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Taxation of EPC Contracts: Analysis of Nigerian Case Law and Emerging Trends

*By Kingsley Amaefule**

Introduction

EPC contracts with significant foreign elements are a common feature in Nigeria's economy especially in the petroleum industry where substantial components of the technical requirements for project development do not exist domestically but are sourced from abroad. Considerable tax planning is deployed into designing a structure that shields majority of the incomes from such contracts from Nigerian tax. The usual structure is to demarcate activities in a turnkey project into overseas and local elements, with the former executed outside Nigeria and the latter performed in-country.

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Certain reasons which include deficiency in local technology had, in the past, impelled the performance of the more technical aspects of major infrastructure projects in engineering yards outside the country while delivery and installation, tasks which are domestic in nature and within local competence, are undertaken in-country. A common operational structure for this type of arrangement is that the foreign contractor would subcontract the domestic segments to Nigerian firms in a bid to ring-fence the overseas revenues from local taxation. Usually, the overseas–domestic revenues matrix is heavily skewed in favour of offshore incomes, the implication being that only a small fraction of contract sum is available for local taxation. Over time, the tax benefits of this arrangement have motivated the continuation of this practice notwithstanding advancements in local technology.

It is for this reason that arrangements of this nature receive a hostile reception from FIRS,[1] Nigeria's federal tax authority. As Nigeria pursues a multiple income-based economy by de-emphasizing petro-revenues and shoring up, *inter alia*, its tax collection capacity, turnkey contracts will increasingly attract FIRS' scrutiny, increasing the chances of income tax disputes. In recent years, Nigerian courts have been called upon to resolve revenue litigation arising from EPC projects. But, the law seems far from settled as recent statements of Nigerian courts have rather tended to introduce uncertainty into the tax implications of turnkey transactions. In this article, this author will endeavour to explain the income tax regime for turnkey transactions and attempt a critique of applicable case law with legal analysis and illustrations from commercial arrangements and operations.

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Tax Regime for Turnkey Projects

A turnkey transaction is one where "the contractor undertakes the entire responsibility from design through to completion and commissioning. The client only has to turn the proverbial key to make everything function as it should."[2] An EPC project could also be described as a one-off major construction project in a country where usually a foreign contractor (operating either alone or as a leader of a consortium of firms) is responsible for the design and construction of a facility.[3] A turnkey project is typically comprised of different operations which are executed in distinct phases. The performance of each phase is necessary for the completion and delivery of a specific infrastructure.

Nigeria's income tax legislation does not expressly reference income from EPC projects as the subject of corporate tax. Rather, it is inferred from Code Sec. 13(2)(c) of CITA[4] which provides that the profits of a foreign company from a trade or business shall be deemed to be derived from Nigeria if that trade or business "involves a single contract for surveys, deliveries, installations or construction."[5] Under Nigerian law, taxable incomes include profits that are derived from Nigeria.[6] For foreign companies, it is sufficient if their revenues are deemed to be derived from Nigeria.[7] Code Sec. 13(2) contains a list of circumstances that qualifies revenues of non-resident firms to be deemed to be derived from Nigeria and therefore chargeable to income tax. One of these circumstances is provided for at Code Sec. 13(2)(c) of CITA which relates to incomes from a single contract for surveys, deliveries, installations and construction.

An essential feature of Code Sec. 13(2)(c) is the enumeration of activities that would be performed locally and abroad. By way of illustration, a contract to South Korea's EPC giant, Samsung Engineering, for an FPSO[8] off Nigeria's Niger Delta would, perforce, involve the delineation of the project into several phases, roughly in this sequence: survey of the oilfield, design of the FPSO, procurement of materials and parts, fabrication of individual parts of the facility and other engineering processes, construction, ocean transportation and inland delivery of the FPSO and finally, installation and commissioning in Nigeria's deepwaters. Typically, FPSO development entails sophisticated processes in the home state of the international contractor while less technical processes are performed domestically, because, beside a lack of technical capacity inhibiting the execution of projects of this size in-country, foreign companies have a bias for undertaking major operations in their home countries. While survey is inherently a local task, the succeeding activities, with the exception of inland delivery, installation and commissioning, are customarily performed abroad.

Prior to the enactment of Code Sec. 13(2) in 1993, revenues from the offshore works of a turnkey contract were not taxable in Nigeria. Then, the operative tax regime was Code Sec. 11(2) of CITA (as at 1990) which deemed as Nigerian profits the incomes of a foreign company that were not attributable to any of the company's operations executed outside Nigeria, which carried the implication that revenues attributable to foreign activities were not liable to Nigerian tax. It was this provision's obvious inability to capture overseas revenues that led to its replacement with Code Sec. 13(2)(c). Briefly put, the objective of Code Sec. 13(2)(c) is to qualify for Nigerian tax profits from an EPC project, notwithstanding the performance of aspects of the project outside the country.

