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

CONSOLIDATED APPEALS Nos.
TAT/LZ/008/2014 &TAT/LZ/009/2014

Between

The Shell Petroleum Development Company of Nig. Ltd Appellant

And

Federal Inland Revenue Service Respondent

Judgment

Introduction:

The Respondent assessed the Appellant to additional Petroleum Profit Tax (PPT) of $162,383,712.00 and Education Tax (ET) of $3,820,793.00 for 2011 year of assessment. The assessments were computed solely on the Balancing Charge (BC) from the disposal of the Appellant's 'Undivided Participating Interest' in OML 26 and OML 42. The Appellant disposed its interest by a single transaction with the underlying assets categorised into tangible and intangible. The sales transaction was at arm's length and the values for the underlying assets were assigned by the purchaser. The Appellant claimed capital allowance on all the tangible assets and an inconsequential amount on one of the intangible assets.

The Respondent considered the disposal of the Appellant's participating interests in OML 26 and OML 42 as a bundle and the underlying assets as composite. Thus, the Respondent computed balancing charge on the assets disposedby offsetting the aggregate residue against the consideration paid. The Respondent included Petroleum Investment Allowance (PIA) in the computation of the balancing charge.

Issues for determination:

The Appellant submits 3 issues for determination:

1. Whether the Appellant's undivided participating interest in OMLs 26 and 42 sold in 2011 consisted of a bundle of assets on which different types of qualifying capital expenditure had previously been incurred? And if so, whether pursuant to

Paragraphs 13 & 14 of the First Schedule to the PPTA, the total consideration paid for these underlying assets should be so apportioned before computing the applicable Balancing Charge?

2. Whether pursuant to Paragraphs 5(2) & 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 numbered PPTBA/ED 85 and dated 28 October, 2013 and the PPT Notice of Additional Assessment numbered PPTBA/93 and dated 28 October, 2013 are contrary to law and should be set aside by this Tribunal?

Facts and Proceedings:

The Appellant disposed its undivided participating interest in OMLs 26 and 42 for $488million by a single transaction in 2011. Though the disposal was made as a bundle, the consideration paid specified the values of the underlying assets. Some of the assets were qualifying capital expenditure on which the Appellant had claimed capital allowances. In its 2011 tax returns – **Exhibit IO1/05** – atpage"**A-1**" "Adjustment of Profit for Income Tax Purposes for the Year ended 31 December, 2011" the Appellant reflected a balancing charge (on Asset Disposed) of $24,000,251. The figure was cross referenced to page"**B-6-1**" showing "Computation of Balancing Charge on **OMLs** Disposed for the Period Ended December, 2011. The computation shows – Sales Proceeds of $38,167,022 from which a Tax-written-down-value of $14,166,771 was deducted to arrive at a Balancing Charge of $24,000,251. The balancing charge is shown to be in agreement with the total allowances claimed.

The Respondent considered the disposal of the OMLs as a sale of single asset on which qualifying capital expenditure was incurred. The Respondent deducted from the sales proceeds – the aggregate of all allowances claimed by the Appellant on all the assets – to determine the balancing charge.The Respondent's Notice of Additional Assessment No. PPTBA/93 – **Exhibit BIO 1/02** –shows "Balancing Charge on OML Divestment 2011" of $194,860,454. The Respondent calculated Education Tax of $3,820,793 and PPT of $162,383,712 from the balancing charge. The Respondent, in determining the total allowances claimed by the Appellant, included Petroleum Investment Allowance.

Parties' Positions:

The Appellant argues that the disposal of its undivided participating interest in OMLs 26 and 42 consist of tangible and intangible assets. All the tangible assets were qualifying capital expenditure (QCE) while some of the intangible assets were not. And that the Appellant's interest disposed 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 IO1/09.** The assignment of OML 26 – **Exhibit IO1/08** – 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 contends 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). And "OML" did not make the list of QCE. The Appellant states that the sum of $208 million claimed as capital allowance, over a number of years, was not on a single asset called "OML". But 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 (wrongly quoted by the Appellant as Paragraph 1 of the First 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 expenditure was expensed in the Appellant's profit and loss account. The Appellant relied on its **Exhibit IO1/1** pages **B-1, B-3,** B-4, **B-6,** and B-7 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 computing 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 relied 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 to the Second Schedule cannot alter and rewrite the definition of "residue of the qualifying expenditure". And that Paragraph 10 of the Second Schedule to PPTA (wrongly quoted by the Appellant as First Schedule) renders PIA irrelevant in the determination of "residue of the qualifying capital expenditure" for the calculation of balancing charge.

The Appellant argues that the Respondent's Notices of Additional Assessment for Education Tax and PPT dated October 28, 2013 were 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 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. And 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 argues that the Appellant incurred QCE of N222 million at the time of disposal of the two assets, OMLs 26 and 42. The Respondent asserts that The Appellant interest sold in the 2 OMLs constituted an asset for the purpose of Paragraph 9 of the Second Schedule of PPTA. Thus, further classification into tangible and intangible assets for the purpose of determining balancing charge is not necessary. The Respondent believes that OMLs 26 and 42 are integrated assets without effective value and functions on disintegration. The Respondent also says that The Appellant had recovered in full its QCE of $222 million. Thus, the $230 million Annual Allowance and PIA earlier granted was no longer necessary. FIRS relied on Sections 13, 14 & 15 of the PPTA.

The Respondent argues that the sales consideration of $488million was not analysed according to the Appellant's asset listing contained in Schedule 1 of the Sale and Purchase Agreement (SPA). But the sub-assets as reclassified in Schedule 9 of SPA were QCE.

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 tax planning scheme by the Appellant.

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 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 set 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 base the calculation of balancing charge on the disposal of OMLs 26 & 42 on the separate values of the underlying qualifying assets.

We find Petroleum Investment Allowance extraneous to the determination of balancing charge.

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

We set aside the Education Tax Notice of Additional Assessment numbered PPTBA/ED 85; dated 28 October, 2013 and the PPT Notice of Additional Assessment numbered PPTBA/93 of 28 October, 2013. We direct the Respondent to issue revised assessment in accordance with our decision in this appeal.

Legal Representation:

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

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

DATED AT LAGOS THIS 12TH DAY OF FEBRUARY 2015

Kayode Sofola, SAN
Chairman

Catherine A. Ajayi (Mrs)
Commissioner

Chinua Asuzu
Commissioner

D. H. Gapsiso
Commissioner

Mustafa Bulu Ibrahim
Commissioner

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SIGN.....
DATE 19/2/15

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DATE 18/09/2018