration paid for these underlying assets should be apportioned to the underlying assets before computing the applicable Balancing Charge?

2. Whether pursuant to Paragraph 10 of the Second Schedule to the PPTA, Petroleum Investment Allowance (PIA) is relevant in the determination of the "residue"(i.e. tax written down value of an asset) for the purpose of computing Balancing Charge?

3. Whether the Education Tax Notice of Additional Assessment No. PPTBA/ED 92 dated 28 October 2013 and the Petroleum Profits Tax Notice of Additional Assessment No. PPTBA 103 dated 25 October 2013 are contrary to law and as such, should be set aside by this Tribunal?

Facts and Proceedings:

The Appellant sold its undivided participating interests in OMLs 4, 38, 26 and 41 in 2010 and its undivided participating interest in OML 42 in 2011. Following a tax audit of the Appellant for 2006-2011 accounting years, the Appellant was asked to pay additional petroleum profits tax and education tax amounting to US$27,676,402and US$651,209 respectively for the 2011 year of assessment. The Notices of Additional Assessment were issued in October 2013.

The Appellant objected to the additional assessments on 19 November 2013. But by a letter dated 19 December 2013, the Respondent communicated to the Appellant its refusal to discharge the Notices of Additional Assessment.

The Appellant filed the following:

1. Two separate Notices of Appeal dated 31 January 2014 for each of the two appeals that were subsequently consolidated;
2. Two Amended Notices of Appeal dated 20 May 2014 for each of the two appeals;
3. Consolidated Rejoinder dated 5 August 2014;
4. Two separate Written Statements on Oath dated 20 May 2014 for each of the two consolidated appeals and Additional Written Statement on Oath dated 5 August 2014 by Mr Oluwole Samuel Agbede; and
5. Documentary exhibits.

The Respondent filed the following:

1. Two separate Respondent's Reply Acknowledging Receipt of Notice of Appeal both dated 21 March 2014;
2. A consolidated Respondent's Reply to Appellant's Amended Notices of Appeal dated 20June 2014;
3. Amended Witness Statement dated 20June 2014 by Nonye Nkachukwu; and
4. Documentary exhibits.

Parties' Positions:

The Appellant submits that its undivided Participating Interests in OMLs 26 and 42 sold in 2010 and 2011 consisted of several underlying assets that were grouped as tangible and intangible assets in order to apportion value appropriately. All the tangible assets were qualifying capital expenditure (QCE) while some of the intangible assets were not. The Appellant adds that its interest disposed of was represented by the values assigned to the underlying tangible and intangible assets.

The Appellant maintains that the assets transferred in the sale of OML 42 are listed in Part 3, Schedule 1 of **Exhibit OA1/02B.** The assignment of OML 26 – **Exhibit OA1/02A** – is not as comprehensive but listed some of the assets. The Appellant contends that in determining balancing charge, the sales consideration must be apportioned to the underlying assets. The Appellant relied on Paragraphs 9, 13, and 14 of the Second Schedule to the PPTA to support apportionment of the assets sold in the transaction, before computing balancing charge. The Appellant posits that the Respondent's discretionary powers in Paragraph 14 of the Second Schedule to the PPTA, to make a just and reasonable apportionment, are irrelevant to this appeal. Thus, the purchaser – an independent third party – had already made the apportionment.

The Appellant argues that Paragraph 1 of the Second Schedule to the PPTA defines qualifying capital expenditure (QCE) by listing specific types of assets in subparagraphs (a) to (d). "OML" is not listed among QCEs. The Appellant supports its argument with the unreported decision of this Tribunal delivered on 12th February, 2015 in the Consolidated Appeals Nos.TAT/LZ/008/2014 and TAT/LZ/009/2014 - **The Shell Petroleum Development Company of Nig. Ltd v. Federal Inland Revenue Service.** In that case, the Tribunal held as follows:

> *"Qualifying Capital Expenditure (QCE) are clearly defined by the Act. PPTA provides list of QCE and capital allowances are granted in accordance with that list. The Respondent granted capital allowances on the various assets but not on OMLs 26 and 42. And the Appellant did not claim capital allowances on OMLs 26 and 42. Thus, OMLs 26 and 42 were not QCE at the date the Respondent first granted the Appellant capital allowances and during the period up to the date of disposal of the qualifying assets. QCE do not change in form, otherwise the Act would have anticipated and made appropriate provisions. References to allowances in the computation of balancing charge are capital allowances claimed on QCE."*

The Appellant further states that the amount claimed as capital allowance, over a number of years, was not on a single asset called "OML". Instead, the amount represented the sum of different capital allowances on different assets including plant, buildings, tanks, pipelines, etc. in accordance with Paragraph 1 of the Second Schedule. The Appellant adds that the assets classified as intangible including expenditure incurred in acquiring data relating to possible location, structure, quantity and composition of hydrocarbon accumulations was not QCE. The expenditures were charged to the Appellant's profit and loss accounts for the years in which they were incurred. The Appellant relied on its **Exhibit OA1/03 and Exhibit OA1/04** at pages 10 and 12 to bolster the separate QCE on which it claimed capital allowance.