One Contract, Foreign and Local Components

Recently, Nigerian courts were confronted with the question of the taxation of EPC contracts. The first of this was *Saipem*,[9] where SNEPCO, a Nigerian subsidiary of Shell, awarded a deep offshore petroleum contract to a consortium of contractors, the non-resident contingent (French and Portuguese companies) of which performed their share of the contract overseas while the Nigerian member of the consortium undertook the local activities. Subsequently, a dispute arose over whether the profits of the foreign companies from the contract were liable to Nigerian income tax, which was answered in the affirmative by the court. Without sufficient elaboration, the court held that the incomes of the foreign companies were derived from Nigeria in line with Code Sec. 13(2)(c) and therefore taxable in Nigeria.

Buttressing its position, the court stated that the subject of taxation is the foreign companies' profits derived from the contract with a Nigerian company, signed in Nigeria, performed for Nigeria's benefit and to be paid for by the Nigerian entity. This reasoning seems dubious considering that the only requirement for tax under Code Sec. 13(2)(c) is that the contract is turnkey and not that it was awarded by a Nigerian entity, signed in Nigeria, for Nigeria's benefit and paid for by a Nigerian entity. Also, it is not Nigerian law that revenues from a transaction or activity that confers a benefit on the country become liable to tax as a consequence.

The second case was *JGC*.[10] Although this case is more of an authority for the split contracts concept, which is discussed below, it contains certain statements in relation to Nigeria's tax regime for EPC transactions. The facts of this case are that Mobil awarded two contracts for the

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completion of its EPC3 Bonny Terminal project in Nigeria. One of the contracts was to JGC, an international engineering company headquartered in Japan, for operations to be performed wholly outside Nigeria and the other was to a consortium of JNL (JGC's Nigeria subsidiary) and Daewoo, for certain tasks in Nigeria. Specifically, the EPC3 project had procurement and engineering activities which constituted the overseas functions on the one hand while the local end of the project comprised of construction, inland delivery and commissioning. A dispute arose from FIRS' attempt to tax JGC's income from the overseas contract. After an initial setback at the TAT,[11] the adjudicatory forum of first instance, JGC appealed to the Federal High Court which accepted JGC's arguments that its contract revenues were not liable to Nigerian tax.

But in the course of its judgment in *JGC*, the court opined that when a contract has both overseas and local components, any income that is apportionable to the foreign activities would not be liable to Nigerian income tax so long as the contract provides for distinct pricing for each of the components. In reaching this decision, the court relied on Indian case law[12] in which the Indian Supreme Court held that, notwithstanding that a certain contract was turnkey, incomes from the offshore functions were not liable to Indian revenue tax as they were not attributable to operations undertaken in India. It is this author's view that this statement of the Federal High Court is not representative of Nigerian law. Taking recourse to case law to explain statute is not appropriate unless the case law was a product of statutory provisions similar to the legislation under consideration. In *Ishikawaima-Harima*, the Indian apex court considered Art. 7 of the Double Tax Avoidance Agreement between India and Japan (the "DTAA"), which is essentially the converse of Nigeria's Code Sec. 13(2)(c). Art. 7 provides as follows:

> The profits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business aforesaid, the profits of the enterprise may be taxed in that other Contracting State but only so much of them as is directly or indirectly attributable to that permanent establishment.[13]

Ishikawaima-Harima had to do with an EPC project where the overseas and in-country components were clearly demarcated. The foreign activities were undertaken by a Japanese company in its home country while the domestic segments were carried out in India. In view of the uncertainty surrounding the Japanese company's revenues from the foreign activities, it sought an advanced ruling from the relevant Indian tax authority. Unhappy with the ruling, the Japanese contractor initiated litigation. In the Supreme Court's view, and rightly so, the matter fell within the purview of Art. 7 of the DTAA which excludes from Indian income tax jurisdiction any income of a Japanese entity that is not attributable, whether directly or otherwise, to a PE[14] in India. The effect of this is that, notwithstanding that its revenues were generated from an EPC contract, the Japanese company was not liable to Indian tax to the extent that those revenues were not from any Indian operations. As stated above, Art. 7 of the DTAA is the opposite of Nigeria's Code Sec. 13(2)(c) which subjects to Nigerian income tax profits from overseas operations that are generated from an EPC contract.

