IN THE TAX APPEAL TRIBUNAL
LAGOS ZONE
SITTING AT LAGOS

TAT/LZ/PPT/041/2014

Between

**Mobil Producing Nigeria Unlimited** Appellant

And

**Federal Inland Revenue Service** (FIRS) Respondent

## Judgment

### Issue for Determination

The Petroleum Profits Tax Act (PPTA) allows companies that incur expenses from petroleum operations to deduct operational costs. Under contracts between the Appellant and NNPC, both parties had to verify and approve costs before they could be deducted. The Respondent disallowed deductions the Appellant had made without the requisite approval. Does the contractual-verification requirement overwhelm the Appellant's statutory right to deduct?

### Introduction

The Appellant's case is that by virtue of Sections 10, 20, and 30 and the 2nd Schedule to the PPTA, it is entitled to make deductions from its petroleum tax profit as a result of the capital expenditure it incurred in executing a joint-venture agreement with NNPC. The Respondent disagrees with this position, maintaining that the Appellant could only recover costs that have been verified and approved in accordance with the requirements of the MCAs. The Respondent also maintains that the costs incurred by the Appellant are not covered by the provisions of the PPTA.

### Facts and Procedural History

The Appellant and NNPC entered into a joint-venture agreement with the participating ratio of 40:60. They agreed to bear the cost of the capital expenditure associated with the joint-venture operations in the ratio of their participating interest. Later, they signed three Modified Carry Agreements (MCAs), stipulating that the Appellant would fund both its 40% participating interest and NNPC's 60% participating interest.

The Carry Capital Cost is NNPC's 60% participating interest share of the capital expenditure borne by the Appellant. Under the MCAs, the Appellant would be entitled to recover 85% of the Carry Capital Cost through Carry Tax Relief, and 15% through Carry Oil/Gas and Share Oil/Gas.

The Appellant deducted US$198 million as carry tax relief for the 2006 - 2011 assessment periods on the ground that it incurred Carry Capital Cost under the joint-venture operations. The Respondent rejected the deductions arguing that under the MCAs, the amount claimed by the Appellant as Carry Capital Cost had to be verified and approved by both parties before the Appellant could recover the cost. The Respondent insists that in the absence of such verification and approval, the Appellant cannot make the deductions. The Respondent therefore issued two Notices of Additional Assessment disallowing the cost in excess of the amount verified. The Appellant was unhappy about the Respondent's position and appealed against both Notices of Assessment.

## Parties' Positions

**The Appellant argues that by the Petroleum Profit Tax Act, it is entitled to deduct capital allowances in respect of qualifying expenditure incurred from its petroleum operations.**

The Appellant relies on sections 10, 20, and 30 and the 2nd Schedule to the PPTA in arguing that any company involved in petroleum operations is entitled to deduct all expenses incurred from its chargeable profits. The Appellant argues that under the joint-venture agreement with NNPC with respect to petroleum operations, it incurred capital costs that allow it to make deductions from its petroleum profits.

The Appellant maintains that this position overrides the provisions of the MCAs which require that all capital expenditure must first undergo approval and verification by the parties to the MCAs before it can be recovered through Carry Tax Relief.

**But the Respondent disagrees, pointing out that the Appellant's entitlement to capital allowances is governed by the MCAs not the PPTA.**

The Respondent counters that as far as the amount the Appellant claims as capital expenditure remained unverified as the MCAs require, the Appellant's right to deduct cost does not arise.

The Respondent states that since the MCAs vested the power to verify on NNPC and the Appellant, the Respondent is not in the position to approve Carry Capital Cost.

## Analysis

**Is the Appellant entitled to deduct from its petroleum profit under the PPTA notwithstanding the requirement of the MCAs?**

The Appellant relied on the provisions of sections 10, 20, and 30 and the 2nd Schedule to the PPTA in maintaining that it is entitled to make certain deductions from its petroleum profits because of the expenses it incurred during its petroleum operations under the joint-venture agreement with NNPC.

Precisely, section 10(1) PPTA provides that:

> "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…"

Under section 20(1) of the Act, "the chargeable profit of any company of any accounting period shall be the amount of the assessable profits of that period after the deduction of any amount to be allowed in accordance with the provisions of this Section."

