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

TAT/LZ/016/2013
TAT/LZ/017/2013
(CONSOLIDATED APPEALS)

BETWEEN

ESSO EXPLORATION & PRODUCTION NIG. LTD
SHELL NIG. EXPLORATION & PRODUCTION LTD .....APPELLANTS

AND

FEDERAL INLAND REVENUE SERVICE .....RESPONDENT

JUDGMENT

INTRODUCTION

The Appellants filed two appeals on 26th September 2013 challenging the Respondent's refusal to revise, reverse or discharge the respective Petroleum Profits Tax (PPT) and Education Tax (EDT) Notices of Assessments, PPTBA 35 and PPTBA/ED 37 both dated 5th June 2013 in respect of the OML 133 Contract Area for 2012 tax year; and to issue PPT and EDT receipts for the 2012 PPT and EDT assessments to all the Production Sharing Contract (PSC) parties in the OML 133 Contract Area. The two appeals were consolidated by an order of the Tribunal on 7th February 2014.

BACKGROUND DETAILS

The Respondent issued the Appellants with PPT and EDT Notices of Assessments, PPTBA 35 and PPTBA/ED 37 dated 5th June 2013 whereby it charged and assessed PPT and EDT on the operations of the OML 133 Contract Area for the 2012 tax year. The Respondent charged and assessed PPT and EDT on the operations on the OML 133 Contract Area on the Appellants in the sum of US$2,334,149,806.78 and US$96,703,857.67 respectively.

The 1st Appellant, on behalf of itself and the 2nd Appellant, objected to the assessments vide a letter of objection dated 13 August 2013 on the basis that at its

assessment, the Respondent incorrectly computed, amongst others, the adjusted/assessable profits for the OML 133 Contract Area in a manner inconsistent with the provisions of the PPTA, the Tertiary Education Trust Fund Act and the DOIBPSCA. As a result of the errors and misrepresentations in the Respondent's assessment, the PPT and EDT liabilities were understated and they ought to be US$2,377,878,652.00 and US$98,743,373.00 respectively.

The Respondent on 23rd August, 2013 refused to amend the notices of assessment stating that the Appellant's objection was submitted well over the allowed time for objection (30 days) after the notices of assessment were served on and acknowledged by the NNPC and that the returns were filed by the concessionaire of the Contract Area, who has the obligation to file returns with the Respondent as provided under the PSC. The difference between the Appellants' returns and the one prepared by NNPC is the basis of the reduced assessment and the source of disagreement between parties, which is the subject matter of this appeal.

In spite of the request made by the 1st Appellant to the Respondent, the Respondent refused to issue separate notices of assessment and individual PPT and EDT receipts bearing the respective names of all the parties to the OML 133 Contract Area, evidencing their pro-rata payments for the relevant tax year.

The evidence of the Appellants is contained in the respective witness statements of their factual witnesses, Mr Adegbola O. Salako and Mrs Olufunsho Eberendu as well as their expert witness, Mr Victor Onyekpa and admitted in evidence in these consolidated appeals.

The Respondent filed its response to the Notice of Appeal, but neither led any evidence nor tendered any documents before the Tribunal.

ISSUES FOR DETERMINATION

The following two issues are for determination:

1. Whether the Notice of Assessment issued by the Respondent is substantively defective and at variance with the provisions of the PPTA, the DOIBPSCA, the TETFA and other relevant legislations on appropriate treatment of tax items?

2. Whether the Respondent is obligated to issue separate PPT and EDT receipts bearing the names and pro rata payment of each of the parties to the OML 133 Contract Area?

PARTIES' POSITION

Issue One

Whether the Notice of Assessment issued by the Respondent is substantively defective and at variance with the provisions of the PPTA, the DOIBPSCA, the TETFA and other relevant legislations on appropriate treatment of tax items?

The Appellants argue that the cause of the dispute between the Appellants and the Respondent under this issue emanates from the fact that NNPC ignored the Appellants' returns and filed a different set of returns on the basis of which the Respondent determined the assessment. The Appellants state that this issue can be broadly divided into the following sub-issues:

a) The application of the wrong fiscal value of crude oil;

b) The application of the wrong Royalty rate;

c) Double-picking of Education Tax;

d) The wrongful exclusion of tax-deductible items;

e) The wrongful inclusion of non-tax deductible items;

f) The reclassification of expenses;

g) Exclusion of certain items from Capital Expenditure;

h) The wrongful treatment of Investment Tax Credit (ITC); and

i) Proration of Capital Expenditure.