DTAs[15]—Any Reprieve from Taxation of EPC Revenues?

In *Saipem*, one of the contractors was a French company and it was contended on its behalf that its profits from the overseas works were not liable to Nigerian income tax by virtue of Art. 7 of the France/Nigeria DTA which seeks to protect the profits of French contractors from Nigerian tax unless the profits are attributable to a PE in Nigeria. This argument was rejected by the court which instead resorted to Code Secs. 9(1) and 13(2)(c) in support of its decision that the profits of the French firm were subject to Nigerian tax. Scant, if any, attention was paid to the France/Nigeria DTA, as in the court's view, the target of Nigerian tax was the incomes of the French company from the foreign components of the contract that it executed for a Nigerian entity and not its global profits which may be chargeable in France. Another reason for the dismissive attitude to the DTA was the court's view that accepting, on the basis of the DTA, that the French company's incomes were not subject to Nigerian tax would result in the DTA having the effect of denying Nigeria of revenues within its taxing powers and transferring those profits to another state for taxation.

It is debatable whether the court was right to ignore the DTA in determining the liability to income tax of an enterprise from a Contracting State. While CITA applies to all companies generally, DTAs have overriding impact, by the consensus of Contracting States, in deciding the liability to tax of companies resident in one Contracting State and earning incomes from another Contracting State. Inherent in the DTAs is the concept of PE, which supersedes Code Sec. 13(2) CITA as the operative requirement for

taxing incomes of a foreign company from a Contracting State.[16] A PE is a fixed place of business from which a foreign entity wholly or partly carries on its business and its identification is necessary for taxing incomes of a non-resident entity in a Contracting State.

Interestingly, Nigeria's DTAs do not contain a provision with a tax effect that is similar to Code Sec. 13(2)(c). In fact, Art. 7, the principal DTA provision on taxation of revenues from EPC transactions, appears to be the direct antithesis of Code Sec. 13(2)(c). Art. 7(1) provides that the profits of a non-resident enterprise shall be taxable in a Contracting State only if the profits are attributable to a PE in the Contracting State. In effect, the incomes from the overseas activities of an EPC firm from a Contracting State would fall outside Nigeria's tax jurisdiction with the exception of revenues that are attributable to the Nigerian operations of the turnkey project.

Regarding the arguments of the French member of the consortium, the last is yet to be heard about them as the key issue for determination remains unresolved which is the tax implication of its revenues in view of Art. 7 of the France/Nigeria DTA. The above-cited Indian Supreme Court case[17] would have a weighty precedential value in the appeal on *Saipem*.[18] *Ishikawaima-Harima* involved a consortium of firms required to deliver a turnkey LNG storage and degasification facility in the Indian state of Gujarat. The project was structured such that certain activities were performed overseas by the Japanese member of the consortium. Unsure of its income tax liability, the Japanese contractor sought an advance ruling from the relevant Indian tax authority and commenced litigation on receiving an unacceptable decision. In deciding this case, the Indian apex court relied on the DTAA between Japan and India and held that by virtue of Art. 7(1) of the DTAA, which is the same as Art. 7(1) of the France/Nigeria DTA, the Japanese firm had no tax exposure with respect to its profits from the overseas components of the LNG project.

Furthermore, besides shielding foreign revenues from local tax, DTAs present avenues for excluding profits from local components from Nigerian tax. Under some Nigerian DTAs, certain structures such as building sites, construction and assembly projects, and supervisory activities do not constitute PE immediately, but must first meet a threshold period of, for the most part, three (3) months. The implication is that no PE would be created if local operations terminate by the cut-off date. Drawing this point to its logical conclusion would mean the exclusion from Nigerian tax of revenues attributable to the installation of pre-fabricated parts of a stadium in Nigeria by a firm from a Contracting State before the cut-off date.

However, it does not seem that a foreign enterprise can avoid local taxation by subcontracting survey and delivery activities to local companies. It is often the case that the non-resident firm will make some profit from subcontracting by paying the local contractors less than it would expend in executing these in-country activities. As noted earlier, Art. 7(1) subjects to Nigerian tax profits of a non-resident company that are attributable to a Nigerian PE and through which PE the business of the company is carried out. The language of Nigeria's DTAs appears inclined to prevent revenues of a foreign company from escaping Nigerian tax in so far as the revenues are attributable to any business carried on by the company in Nigeria. In other words, the overseas firm will not be allowed to argue that by subcontracting, the survey and delivery activities are no longer its business.

