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Nigeria: Tax Treatment of Dividends from Gas Income

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The Tax Appeal Tribunal (''TAT'') has decided that gas dividends are liable to withholding tax which, it is understood, was affirmed by the Federal High Court. But a review of the applicable law and the tax accounting treatments that the dispute entails appears to raise doubt about the accuracy of the decision.

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In late 2014, the TAT, Nigeria's specialist tax adjudicatory body, ruled on a suit initiated by Nigerian Agip Oil Company Limited ("NAOC") against an assessment by the Federal Inland Revenue Service ("FIRS"). FIRS had assessed NAOC to withholding tax on dividends that the latter paid to its shareholders from its gas profits post-tax. Under the law, dividends from corporate profits generated from the sale of crude oil are not liable to petroleum income tax. This is because section 60 of the Petroleum Profits Tax Act ("PPTA") insulates from revenue tax, dividends paid out of profits that were "taken into account" in the calculation of chargeable profits on which petroleum profits tax is assessed. But it was not clear how profit distributions from gas revenues were to be treated. The resolution of this dispute therefore hinges on the determination of whether gas profits were "taken into account" in computing taxable incomes under the PPTA. The TAT answered this question in the negative, which led it to rule in favor of FIRS that gas dividends are liable to tax. NAOC subsequently appealed to the Federal High Court which, it is understood, upheld the TAT's decision.

Due to the concerted approach that major oil companies adopt in Nigeria regarding matters affecting the petroleum industry, especially tax, disputes involving this issue are replicated in several instances in Nigeria's upstream sector. Regarding taxation of gas dividends, some international oil companies, like NAOC, progressed their disagreement with FIRS to

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litigation, but others adopted a "wait and see" attitude, monitoring with keen interest, proceedings in the test case. Despite NAOC's present inability to argue against taxation of gas profit distributions, a technical analysis of the law appears to create room for some optimism among the international oil companies of a successful resistance of FIRS' gas dividend assessments.

Petroleum Revenues

By virtue of section 9(1) of the PPTA, petroleum revenues refer to four classes of incomes, namely:

(a) Sale proceeds of chargeable oil sold;
(b) Value of chargeable oil disposed of;
(c) Value of all chargeable natural gas; and
(d) Incomes incidental to or arising from petroleum operations.

Wrongful Omission of (c)

Beside receipts from liquid hydrocarbon, upstream profits extend to earnings from the sale of natural gas. However, a key difficulty currently faced by opponents of gas dividend taxation is that the 1990 version of the PPTA (the "1990 PPTA") does not include (c) as part of E&P profits.

When the PPTA was enacted in 1959, only (a), (b) and (d) were included as part of petroleum incomes. Subsequently, the PPTA was amended in 1979 ("1979 PPTA Amendment") with the addition of (c) to the 1959 list of upstream revenues. Subsequently, (c) was erroneously omitted in the 1990 PPTA as part of eligible profits.

There does not seem to be any statutory authority for the omission of (c). The Law Revision Committee, the body responsible for compiling the 1990 PPTA, was prohibited by its establishment enactment, from altering any enactment without the prior approval of the appropriate authority. Typically, approvals, under the establishment enactment, are evidenced by "statutory orders," and there is no statutory order authorizing the omission of (c).

Under Nigerian law, the mere omission of a provision or law from the compilation of laws does not tantamount to a repeal of that provision or law, and so, the provision or law would continue to have effect and validity. Hence, E&P incomes would include the value of chargeable natural gas.

As further proof of the invalid omission, the fourth Schedule to the PPTA (which was also introduced into the PPTA by the 1979 PPTA Amendment) was retained in the PPTA. The fourth Schedule contains the methodology for valuing natural gas. Its retention in the PPTA suggests that the omission of (c) was in error. Instructively, the fourth Schedule still bears reference to section 9(1)(c) of the PPTA (i.e. the value of chargeable natural gas).

Another reason for taking the view that the omission of the value of natural gas from the 1990 PPTA was in error is that section 11 of the PPTA, which contains gas related provisions, was enacted in 1998 and 1999. Prior to section 11 of the PPTA, taxation of gas incomes was under the PPTA. This was halted by section 11 of the PPTA, which transferred taxation of gas profits to the Companies Income Tax Act ("CITA"). Hence, the argument would not succeed, if indeed it can be made, that the omission of gas sales proceeds from the 1990 PPTA was as a result of section 11 of the PPTA (enacted in 1998 and 1999). It, thus, appears justified to hold the view that the value of chargeable natural gas is a component of petroleum revenues, notwithstanding its omission from the list of petroleum revenues in the 1990 PPTA.