The Appellant argues that upon the disposal of various assets on which QCE had been incurred, the computation of balancing charge should align with the assets in respect of which the QCE had been incurred. For the Appellant, it is inconsistent with the provisions of the Second Schedule and tenuous for the Respondent to take an OML as the asset for the purposes of incurring QCE and consequently compute balancing charge.

The Appellant submits that Petroleum Investment Allowance (PIA) should not form part of the total allowances in the computation of balancing charge. It asserts that balancing charge is the excess of the sales proceeds over the *Residue* of the QCE; restricted to the total annual allowance claimed to the date of disposal. The Appellant relies on the provisions of Paragraphs 9 and 10 of the Second Schedule. The Appellant argues that the general provisions of the proviso to Paragraph 9 of the Second Schedule cannot alter and rewrite the definition of "residue of the qualifying expenditure". Further, the Appellant says that Paragraph 10 of the Second Schedule to PPTA renders PIA irrelevant in the determination of "residue of the qualifying capital expenditure" for the calculation of balancing charge. The Appellant relies on The Shell V FIRS (*supra*) where this Tribunal held thus:

> *"Annual Allowance and PIA are separate sets of allowances, though they are subject to the same rules under the Act. Thus, where one is categorically mentioned, to the exclusion of the other, that other's inclusion is not intended. The residue of QCE on disposal is total QCE less total annual allowance, if any. We cannot find Petroleum Investment Allowance mentioned in the computational process of residue in Paragraph 10 of the Act."*

The Appellant argues that the Respondent's Education Tax Notice of Additional Assessment numbered PPTBA/ED 92 and dated 28 October 2013 and the PPT Notice of Additional Assessment numbered PPTBA/103 and dated 25 October 2013 were both based on erroneous computation of balancing charge by taking OMLs 26 and 42 as a qualifying asset. The Appellant asserts that its uncontested evidence before the Tribunal shows the broad categorisation of the assets disposed of and capital allowances claimed. With this disclosure, the Respondent's discretionary power of apportionment has been rendered ineffective.

The Appellant also submits that the Respondent is wrong in its computation of additional assessment of Education Tax on The Appellant. It argues that Education Tax is assessed at 2% of assessable profits, while capital allowance is claimed on assessable profit after charging Education Tax. Thus the Appellant contends that balancing charge is written back to accounts at the level of tax computation at which capital allowances are claimed. And this has neutral effect on Education Tax.

The Respondent submits that the Appellant erred when it separated the sale of its undivided participating interests into tangible and intangible assets for the purpose of computing its balancing charge liabilities because the OML, being a lease/permit, is a single title and cannot be separated.

The Respondent states that the Appellant had apportioned a much smaller amount of US$50 million to the tangible portion of the assets and US$535 million to the intangible assets. By this apportionment the Appellant claims that the intangible assets were not QCE and therefore not subject to balancing charge. The Respondent argues that this apportionment is indiscriminate, with no evidence of how the sums were derived and is therefore simply a ploy to unlawfully reduce the Appellant's tax obligation. The Respondent relies on Paragraph 13 of the Second

Schedule of the PPTA which states that *"..... For the purposes of this sub-paragraph, all the assets which are purchased or disposed of in pursuance of one bargain shall be deemed to be purchased or disposed of together; notwithstanding that separate prices are or purport to be agreed for each of those assets....."*

The Respondent submits that "Data" as stated in Schedule 9 of the Appellant's *Agreement for Assignment* which is *"Data relating to possible location, structure, quantity and composition of discovery of hydrocarbon accumulations"* is the same as Paragraph 1(d)(ii) of the Second Schedule of the PPTA which is *".....searching for or discovering and testing petroleum deposits, or winning access thereto."*The Respondent states further that it is the details of the search for and discovery of hydrocarbon accumulation (petroleum) that was transferred to the buyer by the Appellant as "Data". It is therefore unclear to the Respondent that the Appellant claims the "Data" did not suffer QCE and is not liable to balancing charge.