Nigerian case law has addressed this point in a much earlier decision. In *Offshore S. A.*,[19] the Federal Revenue Court[20] held that the plaintiff, a Panamanian company, was carrying on business in Nigeria even though it had no physical presence in Nigeria. This case involved agreements by the foreign company to provide oil well drilling and completion operations for Shell-BP, Mobil Oil and Japan Petroleum Company in Nigeria. For this purpose, the non-resident enterprise incorporated a local subsidiary to which it subcontracted the portions of the contracts to be performed in Nigeria. At the time,[21] the applicable provision of CITA[22] regarded as Nigerian incomes any profits of a foreign company that were not attributable to any of its operations elsewhere. In response to an assessment on its revenues from the local services, the foreign company contended that it had no business in Nigeria and could not therefore be liable to income tax on its profits from the portions of the contracts executed in-country. But the court demurred, preferring instead the argument that by performing through a local firm, services that could only be performed in Nigeria, the plaintiff was carrying on business in Nigeria.

Is This the End of the Road for an EPC Company from a Non-Contracting State?

Perhaps not. The conclusion of the matter is not as straightforward as the court made it out to be in *Saipem*. While companies from non-Contracting States would not enjoy the DTA benefits that would exempt foreign revenues from income tax, there, nevertheless, appears to be available to such enterprises some arguments against EPC taxation. Disputes similar to that in *Saipem* are present in

several other instances in Nigeria's hydrocarbons industry. The successful exploration of contract areas under Nigeria's Production Sharing Contracts (PSC) led to awards of various oilfield contracts to specialised international contractors who designed their operations with an eye on tax efficiency.

A case in point is a contract (EPCI Contract) awarded by one of the IOCs operating a Nigerian PSC to a consortium of local and foreign contractors for engineering, procurement, construction, installation, pre-commissioning, commissioning and other ancillary services in relation to flowlines, risers, offloading systems and offshore works necessary for exploiting the offshore petroleum resource (Works). The foreign contingent of the consortium also included French and Portuguese companies. The EPCI Contract provides that the consortium members were jointly and severally liable to the IOC for the Works. Also, the EPCI Contract incorporates a Consortium Agreement between the consortium members which specifies the individual scope of work for each consortium member under the EPCI Contract. The Consortium Agreement specifically indicates, in the case of the Portuguese contractor, that three of its four operations will be undertaken outside Nigeria.[23]

Financial terms in the EPCI Contract provide for both a contract price and variable prices for different tasks. The EPCI Contract obliges the IOC to pay and the consortium members to accept a contract price as full compensation for the performance of the Works. Each consortium member is to submit, through the leader of the consortium, its invoices for the part of the Works it performs to the IOC for payment. Payment mechanism contains a mandate to the leader of the consortium to communicate to the IOC instructions to pay directly into the account of each consortium member the sums invoiced by that member.

With payment periods under the EPCI Contract looming, part of the IOC's concern devolved on whether its payments to the contractor from a non-Contracting State (*i.e.,* the Portuguese firm) for the performance of its portions of the Works constituted Nigerian income and therefore taxable. While the IOC was not in a position to derive any gain regardless of the answer, it was exposed to significant risk if it made full payments to the contractor without withholding a portion of the payments as its income tax. Nigerian law requires paying companies to deduct and remit to the FIRS, an amount from payments that qualify for income tax.[24] As would be demonstrated shortly, the IOC's concern remains unresolved.

As noted above, a firm from a non-Contracting State can still make certain arguments against turnkey impost. Turnkey revenues of a contractor that performs engineering and procurement may not qualify as Nigerian income since the activities it performs are not expressly included in Code Sec. 13(2)(c). Code Sec. 13(2)(c) does not mention engineering, procurement, *etc.*, as activities the revenues of which are Nigerian incomes. The applicability of the EPC tax regime should be confined to profits from operations that are expressly mentioned in CITA, and not extended gratuitously to capture incomes from unreferenced activities. Also, engineering and procurement are important processes for infrastructure delivery and their omission from the list of activities in Code Sec. 13(2)(c) is tellingly indicative of a clear legislative intent that does not recognise revenues from such activities as Nigerian incomes.[25]

Furthermore, to the extent that no part of the business or trade of an enterprise from a non-Contracting State involves activities that are local in nature, it may resist taxation. It is apposite at this juncture to investigate the purport of Code Sec. 13(2)(c) a bit further. This provision states that "the profits of a company other than a Nigerian company from any trade or business shall be deemed to be derived from Nigeria if that trade or business or activities involves a single contract for surveys, deliveries, installations or construction, the profits from that contract." Basically, this means deeming as Nigerian profits, the incomes of a foreign company from a trade or business where that trade or business involves a contract with onshore and foreign activities. Since an EPC contract contemplated by Code Sec. 13(2)(c) involves the performance of at least one component in-country, this provision can be rephrased thus; that the business incomes of a non-resident firm would be deemed to be Nigerian revenues if the business of the foreign company involves a contract with domestic and overseas activities.