The above sections entitle any company involved in petroleum operations to deduct all expenses incurred during the period of its petroleum operations from its profits. The Appellant incurred capital expenditures in the course of executing the joint-venture agreement with NNPC. The joint-venture agreement is in relation to petroleum operations. This entitles the Appellant to deduct from its profits as there are no additional prerequisites provided by the PPTA for a company to be entitled to make deductions.

The Appellant's entitlement to deductions is not disputed by the Respondent. The Respondent's dispute is that the Appellant is bound by the MCAs which require all capital expenses to be recovered principally through Carry Tax Relief based on the cost approved and verified by the parties.

In deciding what deductions can be made from a company's profit, section 10 of the PPTA allows only those costs that were wholly, exclusively, and necessarily incurred by the company for the purpose of its petroleum operations. For the Appellant to rely on section 10 and other relevant provisions of the PPTA, the onus is on the Appellant to show that it incurred cost under the joint-venture agreement with NNPC in relation to petroleum operations. The Appellant discharged this burden when the Appellant showed that it had acquired Carry Project Assets amongst other things, and relied on Article 6.8 in claiming full ownership of the assets.

The Respondent cannot rely on the MCAs, an agreement to which it is not a party in determining the rights and liabilities of the Appellant. This is because the words of the statute regulating the rights and liability of the Appellant are unequivocal as to when a company can make deductions.

Section 8 of the Federal Inland Revenue Service (Establishment) Act authorizes the Respondent to collect taxes under the provisions of the Act or any enactment or law. The Respondent is the body charged with implementing tax laws in Nigeria. In carrying out this obligation, it must look, first, to the requirement of the tax laws it administers and not the agreement between taxpayers and third parties. The Respondent's power to tax companies arises not from the provisions of the MCAs or any agreement between parties but from the provisions of the relevant tax laws.

The Respondent cites *Shell Petroleum Development Company v. Federal Board of Inland Revenue* [1996] 8 NWLR (Part 466) 256, in support of two main propositions. First, the Respondent says that the Appellant is bound by the provisions of the MCAs since it willingly entered into the contract. Second, the Respondent maintains that the Appellant can therefore claim Carry Tax Relief only in accordance with the terms of the MCAs.

This Tribunal must first of all point out that the facts of the *Shell* case are not on all fours with those in this case and moreso, the Supreme Court decision does not support the Respondent's case. The facts were that Shell submitted its Petroleum Profit Tax returns to Federal Board of Inland Revenue (FBIR). FBIR disallowed cost incurred by Shell because the expense deductions claimed by Shell were not deductible for the purpose of computing chargeable tax under the Petroleum Profits Tax Act, 1959. The 4 items are:

1. Exchange losses on the payment of Petroleum Profits Tax
2. Central Bank Commission for payment of Petroleum Profit Tax
3. Scholarship Expenses
4. Gifts and donations.

Shell appealed to the Body of Appeal Commissioners. At the hearing of the appeal, the 4th item was abandoned by Shell. Several intermediate appeals followed. On ultimate appeal to the Supreme Court, all 3 expenses were held to be deductible in computing the adjusted profit of Shell. The question whether a contract could operate to exclude the provisions of the PPTA did not arise. Rather, the issue was whether the expenses claimed by Shell fell within the definition of "petroleum operations" under the Petroleum Profits Tax Act, 1959, qualifying them to be deducted from petroleum profit. The Supreme Court answered in the affirmative when it held that it would have been impossible for Shell to continue its operations without complying with the statutory requirements that led to the costs it incurred.

In the present case, the Appellant claims its authority to recover Carry Capital Cost through Carry Tax Relief from PPTA, which allows it to deduct expenses incurred for petroleum operations. We are of the opinion that the only obligation required for the Appellant to be entitled to invoke the provisions of section 10 PPTA is that the cost incurred by them was wholly, exclusively, and necessarily for the purpose of its operations. Such operations must be petroleum operations as defined under section 2 of the Act. Section 2 of PPTA defines Petroleum Operations as follows:

> "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 the refinery, in the course of a business carried on by the company engaged in such of or any disposal of chargeable oil by or on behalf of the company."

