Transmuting from Petroleum Profit Tax Act 2004 to Petroleum Industry Act 2021: Challenges and Prospects

@ CITN Webinar on Petroleum Industry Act 2021 Legal and Regulatory Framework of the Governance Structure and Fiscal Provisions of the Petroleum Industry Act, 2021

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Learning Objectives

At the end of the session, participants are expected to:

1. Have an overview of the transitioning from PPTA to PIA
2. Review the Challenges of the PIA
3. Review the prospects of the PIA
4. Recommendations

The following areas will be examined / discussed during this session:

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- Highlights of the Changes from PPTA to PIA
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- Highlight of key issues in the PIA
- Conclusion/ Recommendation

INTRODUCTION – Memory Lane in the Petroleum Industry in Nigeria

- Oil was first discovered in commercial quantities in Nigeria in 1956 near Oloibiri Village in Rivers State.

- The discovery of crude oil in Nigeria led to the enactment of Petroleum Act 1969.

- This gave birth to several other laws within the oil and gas industry e.g., Petroleum Profit Tax Act, The Deep Offshore and Inland Basin Production Sharing Contracts Act, Nigerian National Petroleum Corporate Act, The Niger Delta Development Commission (Establishment) Act, The Nigerian Oil and Gas Industry Content Development Act 2010, Oil Pipeline Act etc.

- There have been about three other unsuccessful attempts to enact the Petroleum Industry Bill now Act (2009, 2012 and 2018 respectively).

- The Petroleum Industry Act 2021 was enacted by the 9th National Assembly and assented by the President.

- As at today the President have set up the Transition committee for the implementation of the PIA. The committee has recorded progress already. NNPC Ltd has been incorporated and the Upstream and Midstream/Downstream Regulators are already commissioned.

Introduction to the PIA

Governance and Institutions

- Vesting and Objectives
- Minister of Petroleum
- The Commission
- The Authority
- The Nigerian National Petroleum Company Limited

Chapter One

Administration

- General Administration
- Administration of Upstream Operation Environment
- General Administration of Midstream and Downstream Petroleum Operations
- Administration of Midstream and Downstream Gas Operations
- Administration of Midstream and Downstream Petroleum Liquids Operations
- Other Matters Related to Midstream and Downstream Operations
- Common Provisions for Upstream, Midstream and Downstream Petroleum Operations

Chapter Two

Host Communities Development

- Objectives and Regulations
- Incorporation of host communities' development trust
- The Board of the Trustees, composition and management
- Allocation of Funds
- Host Communities advisory committee and composition
- Financial year of the host communities' development trust
- Accounts and audit. etc

Chapter Three

Petroleum Industry Fiscal Framework

- Objectives and Administration
- Hydrocarbon Tax
- Ascertainment of Chargeable Profits and Consolidation
- Persons Chargeable
- Applicability, Accounts and Particulars
- Appeals
- Collections, Recovery and Repayment of Tax
- Offenses and Penalties
- Application of Companies Income Tax to Petroleum Operations
- General Provisions
- Miscellaneous Provisions

Chapter Four

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Objectives of PIA

To create efficient and effective ***governing institutions* with *clear and separate roles*** for the petroleum industry

To foster a **conducive business environment** for petroleum operations

To establish a framework for the creation of a **commercially oriented and profit-driven national petroleum company**

To deepen **local content** practice in Nigeria oil and gas industry.

To promote **transparency, good governance and accountability** in the administration of the petroleum resources of Nigeria

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Highlights of the Changes from PPTA to PIA

Petroleum Profit Tax Act 2004	Petroleum Industry Act 2021
✓ **Single tax** – only Petroleum Profit Tax (PPT)	✓ **Dual tax** – Hydrocarbon Tax (HCT) and Companies Income Tax (CIT)
✓ **Scope of the Law** – covers only Upstream Sector of the Oil and Gas Industry	✓ **Scope of the Law** – covers Upstream, Midstream and Downstream Sectors of the Oil and Gas Industry
✓ **Returns** – only PPT returns applies under the PPTA	✓ **Returns** – two returns NHT and CIT returns applies under the Act.
✓ **Rate of Tax** – under PPT the rates of tax include the following 50% (PSCs), 65.75% and 85% (Sole Risks & JVs) respectively.	✓ **Rate of Tax** – HCT (15% (PPL) to 30% (PML) depending on the terrain) and CIT (30%) (Offshore rate omitted)
✓ **Allowable Deduction** – was not guided by the reasonability test under the act.	✓ **Allowable Deduction** - the PIA deductibles is guided by reasonability test.