So, the in-country element is key and must be present for the business of the foreign entity to come within the precincts of Code Sec. 13(2)(c). For FIRS to succeed, it would have to demonstrate that the business of the foreign company from which the profits are generated was in relation to Nigerian and offshore activities. A foreign company whose participation in an EPC transaction is restricted to overseas operations may therefore argue that the business through which it generated the profits does not involve any local element, and consequently, any revenues from this business should not be deemed to be derived from Nigeria.

Thus, a contract creating different obligations and assigning various functions just like the EPCI Contract could be signed by several parties. However, it should not be presupposed that the business of each party is the range of activities provided for in the contract. Rather, the

business of each party extends only to the activities that it performs under the contract. To counteract this argument, each contractor would have to be assigned both domestic and foreign activities under the contract.

Also, the non-resident company can argue against income tax on the ground that a contract with multiple parties, obligations and tasks similar to the EPCI Contract is not a single contract, but contains a multiplicity of contracts in the mode of split contracts. Tersely put, the split contracts concept refers to a situation where activities relating to a turnkey project are separated into two or more contracts by the project owner and awarded as individual contracts. Typically, the composition of each contract is determined by the location for contract execution. Activities that would be performed abroad are lumped into separate contracts while the remaining tasks are gathered into another set of contracts for domestic performance.

Clearly, Nigeria's turnkey tax regime is not as straightforward as it appears to practitioners, taxpayers and the courts.

In support of the split contracts argument, reference can be made to provisions in a multiple-functions contract that splits the activities to be performed by the consortium members and assigns to each contractor a distinct set of tasks. Evidence that each contractor deals directly with the project owner regarding its invoices and payments are made directly into their respective accounts may be useful. These two features would appear to bolster the contention of the foreign enterprise that the contract is a split one in which the tasks assigned to it constitute a distinct and separate contract from those of the other members. By agreeing a system that separates the activities under the contract and assigns them to specific members of the consortium, as well as accepting an invoicing system under which it recognizes and deals directly with each contractor, the project owner should be imputed with the intention to create split contracts within one contract documentation.

It could be canvassed that this approach was taken in preference to having separate contracts with each consortium member which would undermine the single point of responsibility, a key benefit of conventional turnkey arrangements. Traditionally, EPC projects are preferable to project owners because they ensure effective transfer of project risks to contractors, whose duty is to deliver a "ready to use" facility. But over time, project implementation structures have witnessed a revolution owing to increased specialization and the difficulty in identifying a contractor that warehouses the various technical skills and expertise required for sophisticated and highly complex infrastructures. Hence, project owners are compelled to source requisite services from different contractors.

The USD9b Dangote refinery offers a fine example of the diverse expertise and operations major infrastructure projects entail. Dangote refinery in Lagos, Nigeria, would on completion in 2019 be the largest single train facility in the world. A host of international contractors are involved in the project, namely: Engineers India, US' UOP, C & I Leasing, China's Hang Xiao Steel, Luxembourg's Jan De Nul Group, and suppliers, such as MAN Diesel and Turbo, Air Liquids E & C, Fabtech, Schneider Electric, SOFEC, and India's WABAG. These companies handle various aspects of the project, ranging from EPC to process automation systems, catalyst regeneration systems to steel structure for the refinery, compressor trains, SMR units, and provision of sundry plants and equipment.[26]

But separating project development phases and assigning each to the relevant expert in line with the split contracts structure may not necessarily represent an efficient system for project owners as it allocates risk amongst different contractors and weakens the project risk management virtue inherent in turnkey arrangements.[27] It also creates the risk of horizontal defence where a contractor relies on another's default as a defence for its own default.[28] To remedy this, project participants have developed a contract system that provides for project execution by a consortium of contractors who agree to perform distinct services. Perhaps, the nickname for this kind of arrangement "umbrella agreements" epitomises the fact that a collection of contracts are collated into one documentation. So, "umbrella agreements" evolved to cure the risk dispersal problem in split contracts arrangements while retaining the project owner's ability to aggregate diverse skill sets and expertise in a manner reminiscent of the split contracts system.