Incidental Income does not Relate to Natural Gas Income

Moving to a related point, it has been posited in certain quarters, that sales proceeds of natural gas may qualify as upstream profits by reason of the inclusion in petroleum revenues of incomes that are incidental to or arise from petroleum operations. That being the case, the omission of (c) would not prevent the recognition of natural gas income as a part of petroleum profits. It is debatable if this is a correct interpretation of the relevant provision. Petroleum operations is defined as follows:

> means 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 a refinery, in the course of a business carried on by the company engaged in such operations, and all operations incidental thereto and any sale of or disposal of chargeable oil by or on behalf of the company.

Unlike chargeable oil whose sale or disposal constitutes petroleum operations, no such reference is made of natural gas. Rather, petroleum operations in relation to natural gas are confined to the processes of extraction through a wellhead (i.e. winning or obtaining) and transportation within Nigeria. It therefore seems plausible to argue that, with respect to natural gas, only incomes earned in the course of drilling and transportation should fall within the category of revenues incidental to or arising from petroleum operations.

Taxing Gas Incomes

The first step in taxing gas incomes is to determine the amount. Gas revenues are determined in accordance with the methodology in the fourth Schedule to the PPTA. In determining gas sales values for tax purposes, some discount, which represents losses arising possibly from evaporation, is deducted from the price of the gas sale and purchase agreement.

The second step in taxing natural gas revenues is transferring these incomes to CITA where they are taxed. Although gas revenues are part of upstream earnings, they are taxed not under the PPTA, but by reference to the taxing provisions in CITA. This is by virtue of section 11(2)(d) of the PPTA which provides that gas income and profit is to be taxed under CITA.

Another Example of the Application of Multiple Laws in Determining Tax

As is clear from the taxation of gas incomes, Nigerian law permits the use of tax values derived from one law in calculating tax created by another law. The country's tax system does not always erect strict demarcations between its tax laws, such that an outcome in one tax legislation is solely determined by provisions of that law without any impact by provisions in another tax statute. In certain cases, Nigeria's tax system requires compliance with more than one statute in tax computation.

Another example of a tax being impacted by more than one law is in the calculation of education tax. Education tax, payable by virtue of section 1(2) of the Tertiary Education Trust Fund (Establishment) Act ("TETF Act")), is calculated at 2 percent of assessable profits. However, the TETF Act does not contain provisions for determining assessable profits. Rather, it provides that assessable profits shall be ascertained in compliance with either the PPTA or CITA. Thus, the computational machinery for determining the base value for education tax is outside the TETF Act. Similarly, the basis for determining gas revenues is absent in CITA, but present in the PPTA.

Treatment of Natural Gas Income in PPT Computation

Step 1—Calculate Petroleum Profits

The calculation of petroleum revenue tax requires as a starting point, the aggregation of all the incomes that constitute gross petroleum revenues. Gross upstream incomes include several components, one of which is natural gas profits.

Step 2—Deduct Natural Gas Income from Gross Petroleum Profits

Section 11(2)(d) of the PPTA provides that taxation of gas income shall be under CITA. Consequently, deduct natural gas income from gross petroleum revenues to arrive at petroleum revenues.

Step 3—Continue with Calculation of Chargeable Profits

The computation process should continue to adjusted profits (petroleum profits – expenses), assessable profits (adjusted profits/ losses) and chargeable profits (assessable profits/capital allowances).

Step 4—Continue to Calculation of PPT

Thereafter, tax is charged and assessed on the chargeable profits at either 85 percent (as under the PPTA) or 50 percent in accordance with the Deep Offshore and Inland Basins (Production Sharing Contracts) Act (the "PSC Act").

As is evident from the table, revenues from natural gas are first added in the calculation of E&P incomes, and thereafter deducted. In other words, gas profits are first recognized, and subsequently deducted in compliance with the law.

Another Example of this Type of Tax Accounting (Recognition and Deduction)

Income tax calculation that involves, firstly, the recognition of an item and secondly, the deduction of that item is not strange, but reminiscent of the computational framework for taxing dividends under CITA. Nigeria's income tax system requires withholding tax from payments to a recipient company. At the end of the accounting period, the recipient company's gross incomes for that year are aggregated in line with section 9 of CITA for the purpose of determining its total profits. Under CITA, total (or taxable) profits are gross profits less deductions (i.e. expenses, capital allowances and losses). Total profits are then multiplied by the tax rate (i.e. 30 percent) to generate the recipient company's tax liability. In paying its tax liability, a credit is allowed the company that is equal to the withholding tax earlier remitted on its behalf.

Under CITA, dividend is taxable at the statutory rate for business revenues (i.e. 30 percent) since, by virtue of section 9(1)(c), dividend constitutes part of gross profits. However, by virtue of a subsequent provision (section 80 of CITA), dividend is liable to withholding tax at 10 percent of the gross amount of the dividend, which tax is final. In other words, post-withholding tax dividend is not liable to additional tax. Now, this potentially generates some uncertainty regarding how to tax dividend. On one hand, dividend is to be included in a company's gross profits upon which income tax at 30 percent shall be payable, and on the other hand, the withholding tax on profit distributions is the final tax.