The Appellants assert that the sub-issues listed above, except for item (c), were erroneous and should have ordinarily overstated the 2012 PPT and EDT liability for the OML 133 Contract Area, but the Respondent's double-picking of the amount of allowable EDT deductions in item (c) reduced the assessable/adjusted profit and therefore resulted in an understatement of the 2012 PPT and EDT liability for the OML 133 Contract Area.

The Appellants submit that the Respondent, in computing the fiscal value of lifted barrels of crude oil on the Contract Area for the 2012 YOA, applied NNPC's unilaterally determined Official Selling Price (OSP) as opposed to the actual realisable price which was applied by the Appellants, thereby causing a divergence in the gross proceeds from

the crude oil export liftings. The Appellants claim that as stated in the additional witness statement of Adegbola O. Salako, the Respondent's application of OSP contravenes the provisions of section 23 of the PPTA and the contractual agreement between the PSC parties.

The Appellants also submit that the Respondent, relying on the PPT returns wrongfully submitted by the NNPC, applied a royalty rate of 1% instead of 0.00331% sanctioned by paragraph 61(2) of the Petroleum (Drilling and Production) Regulations (PDPR). The Appellants further argue that the royalty rate for OML 133 PSC is currently in dispute and is receiving the attention of the Department of Petroleum Resources (DPR). They assert that paragraph 61(2)(a) of the PDPR provides that when the rate is in dispute, whatever the undisputed rate should be applied pending the resolution of the dispute. The Appellants add that the Respondent is bound to use the undisputed royalty of US$8,213,279,00 in computing the adjusted/assessable profit of OML 133 Contract Area for the 2012 YOA.

The Appellants argue that the Respondent erred in law by double-picking the amount of allowable EDT deductions thereby arriving at a lower assessable profit and thus resulting in an under-assessment of the EDT for the 2012 YOA. This is clearly shown in Exhibit AS 14.

The Appellants argue that the operator sole costs incurred respectively by the 1st and 2nd Appellant amounting to US$4,151,552.00 and US$8,983,847.00 – totalling $13,135,399.00 – were wholly, exclusively, and necessarily incurred on OML 133 Contract Area during 2012 YOA. The Appellants also submit that the 1st Appellant incurred interest on inter-company loan of US$2,993,769.00 and posit that the expenditure is allowable deduction according to Section 10(1)(g) of PPTA, as the 1st Appellant had obtained the loan from an affiliate company on arm's length basis for the purpose of conducting petroleum operations. They also relied on the evidence of the Appellants' expert witness (Exhibit VO 1) who articulated the reasonableness test of wholly, exclusively, and necessarily incurred expenditure. It also stressed that the sums incurred on inter-company loan interest must be under terms prevailing in the open market i.e. the London Inter-Bank Offer Rate (LIBOR). The Appellants also relied on the adjudication of this Honourable Tribunal in the recent case of *Nigerian Agip Oil Company v. Federal Inland Revenue Service*16 TLRN 25that interests on intercompany loans obtained at arm's length are tax deductible.

The Appellants submit that the Respondent, in arriving at the adjusted/assessable profits of the OML 133 Contract Area for the 2012 YOA, also disallowed other costs, specifically: Legal Costs (US$1,255,455.00), Head Office Overhead Charge (US$418,351.23), Investment Income (US$41,242.00), and Exploration and Intangible Drilling Costs (US$338,501.01) as being non-tax deductible expenses, contrary to

section 10(1) of the PPTA. The Appellants have provided the full details of these costs in Exhibits AS 11, AS 28, AS 29, AS 15, AS 31, AS 13, AS 30, and VO 1; and submit that they were all wholly, exclusively and necessarily incurred for the petroleum operations of the OML 133 Contract Area during the 2012 YOA.

The Appellants submit further that the Respondent, in arriving at the adjusted/assessable profits of the OML 133 Contract Area for the 2012 YOA, also wrongfully included certain expense items, specifically; G&G United Ways Costs (US$129,248.00), and Pension Adjustment Costs (US$5,852,495.82), as allowable expenses contrary to section 10(1) of the PPTA. The inclusion of these costs in allowable expenses resulted in a higher operating expense amount and a lower amount of assessable profits.