Instructively, a common denominator appears in both multiple-obligations arrangements and split contracts which is the collation of onshore activities and overseas tasks required for project development and their allocation to local and foreign contractors, respectively. The fact that multiple-functions contracts are contained in one documentation should not obscure the significance of the similarity between both contract systems. Nigerian law recognises the doctrine of equity that looks to the substance of a matter and not its form. While the form of split contracts and multiple-obligations contracts may differ, in substance they are basically alike.

Conversely, arguments can be made in favour of taxation, one of which is that engineering and procurement fall within the processes typically undertaken in construction. Construction contracts are building contracts.[29] In a turnkey construction project, it is reasonable to expect the contractor to undertake surveys, engineering, procurement and the other processes required to ensure construction of the facility, otherwise, he would be liable for breach of contract. It would lie ill in the mouth of such a contractor to argue that its obligation to construct does not involve any unmentioned process that ordinarily precedes construction. Consequently, to the extent that engineering and procurement are industry processes antecedent to construction, their omission notwithstanding, they are implicit in construction and come within the contemplation of Code Sec. 13(2)(c) CITA. In fact, turnkey projects have come to be denoted by the acronym EPC as proof of the strong connection between engineering, procurement and construction.

In response to the split contracts argument, it may be necessary to highlight the significance of the expression "a single contract" in Code Sec. 13(2)(c) as meaning what it says—one contract which irrespective of the multiplicity of obligations aims to achieve a single purpose—the construction of a facility. Consequently, the embodiment of obligations and functions in one contract renders revenues from the execution of that contract eligible for EPC taxation. It is irrelevant if specific tasks are assigned to individual contractors with distinct prices for each set of services. In other words, provisions for separate and distinct obligations in a contract should not transform such a contract into multiple contracts. Indeed, in contracts with more than two parties, contract participants may divide the obligations amongst themselves in order to create certainty in terms of allocation of obligations and ensure efficient project management and execution. Internal arrangements of this nature should not be imputed with the effect of creating separate contracts within the main contract.

There may be other features that tend to suggest that the parties intended a single contract. For instance, a contractual provision for joint and several liability may be a strong submission against split contracts argument. Liability is joint and several when, at least, two or more persons are responsible together and individually for an act.[30] The implication is that the foreign entity is equally responsible for the local components, thus solidifying the notion of "a single contract." Furthermore, any suggestion of an inclination towards split contracts as a result of the reference to separate invoicing by each contractor may be weakened by the provision for a contract price.

Perhaps, the last word in this section should be reserved for opponents of turnkey taxation. Regarding the argument that implicit in a construction contract are all the other processes, this, if correct, would apply only to traditional turnkey contracts where one or several contractors are engaged in a "building contract." This is unlike the case in a multiple-obligations contract, where specialist firms are employed primarily to discharge various functions in line with their expertise, and none is tasked with the overarching construction function that involves other processes such as engineering, procurement, *etc*. Using the Dangote refinery, where the engineering and other technical processes were assigned to different contractors, as a case study, is it possible to identify the activity that implies all the other processes usually associated with construction in traditional turnkey projects? Are all these other processes implicit in Engineers India's EPC scope of work when several engineering functions were excluded from its remit? Can a contractor in the position of Engineers India argue that its engineering and procurement functions are not within the contemplation of Code Sec. 13(2)(c)? Can the other foreign companies responsible for services which are not expressly mentioned in Code Sec. 13(2)(c) also make this argument?

Split Contracts—A Tale of Two or More Parts of a Whole

In the preceding section, the point was made that an EPC transaction within the contemplation of Code Sec. 13(2)(c) involves a project with multiple activities, executed locally and outside the country, all of which constitute the business of the foreign contractor. So, foreign revenues from a contract would qualify for Nigerian tax if the non-resident contractor's business that is generated from the contract is turnkey in nature (*i.e.*, has both overseas and local aspects). If project development is divided into two or more contracts in line with the foreign and domestic segments thus creating an "offshore contract" and an "onshore contract" respectively, would the project still be EPC? Certainly not. Splitting the project into two or more sets of activities in line with their locale would break the link between the diverse elements that give the transaction that distinguishing turnkey character.

A split contracts arrangement therefore entails a project execution mechanism that utilises foreign expertise without exposing any associated revenues to Nigerian tax. Each contract is executed separately without any nexus between them, thus enabling foreign revenues to stay outside Nigerian income tax space. The facts of *JGC*[31]

present a classic example of the tax implications of this project development structure.