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Highlights on the Changes in PPTA and PIA

Petroleum Profit Tax Act 2004	Petroleum Industry Act 2021
✓ **Deductions Not Allowable** –	✓ **Deductions Not Allowable** – items like interest on loan, bank charges, HCT etc., are not allowable deductions.
✓ **Transfer Pricing –** not specifically mentioned. Only recognizes artificial transactions.	✓ **Transfer Pricing –** is specifically mentioned in Section 269 (5) that TP Regulations 2018 shall apply to the TP under the PIA.
✓ **Revised Estimate on Budget** – is taxable under the Act.	✓ **Revised Estimate on Budget** – now taxable at Libor at 10% under the Act. Sec 280 of PIA.
✓ **Appeal** – provides for appeals to be addressed to the Appeal Commissioners. Section 41.	✓ **Appeal** – the Act specifically provides that appeals from the Act shall be referred to the Tax Appeal Tribunal (TAT). Sec 279 (3).
✓ **Penalties** – is N10,000 fine and N2,000 for every subsequent day the offence persist.	✓ **Penalties** – for late filing is N10 million for the first day and N2 million every other day.
✓ **Host Communities Fund** – not specifically provided for, however Oil Companies and host communities were adopting a negotiated Global Memorandum of Understanding (GMoU) e.g., 4%.	✓ **Host Communities Fund** – the act specifically provides for 3% of expenditure and a trust is to be set up for each asset management communities.

Highlights on the Changes in PPTA and PIA

Petroleum Profit Tax Act 2004	Petroleum Industry Act 2021
✓ **Multiple Regulation (DPR, PPPRS, NEITI etc)**	✓ **Single Regulatory Agency (Commission or Authority)**
✓ **Does not admit Cost Price Ratio**	✓ **Cost Price Ratio Limit** of 65% should impact the total allowable deductions in determining the chargeable profit in any assessment year. Unclaimed costs to be carried forward.
✓ **Royalties** - onshore field attracts a flat royalty rate of 20%, while royalty rates applicable for offshore production vary from 4% to 18.5% depending on water depth.	✓ **Royalties** - on oil production across terrains ranging from 7.5% to 15%.
✓ **Gas Reinjection** – cost is treated under PPT, while the revenue to is taxed under the CITA.	✓ **Gas income** - cost and revenue is treated under the PIA and to be fully taxed under CITA.
✓ **Petroleum Investment Allowance –** makes allowable expenses incurred in any qualifying capital expenditure wholly, exclusively and necessarily for the purpose of petroleum operations. Second Schedule to the Act	✓ **Production Allowanc**e – the Act creates this allowance for leases for crude oil production and pegs it at certain percentage per barrel. Sixth Schedule to the Act.

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Challenges to look out for in the PIA

- Faulting on the Principle of one Tax one Law.
- Multiple taxation & Dual Regime of PPTA and PIA
- Confusion on the classification and definition of asset in PIA & CITA
- No Tax rate for Offshore Productions
- Deductions not allowable e.g. HCT, interest on Loan etc.
- High cost of operation may lead to divestments
- Host Community Issues not yet fully resolved
- The Act is yet to address the objectives

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Prospects of the PIA

Introduction of separate regulatory authorities for the upstream subsector on the one hand and midstream & downstream subsectors on the other hand.

The Commission and the Authority are to publish their respective annual reports and audited financial accounts on their websites to ensure accountability and transparency. They are also to keep public registers of issued licences, permits and other authorisations, and in the case of the Commission, records of beneficial ownership in petroleum interests, all awards renewals, assignments, amendments, suspensions and revocations.

The Nigerian National Petroleum Corporation (NNPC) will transform into NNPC Limited, a profit-oriented incorporated company, to be jointly owned by the Ministry of Finance Incorporated and the Ministry of Petroleum Incorporated.

Establishment of a Frontier Exploration Fund and establishment of a Midstream and Downstream Infrastructure Fund.

Government agencies shall first consult with the Commission (on upstream matters) or the Authority (on midstream or downstream matters) prior to issuing any regulation, guideline, enforcement order or directive; or exercising any power or function which may have direct impact on petroleum operations. The Commission or Authority shall review such action and communicate a decision according and such decision shall be complied with by the relevant agency.