The Appellants state that the Respondent, in its computation of the qualifying capital expenditure (QCE) attributable to the OML 133 Contract Area for 2012 year of operation, included data acquisition and related costs amounting to US$19,633,668.86 and reclassified other expenses totalling US$416,318.61 as QCE which were already included in the Appellants' operating expenses thereby distorting the total QCE and the resultant capital allowances and investment tax credit (ITC). The Respondent had applied, as the amount of QCE, the sum of US$145,721,836.90 (instead of the **US**$128,730,910.95 incurred by the Appellant) thereby arriving at US$72,860,919 as the ITC claimable by the Appellants for 2012 year of operation; but has wrongfully reduced the value of capital expenditure by the amount of the applicable ITC for the purpose of claiming capital allowance rather than applying it as a full tax credit. This resulted in a significant reduction in the value of the QCE for the purpose of claiming capital allowance. Consequently the amount of capital allowance assessed by the Respondent (US$21,171,433.42) is significantly lower than the amount claimed by the Appellant (US$52,680,443). All these are clearly shown in Exhibits AS 2, AS 18, AS 16, AS 1, AS 17, and VO 1. The Appellants supported their argument with section 22 of the PPTA and section 4(1) of the DOIBPSCA.

The Appellants avers that the Respondent, in calculating the capital allowances due to the Appellants in the 2012 year of operation, has prorated the initial capital allowance due on the capital assets of the Appellants based on the month in the accounting year when the asset was purchased or put into use; this is a departure from the established law and practice of applying the full amount of annual capital allowance regardless of the time of year the capital expenditure was incurred. This pro-rata application caused a reduction in the capital allowance applied on the assessable profits and results in an increase in the chargeable tax payable on the OML 133 Contract Area for the 2012 tax year.

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The Respondent submits that it based its assessment on NNPC's returns for 2012 YOA. It argues that NNPC (the Concessioner) has the sole responsibility for filing returns in line with the provisions of the Production Sharing Contract (PSC), the PPTA and the DOIBPSCA.

The Respondent argues that parties to the Production Sharing Contract agreed that the Concessioner should file returns with the Respondent. The Respondent acted upon the returns filed by the Concessioner to compute both the PPT and EDT liability of the parties. The Respondent quoted extensively from the Production Sharing Contract document to buttress its point that NNPC has the mandatory responsibility of filing returns with the Respondent and that the returns filed by NNPC govern the basis of PPT and EDT assessment for OML 133 Contract Area.

The Respondent submits that since the Appellants' claims are mostly on the tax deductibility of its various expenditures on the OML 133 Contract Area, the only option available to the Respondent would be to conduct an audit exercise on the OML 133 to ascertain the Appellants' claims.

As regards the fiscal value of crude oil, the Respondent submits that the value of crude oil applicable is yet to be determined by the Ministry of Petroleum Resources or DPR, in view of the absence of a mutual agreement between parties on the issue. It also avers that this aspect of the dispute can only be settled by the parties to the PSC agreement themselves and that neither the Tribunal nor the Respondent can impose a fiscal regime on the parties.

With regard to applicable royalty rate, the Respondent argues that the Appellants in their written address (paragraph 49) assert that the dispute concerning the applicable royalty rate had been referred to the DPR and the DPR was yet to make a determination of the applicable royalty rate for OML 133 Contract Area. The Respondent agrees with the Appellants that the provisions of paragraph 61(2)(a) of the PDPR should prevail, but contends that the NNPC is the licensee and hence can take advantage of paragraph 61(2)(a) of the PDPR in deciding the applicable royalty rate.

The Respondent submits that concerning the issues of double picking of the EDT allowable deductions, disallowing the Appellants' expenses, interests on intercompany loans, and incorrect treatment of ITC and its impact on capital allowance, the Respondent has relied on NNPC returns. In addition, says the Respondent, under the PSC, NNPC has the sole right of filing returns and if the Appellants desired an explanation on the returns, such should be directed to the NNPC and not the Respondent. It submits further that for the expenses to be deductible they have to be verified by a thorough and comprehensive tax audit.

The Respondent urges the Tribunal to declare that the Notices of Assessment, PPTBA 35 and PPTBA/ED 37 issued in respect of the OML 133 Contract Area for 2012 tax year are valid and should be upheld.