JGC involved the completion of Mobil's EPC3 Bonny Terminal project in Nigeria for which reason Mobil awarded two contracts to different companies. One of the contracts was for offshore works while the other was for local activities, both to be undertaken by JGC and the JNL/Daewoo consortium, respectively. Subsequently, a dispute ensued when the FIRS sought to collect tax from JGC's income from its overseas contract. In its decision, the Federal High Court held that JGC's profits from the contract were not liable to Nigerian tax because JGC had no fixed base in Nigeria for the purpose of the contract. This decision was informed by the facts that the contract was performed outside Nigeria without any local component, and neither did any of JGC's personnel visit Nigeria with respect to contract execution.

This author agrees with the court's judgment, although the fixed base concept is an off the mark argument to make in this case. Fixed base is one of the statutory rules by which the revenues of a foreign company may qualify as Nigerian income. This rule seeks to subject to local tax, any profit of a non-resident contractor that is attributable to its fixed base in Nigeria.[32] Hence, fixed base discussions are appropriate in disputes where the nature of the transaction suggests some Nigerian operations but uncertainty exists as to whether the degree of Nigerian involvement approximates to a fixed base under the law.

A more pertinent basis for the *JGC* decision is that the project was executed with the split contracts framework that isolates the different project strands into separate offshore and domestic contracts effectively ringfencing foreign incomes from extending into Nigerian tax jurisdiction. Basically, the split contracts system breaks the turnkey link between several project phases, thus transforming these activities into distinct standalone contracts. Usually, the foreign contractor would, in order not to imperil its tax position, decline any obligation to deliver the fabricated/constructed materials in Nigeria but would use incoterms to designate the point of supply as some location outside Nigeria.

But complications may arise when various project-related contracts are awarded to the same foreign company. Certainly, profits from the local contract would be taxable in Nigeria by virtue of the fixed base rule. Regarding the foreign revenues, it is not inconceivable for a court to take a holistic view of the project and hold in favour of Nigerian tax on the ground that the splitting of the contracts is a poorly concealed tax-avoidance scheme intended to deny the country of the full tax benefits of the project. This position could be supported by the reasoning that this is a deserving case for the enforcement of the spirit of the law rather than its letters. Whatever the position of the courts on this point, a project development structure that involves awarding split contracts to a foreign contractor is fraught with risks which do not appear to abate if the foreign contractor executes the domestic contract through a local subsidiary.

Reverse EPC Arrangements

What if a Ghanaian company secures an EPC contract in Togo and executes it with parts fabricated and constructed in an engineering yard in Lagos? Would Nigerian tax apply to the profits from the project or only the fabrication and construction components? Nigerian technology is making significant advancements as the country's capacity for highly technical processes is on the upswing, testament to which is the proposed integration of six locally fabricated modules into the USD3.3b Egina FPSO that berthed recently in an engineering yard in Lagos, Nigeria.[33] With the country's rising technology profile, transactions of this nature would likely begin to stoke tax controversy and perhaps, litigation.

A likely answer to the above question is that Nigerian tax would apply to only the fabrication and construction activities and not the project revenues, reason being that the transaction is not an EPC contract under Code Sec. 13(2)(c). Earlier in this article, a turnkey project was identified as one where a contractor undertakes a gamut of project development activities, ranging from design through to completion and commissioning. This author therefore expects Code Sec. 13(2)(c) to be construed in a way that requires infrastructure completion and commissioning in Nigeria.

EPC Arrangements Between Non-Residents

How then would Nigerian law treat incomes from a contract by non-residents for infrastructure in Nigeria? If, for instance, the World Bank engages Buhler AG, a leading Swiss rice mill manufacturer, to set up a 32 tonnes per hour rice mill in Kebbi State, would it matter for the purpose of income tax that neither of the parties to the contract is a Nigerian entity?

It will be recalled that in *Saipem,* the court was motivated to hold in favour of Nigerian taxation because the EPC contract was with a Nigerian party, signed in Nigeria, performed for Nigeria's benefit and to be paid for by the Nigerian counterparty. It is possible to infer from this a different treatment

if the project owner turns out to be a non-Nigerian entity. This kind of analogies highlights the defect in the court's decision and suggests the likelihood of an appellate court reversing the judgment of the court in *Saipem*.