That the petroleum operation arose from three Modified Carry Agreements is completely irrelevant in invoking the provision of section 10 of the PPTA. As a matter of fact, there was a contractual obligation on the Appellant to incur the expenditure (Carry Capital Cost). This Tribunal cannot therefore see how the provisions of the PPTA do not apply in this case. This is the position of the Supreme Court in *Shell*, where Uwais CJN held follows {[1996] 8 NWLR (Part 466) 256, 295B-D}:

> "Once there is a statutory or contractual obligation, and in this case it is the former, for a company engaged in petroleum operations to perform, such obligation is "wholly, exclusively and necessarily" for the purpose of the operations of the company. ... Again the current findings by the lower Courts that the expenditures incurred on awards of scholarship were not "wholly, exclusively and necessarily incurred" were wrong because there was a statutory duty on the appellant to incur the expenditures and this is what the expenditure in question is about. It cannot, therefore, be held that the expenditures were not solely and inevitably incurred."

**Do the MCAs operate to exclude the provisions of the PPTA?**

In its argument, the Appellant maintains that the primary source of authority regarding the nature of the Appellant's right to deduct tax under the PPTA stems from the PPTA itself and not from the MCAs.

The Respondent is saddled with the responsibility of enforcing the various tax laws in Nigeria. In doing this, the Respondent must look to the requirement of the relevant tax law itself and not to the content of an agreement between taxpayers. This is in line with the earlier decision of this Tribunal in *Addax Petroleum Development (Nigeria) Limited v Federal Inland Revenue Service* 8(ALL NTC) 181, when it held as follows:

> "The correct assessment is of course the assessment that complies with the relevant tax law. With regard to Petroleum Profit Tax, the PPTA is the relevant litmus test…"[1]

The clear provisions of sections 10, 20, and 30 and the 2nd Schedule to the PPTA is to the effect that in calculating the adjusted profit of a company, all expenses wholly, exclusively, and necessarily incurred during the period of its operations may be deducted. No further requirement is needed in applying these provisions. The Appellant's claim is based on these provisions. Article 17.3 of the MCAs provides that the Laws of the Federal Republic of Nigeria shall govern the validity, construction, interpretation, and effect of this Carry Agreement. It cannot therefore be said that the provisions of the MCAs as to recovery of capital expenditure through Carry Tax Relief bars the application of the provisions of sections 10, 20, and 30, and the 2nd Schedule to the PPTA.

We are of the opinion that the Appellant has shown that it incurred cost during its petroleum operations. The Respondent is therefore bound to apply the provisions of sections 10, 20, and 30, and the 2nd Schedule to the PPTA accordingly; subject to the Respondent's entitlement to verification in accordance with the PPTA.

**Conclusion**

We allow the appeal in part. The provisions of the MCAs are applicable only to the extent that they do not affect the Appellants liabilities to pay tax under the PPTA. Regardless of the Appellant's and NNPC's failure to verify the cost allegedly incurred by the Appellant, the Respondent has the statutory duty to assess the Appellant's tax liability under the PPTA. The Appellant is entitled to make deductions in accordance with the provisions of the PPTA.

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[1] *Addax Petroleum Development (Nigeria) Limited v Federal inland Revenue Service* 8(ALL NTC) 181, 188 paragraphs 5-9

We therefore order the Respondent to effect this verification without further delay and issue fresh Notices of Assessment allowing the verified deductions from petroleum operations pursuant to section 10, 20, and 30, and 2nd schedule to the PPTA.

**Legal Representation:**

Mrs Olufunke Adekoya, SAN with Theophilus Emuwa Esq., Adedapo Tunde-Olowu Esq., Olanipekun Orewale Esq., Ibifubara Berenibara Esq. and Adefolake Adewusi for the Appellant.

Mrs B. D. Akintola for the Respondent.

**DATED AT LAGOS THIS 18TH DAY OF DECEMBER 2015**

**KAYODE SOFOLA SAN** (Chairman)

**CATHERINE A. AJAYI**
Commissioner

**D. HABILA GAPSISO**
Commissioner

**MUSTAFA BULU IBRAHIM**
Commissioner

**CHINUA ASUZU**
Commissioner