Issue Two

> **Whether the Respondent is obligated to issue separate PPT and EDT receipts bearing the names and pro rata payment of each of the parties to the OML 133 Contract Area?**

The Appellants also aver that despite the request made by the 1st Appellant to the Respondent, the Respondent refused to issue notices of assessment and individual PPT and EDT receipts bearing the respective names of all parties to the OML Contract Area (i.e. the 1st and 2nd Appellants and the NNPC), evidencing their pro-rata payments for the relevant tax year. They argue that sections 37(1) and 38(1)of the PPTA provide that the Respondent is obligated to issue all parties named on a Notice of assessment with copies of the notice. They also argue that section 11(2) of the Deep Offshore and Inland Basin Production Sharing Contract Act (DOIBPSCA) provides that each of the parties to the contract must be issued with separate receipts, bearing their names, for the pro-rata taxes paid. They refer the Honourable Tribunal to its decision in *Esso Exploration and Production Nigeria limited & Anor v. Federal Inland Revenue Service* TAT/LZ/001/2013 in support of their submissions.

The Respondent submits that by virtue of Clause 15(6) of the PSC, NNPC is mandated to make copies of receipts issued by the Respondent available to each party; it is not categorical as to whether it is PPT or EDT that it refers to.

However, in relation to EDT receipt, the Respondent argues that sections 11(1) and (2) and 14 of DOIBPSCA are specifically applicable to PPT and not EDT as claimed by the Appellant. It states that section 8 of DOIBPSCA provides that EDT is regarded as cost recoverable under cost oil. The Respondent avers that if EDT receipts are issued in the name of the Contractor Parties, (i.e. the Appellants), there is the possibility of claiming credit for same in their home countries as taxes paid in Nigeria when the EDT amount had actually been recovered from the Government of Nigeria as allowable cost of operations. It therefore concludes that issuance of EDT receipts on the Contract Area would be against the wordings and spirit of the law.

ANALYSIS AND DECISION

Issue One

Whether the Notice of Assessment issued by the Respondent is substantively defective and at variance with the provisions of the PPTA, the DOIBPSCA, the TETFA and other relevant legislations on appropriate treatment of tax items?
The Respondent forecloses the Appellants from ventilating any grievances on PPT other than through NNPC. The Respondent ignored the substantive issues raised by the Appellants and insisted that it can only rely on NNPC returns. The Respondent says that, under the PSC, NNPC has the sole right of filing returns and airing tax-related grievances before it. The Respondent also contends that the Appellants should contact NNPC for PPT receipts and that they are not entitled to EDT receipts.

But as we have indicated in similar appeals in the past, the contractors to OML 133 Contract Area are recognised and accepted as taxable parties under the agreement and DOIBPSCA. The Respondent is well informed about this. NNPC is not a tax authority. It has no competence to test the allowability or otherwise of any expenses or costs in tax returns. NNPC's primary obligation relating to returns is to audit the veracity of the contractors' expenditure on OML 133 Contract Area, as reported in the returns rendered by the contractors. It should establish the genuineness of the income and expenses stated in the returns or any omission in them. NNPC must bring to the attention of the contractors any emanating disagreement in the contents of the returns. The contractors have the right to be informed of any consequential issues relating to their returns. This is because any alteration or modification to the contractors' returns will affect their tax positions. If NNPC has cause to file returns other than the one submitted to it by the contractors to OML 133, it owes the contractors explanation.

The parties to the contract are clearly stated in the PSC document and include the Appellants. The Appellants are co-taxpayers with NNPC and are chargeable to pro-rata taxes in their respective names. The Respondent's acknowledgement of the tax paid is a testimony of its knowledge of the extent of the Appellants' involvement. Thus, the Appellants are taxpayers with tax base of OML 133 Contract Area. They are aggrieved by the 2012 PPT and EDT assessments and have raised the matter with the Respondent. The Appellants' claims relate to allowability or otherwise of certain expenses/costs and the basis of royalty computation. Their protests hinge on points of tax law, which is the statutory mandate of the Respondent.

In articulating the roles of tax authorities, paragraph 2.9 of the National Tax Policy states that "the authorities should create a conducive tax atmosphere and environment which will engender taxpayer confidence at all levels of tax administration. In this regard, tax payers shall be provided adequate time and space to review, challenge, and appeal every tax assessment or demand made by the tax authorities and every claim, objection, appeal, representation or the like made by any taxpayer must be sufficiently considered."