Under Buhler AG's contract, its scope of work would involve operations to be undertaken outside Nigeria such as design, procurement, fabrication of plant parts and perhaps, construction, while installation and project completion would be locally accomplished. Since Switzerland does not yet have a DTA with Nigeria, the resolution of the above question would devolve on whether the contract for the rice mill plant meets the definition of "a single contract" under Code Sec. 13(2)(c). To the extent that the plant would be delivered and installed in Nigeria where the proverbial key would be turned, then the project should qualify as a Nigerian turnkey. It therefore seems that the identities of contract parties would not affect the application of Code Sec. 13(2)(c) to tax revenues from projects commissioned in Nigeria.[34]

Conclusion

Clearly, Nigeria's turnkey tax regime is not as straightforward as it appears to practitioners, taxpayers and the courts. Grey areas exist in the EPC tax system that provide tax avoidance opportunities for foreign contractors. Without dismissing pro-EPC tax arguments, there seems to be a case to be made against turnkey impost by international firms who perform their activities offshore. Also, resort to split contracts is not always fool-proof and may entail some risks in certain situations.

But to convert these loopholes into tax savings or test the security in the split contracts doctrine requires, as a necessity, a knowledgeable judiciary. In this respect, *Saipem*, which is on appeal, affords the judiciary the chance to reconsider the law on the impact of DTAs to the taxation of foreign revenues of enterprises from Contracting States and whether this is the end of the road for a firm from a non-Contracting State.

ENDNOTES

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1 Federal Inland Revenue Service.

2 Definition of Turnkey in Business Dictionary available at *www.businessdictionary.com/definition/turnkey.html* (visited on February 5, 2018).

3 Definition of turnkey project in The Free Dictionary available at *https://financial-dictionary.thefreedictionary.com/turnkey+project* (visited on February 5, 2018).

4 Companies Income Tax Act (as at 2007).

5 In order for this provision to have effect as the turnkey tax provision, the word "or" would have to be interpreted as "and."

6 CITA, Code Sec. 9(1).

7 CITA, Code Sec. 13(2).

8 Floating, Production, Storage and Offloading platform.

9 *Saipem* (2014) 15 TLRN 76.

10 *JGC* (2016) 22 TLRN 37.

11 Tax Appeal Tribunal, Nigeria's specialized tax disputes adjudicatory body.

12 *Ishikawaima-Harima Heavy Industries Ltd. v. Director of Income Tax*, Date of Judgment was January 4, 2007, and available at *file:///C:/Users/kamaefule/Downloads/Ishikawajma-Harima_Heavy_..._vs_Director_Of_Income_Tax,_Mumbai_on_4_January,_2007.PDF* (visited on January 23, 2018).

13 This provision is similar to Article 7 of Nigeria's DTAs with its counterparties.

14 Permanent Establishment.

15 Double Tax Agreements.

16 PE applies to foreign contractors from Contracting States while Code Sec. 13(2) CITA applies overseas firms from non-Contracting States.

17 *Ishikawaima-Harima Heavy Industries Ltd. v. Director of Income Tax.*

18 This dispute is currently at Nigeria's Court of Appeal which hears appeals from decisions of the Federal High Court.

19 *Offshore S. A.*, NTC 1 384.

20 The predecessor of the present day Federal High Court.

21 This judgment was delivered in 1976 and considered a much earlier iteration of CITA.

22 Code Sec. 18(2) CITA (as at 1976).

23 It was borne out in evidence that the Portuguese contractor performed all its contractual activities outside Nigeria.

24 CITA, Code Sec. 81(1).

25 This line of argument would find support in the Latin maxim, which is recognized by Nigerian law, that the expression of one thing excludes that not mentioned.

26 *Dangote Refinery, Lagos*, available at *www.hydrocarbons-technology.com/projects/dangote-refinery-lagos/* (visited on April 10, 2018).

27 *Key issues in split EPC contracts* available at *www.gulfconstructiononline.com/news/160035_Key-issues-in-split-EPC-contracts.html* (visited on February 7, 2018).

28 *Splitting an EPC Contract* available at *www.pwc.com.au/legal/assets/investing-in-infrastructure/iif-9-splitting-epc-contract-feb16-2.pdf* (visited on February 7, 2018).

29 *Definition of Construction* at Collins English Dictionary available at *www.collinsdictionary.com/dictionary/english/construction* (visited on February 6, 2018).

30 Black's Law Dictionary (7th ed.).

31 *JGC* (2016) 22 TLRN 37.

32 CITA, Code Sec. 13(2)(a).

33 *$3.3bn Total's Egina FPSO Arrives Nigeria*, ThisDay, January 25, 2018, available at *www.thisdaylive.com/index.php/2018/01/25/3-3bn-totals-egina-fpso-arrives-nigeria/* (visited on February 2, 2018).

34 This is subject to the application of the DTAs to contracts involving companies from a Contracting State.

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