The Respondent also submits that it is erroneous of the Appellant to suggest to this Honourable Tribunal that it should not pay balancing charges on "the right to win, work ... and carry away all petroleum products " because it did not enjoy capital allowance on them; this is because **Exhibits NN3 & NN4** (erroneously quoted by the Respondent as **Exhibits FIRS C** and **FIRS D**) respectfully show that the Appellant did enjoy capital allowances on intangible portions of the sale in both 2010 and 2011 on "drilling", "pipelines", "building" and "survey and exploration".

The Respondent believes that the additional assessment is correct and valid under its inherent powers in Section 15 of PPTA. The Respondent also views the whole process of unbundling and categorisation of the assets into tangible and intangible as a tax planning scheme aimed at reducing the Appellant's PPT and invariably its EDT liabilities.

The Respondent maintains that by Paragraph 9 of the Second Schedule of the PPTA, balancing charge is restricted to the total of any allowances, inclusive of Petroleum Investment Allowance (PIA).

Analysis and Decision:

The Respondent believes OMLs 26 and 42 are QCE. The Appellant says they are not but the underlying assets are. Qualifying Capital Expenditure (QCE) are clearly defined by the Act. PPTA provides list of QCE and capital allowances are granted in accordance with that list. The Respondent granted capital allowances on the various assets but not on OMLs 26 and 42. And the Appellant did not claim capital allowances on OMLs 26 and 42. Thus, OMLs 26 and 42 were not QCE at the date the Respondent first granted the Appellant capital allowances and during the period up to the date of disposal of the qualifying assets. QCE do not change in form, otherwise the Act would have anticipated and made appropriate provisions. References to allowances in the computation of balancing charge are capital allowances claimed on QCE.

The Respondent seems to maintain that it granted the Appellant capital allowance on both the tangible and intangible QCE on OMLs 26 and 42. There are indeed intangible QCE in the PPTA approved list. But the Respondent is unable to show what capital allowances it granted the Appellant on what intangible portions of the Appellant's interest in OMLs 26 and 42. **Exhibits NN3 & NN4** relied upon by the Respondent are not succinctly corroborative of the arguments canvassed. Thus, those exhibits do not help the Respondent's case.

The Respondent says PIA is inclusive in the total allowances for computing balancing charge. The Appellant says no. Paragraph 9 of the Second Schedule of the PPTA describes balancing charge as the excess of the value of the asset disposed, at the date of disposal, over the **residue** of that expenditure at that date. And Paragraph 10 states that *"The **residue** of qualifying expenditure, in respect of any asset, at any date, shall be taken to be the total qualifying expenditure incurred on or before that date, by the owner thereof at that date, in respect of that asset, less the total of any **annual allowances** due to such owner, in respect of that asset, before that date."*

But Paragraph 5(2) says *"For the purpose of this Act, the Petroleum Investment Allowance shall be added to the annual allowance computed under paragraph 6 of this Schedule and **shall be subject to the same rules under this Act.**"*

Annual Allowance and PIA are separate sets of allowances, though they are subject to the same rules under the Act. Thus, where one is categorically mentioned, to the exclusion of the other, that other's inclusion is not intended. The *residue* of QCE on disposal is total QCE less total annual allowance, if any. We cannot find Petroleum Investment Allowance mentioned in the computational process of *residue* in Paragraph 10 of the Act.

The Appellant says Balancing Charge is added back to Assessable Profit and does not result in additional Education Tax assessment. This assertion is erroneous. Assessable profit is equal to adjusted profit minus losses plus balancing charge. Thus, balancing charge is added back to adjusted profit after losses to arrive at assessable profit.

Conclusion:

We direct the Respondent to calculate the balancing charge on the disposal of OMLs 26 & 42 based on the separate values of the underlying qualifying assets.

We find Petroleum Investment Allowance irrelevant to the calculation of balancing charge.

We hold that Balancing Charge influences assessable profit and results in additional Education Tax assessment.

We therefore set aside the Education Tax Notice of Additional Assessment numbered PPTBA/ED 92; dated 28 October, 2013 and the PPT Notice of Additional Assessment numbered

PPTBA/103 of 25 October, 2013. We direct the Respondent to issue revised assessments in accordance with our decision in this appeal.

Legal Representation:

Chukwuka Ikwuazom Esq. with Shehu Mustafa Esq. and Mrs Oluwafikayomi Ogunrinde for the Appellant.

Mrs Abisola Omeje for the Respondent.

DATED AT LAGOS THIS 28TH DAY OF OCTOBER 2015

KAYODE SOFOLA, SAN (Chairman)

CATHERINE A. AJAYI(MRS)
Commissioner

D. HABILA GAPSISO
Commissioner

MUSTAFA BULU IBRAHIM
Commissioner

CHINUA ASUZU
Commissioner