Tax Accounting for Dividend

- Deduct and remit withholding tax from dividend at the time of paying dividend to the recipient company (shareholder).
- Recipient company will include dividend in CIT computation in calculating gross profits.
- Deduct dividend from gross profits to produce corporate profits.
- Deduct the company's expenses and capital allowances from corporate profits to produce total profits.
- Multiply total profits by 30 percent to generate company's tax liability.

This way, the company would satisfy section 9(1) of CITA that requires incomes aggregation, which incomes include dividend, and section 80(3) of CITA that forbids any tax on dividend post-withholding tax.

Tax Regime for Gas Dividends

Gas revenues are taxed under CITA, and so, ordinarily, it should not be moot whether gas profit distributions should be taxed. Generally, dividends paid out of business profits that are taxed under CITA are liable to withholding tax. Prior to paying dividend to its shareholders, a company whose profits are taxable under CITA is to withhold a percentage of the dividend and remit same to FIRS as representing the tax on the income earned by the shareholders.

However, Nigeria's E&P tax system does not permit these double layers of income taxation. It incentivizes upstream investment by exempting investors and project sponsors from taxation on any profit they receive from the project company. The relevant provision (section 60 of the PPTA) states as follows:

> No tax shall be charged under the provisions of the Personal Income Tax Act or any other law in respect of any income or dividends paid out of any profits which are taken into account, under the provisions of the

Representation of a Simplified PPT Computation

		US$	US$
Add: (s. 9 (1) PPTA)			
a. Sale proceeds of chargeable oil sold		XX	
b. Value of chargeable oil disposed of		XX	
c. Value of all chargeable natural gas		XX	
d. Incidental incomes		XX	
Gross Petroleum profits			XX
Deduct:			
Value of all chargeable natural gas	(s. 11 (2) (d) PPTA)	XX	
Petroleum profits			XX
Deduct:			
Expenses	(s. 9 (3) PPTA)	XX	
Adjusted profits			XX
Deduct:			
Losses	(s. 9 (4) PPTA)	XX	
Assessable profits			XX
Deduct:			
Capital allowances	(s. 9 (5) PPTA)	XX	
Chargeable profits			XX
Multiply at 85% (s. 21 (1) PPTA) or 50% (s. 3 (1) PSC Act)			
Assessable tax			XX
Deduct:			
Investment tax credit	(s. 4 (1) PSC Act)	XX	
Chargeable tax			XX

> Act, in the calculation of the amount of any chargeable profits upon which tax is charged, assessed and paid under the provisions of this Act.

In a nutshell, an oil company is not required to withhold tax from dividends paid out of profits which were taken into account in calculating its chargeable profits upon which its petroleum profits tax is assessed. Applying this provision to oil dividends does not create any interpretational problems as oil revenues are within the taxing limit of the PPTA. But the issue gets shrouded in uncertainty when discussions turn to the impact of section 60 of the PPTA on distributions of gas profits.

Non-taxation of Gas Dividends

Meaning of Section 60 of the PPTA

Section 60 of the PPTA states as follows:

> No tax shall be charged under the provisions of the Personal Income Tax Act or any other Act in respect of any income or dividends paid out of any profits which are taken into account, under the provisions of this Act, in the calculation of the amount of any chargeable profits upon which tax is charged, assessed and paid under the provisions of this Act.

A thing is "*taken into account*" when that thing is considered. That thing need not be accepted or applied; it is sufficient if it is thought of, recognized or attention paid to it, in the course of making a decision. Thus, by capturing gas incomes in its PPT computation, an E&P company has taken such income into account or recognized it in calculating its chargeable profits. This is similar to the notion of taking expenses or capital allowances into account or consideration in calculating chargeable profits. The deduction of expenses or capital allowances does not mean that they were not recognized or taken into account in calculating chargeable profits.

Practical Points

In conclusion, the following practical points are considered:

- Natural gas income is part of petroleum profits, its omission from the 1990 PPTA notwithstanding.
- The aggregation of various incomes, including natural gas income, is the first step in calculating chargeable profits on which petroleum profits tax is assessed.
- By including natural gas incomes in the PPT computation, these incomes are recognized and therefore taken into account when calculating chargeable profits.
- The subsequent deduction of gas profits in the PPT computation should not affect the notion that these profits were taken into account in calculating chargeable profits.
- A parallel can be drawn between the tax treatment of natural gas income and that of expenses and capital allowances, which are similarly recognized and deducted in PPT computation.
- To deny that natural gas profits are taken into account in determining chargeable profits would equally imply that expenses and capital allowances are not recognized or considered in the process that leads up to petroleum profits tax assessment, which can hardly be made.
- Consequently, the recognition of gas revenues in PPT computation brings these revenues within the scope of incomes that are protected by section 60 of the PPTA.

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