Section 8(2) of the FIRS Establishment Act, 2007 states that "The Service may, from time to time, specify the form of returns, claims statements and notices necessary for the due administration of the powers conferred on it by this Act."

Since tax is charged on the Appellants' income from OML 133 Contract Area, their grievances cannot be suppressed by NNPC or the Respondent or both. The Appellants are entitled to fair hearing on their protests on PPT and EDT of OML 133 Contract Area. The Respondent owes listening duty to taxpayers whose tax affairs are placed before it. The Respondent must not discountenance taxpayers' grumbles when they come forward crying for justice and fair treatment of their tax affairs. The Respondent is required to view taxpayers' claims and objections within the overriding objective of its responsibilities for the entire tax regime. It is not fair for the Respondent to use NNPC as a shield to deny the Appellants their legitimate expectations of fair treatment of their tax matters. The Respondent has the inherent capacity of directing NNPC to review the areas of the Appellants' objection and confirm the genuineness of claims. It equally has capacity of inviting all parties to OML 133 Contract Area for roundtable discussion on the tax affairs where conflicting returns are presented to it. It is in the overall interest of the tax regime for the Respondent, to exercise such powers, if only to stimulate the confidence of taxpayers in the tax regime.

We direct the Respondent to liaise with NNPC to ascertain the veracity of the Appellants' claims and address with the computation or applicable laws. We also direct the Respondent to conduct a comprehensive tax audit on the OML 133 Contract Area to ascertain the correct PPT and EDT assessments for the 2012 YOA.

Issue Two

Whether the Respondent is obligated to issue separate PPT and EDT receipts bearing the names and pro rata payment of each of the parties to the OML 133 Contract Area?

Section 11(2) of DOSIBPSCA provides that "Separate tax receipts in the names of the Corporation or the Holder and the contractor for the respective amounts of petroleum profit tax paid on behalf of the Corporation or the holder and contractor shall be issued by the Federal Inland Revenue Service ... in accordance with the terms of the Production Sharing Contract."

Thus, it is the Respondent's duty to issue receipts for taxes collected from OML 133 Contract Area to all the parties. NNPC is a mere messenger for the delivery of receipts to the contractors. The Respondent did not say it has issued PPT receipts in favour of the Appellants. NNPC's duty of delivery of receipts to the contractors is dependent on the Respondent's action. If the Respondent neglects or fails to issue receipt, NNPC cannot transmit what it has not obtained from the Respondent. The Appellants are co-

taxpayers with NNPC and entitled to be issued with receipts bearing their respective names stating the pro rata taxes paid by each party.

Accordingly, we direct the Respondent to abide by Section 11(2) of DOSIBPSCA and issue appropriate receipts for the 2012 PPT and EDT paid by the Appellants.

CONCLUSION

The Appellants are entitled to the Respondent's attention on the tax-related disputes relating to returns on OML 133 Contract Area. The Respondent can only refuse to attend to or reject taxpayers' claims tabled before it on points of tax law. The channel of filing returns defined by a contract agreement is not a wholesome pretext for closing the door on an aggrieved taxpayer. We therefore direct the Respondent to liaise with NNPC to ascertain the veracity of the Appellants' claims and address them on points of tax law.

We set aside the Notices of Assessments PPTBA 35 and PPTBA/ED 37 (Exhibit AS 1) and direct the Respondent to conduct a comprehensive tax audit on the OML 133 Contract Area to ascertain the correct PPT and EDT assessments for the 2012 YOA.

We also direct the Respondent to issue PPT and EDT receipts to the 1st and 2nd Appellants on a pro-rata basis of tax paid for the 2012 YOA.

Legal Representation:

A. Atake Esq. with D. Komolafe Esq., Ms I. H. Whyte, A. Atitebi Esq., Mrs O. Adewunmi, S. Sulaiman and Ms B. Jaja for the Appellants.

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

DATED AT LAGOS THIS 2ND DAY OF JUNE 2016

KAYODE SOFOLA SAN (Chairman)

CATHERINE A. AJAYI
Commissioner

D. HABILA GAPSISO
Commissioner

MUSTAFA BULU IBRAHIM
Commissioner

CHINUA ASUZU
Commissioner

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