Existing Unincorporated Joint Ventures (UJVs) with NNPC participation, which are currently managed under the Joint Operating Agreements (JOAs), may voluntarily convert into Incorporated Joint Ventures (IJVs).

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Key Issues in the PIA

1. Administration of the Upstream, Midstream and Downstream Industry
2. Incorporation of NNPC Ltd
3. Licenses and Leases
4. Payment of Hydrocarbon Tax and CITA
5. Host Communities Fund and other ancillary issues

Administration of the Upstream, Midstream and Downstream Industry

Upstream Sector

- ✓ The Commission takes over the upstream regulatory functions of the DPR and has the power to approve renewal of upstream licenses and leases.
- ✓ Responsible for the technical and commercial regulation of upstream operations.
- ✓ license or lease is granted to only companies incorporated and validly existing in Nigeria under the Companies and Allied Matters Act. The Act renames the existing licenses and leases related to the upstream petroleum operations and replaces it with the following according to Section 70;

Midstream and Downstream Sector

The Authority is responsible for regulation of midstream and downstream operations, including technical, operational and commercial activities, including

- ✓ The determination and implementation of technical standards, codes, practices and specifications applicable to midstream and downstream petroleum operations;
- ✓ Promoting and optimizing midstream infrastructural development;
- ✓ Ensuring crude oil supply for domestic refineries;
- ✓ Promoting a competitive market for midstream and downstream operations;
- ✓ Development and enforcement of a framework on tariff and pricing for natural gas and petroleum products;
- ✓ Regulation of the supply, distribution, marketing and retail of petroleum products.

Incorporation of NNPC Ltd

- ✓ The PIA provides for the incorporation of NNPC limited and the transfer of assets and liabilities of NNPC to NNPC limited.
- ✓ Under the present framework, NNPC Ltd is expected to relinquish all its policy making and regulatory activities and will be treated on an equal basis with private sector operators.

- ✓ The assets and liabilities not transferred will remain with NNPC until they are extinguished or transferred to the government.

- ✓ Furthermore, any transfer of assets, liabilities and interests from NNPC to NNPC Limited will not create a new cause of action for a creditor or parties to an agreement entered into with NNPC prior to the date of transfer
- ✓ It is intended that NNPC Ltd as petroleum lessee or licensee will carry on its operations on a commercial basis, comparable to private companies carrying out similar activities.

    - It will be exempt from the Public Procurement Act, Fiscal responsibility Act and Treasury Single Account.
    - It will also be subject to the fiscal regime applicable to any other player in the relevant sector.
    - It (together with its subsidiaries) will have no recourse to government funds (to be stated on its Memorandum and Articles of Association)

- ✓ NNPC Ltd will carry on as the NOC and be vested as the concessionaire of all PSCs and RSCs.

Licenses and Leases

Petroleum Exploration License (PEL)

Granted to explore petroleum on a speculative and non-exclusive basis. Granted for 3 years and renewable for another three years. A Petroleum Exploration License may cover an area that includes Petroleum Prospecting License or Petroleum Mining Lease, provided that the holders of the PPL and PML shall have no obligation to purchase the results of any survey conducted under the petroleum exploration license.

Petroleum Prospecting License (PPL):

Granted to carry out petroleum exploration operations on an exclusive basis and exclusive right to drill exploration wells and non-exclusive right to carry out petroleum exploration operations within the area provided for in the License.

License Period:

- Onshore and shallow water acreages: Not more than 6 years. Initial exploration – 3 years and optional extension of 3 years.

- Deep offshore and frontier acreages: Not more than 10 years with an initial exploration of 5 years and optional extension of 5 years. No extension is granted upon expiration of the license period.

Petroleum Mining License (PML):

Granted to search for, win, work, carry away and dispose of crude oil, condensates and natural gas. Granted for each commercial discovery of crude oil or natural gas or both. Granted for a maximum period of 20 years, which term shall include the development period. Where the development period is not specified in the Field Development Plan, the period shall be:

- 5 years for an onshore lease and;
- 7 years for a lease in shallow water, deep offshore or frontier acreage

Payment of Hydrocarbon Tax and CITA

Hydrocarbon Tax (HT) – Section 261 of PIA,2021

Hydrocarbon Tax : HT is the tax charged and assessed on the Profits of any company engaged in Upstream ***Petroleum operations in relation to Crude oil , and payable*** during each accounting period.- (PIA Section 261)

Applicability:

- **Applies to:**
- Crude oil
- Condensates and Liquid Natural Gas Liquids (NGL) from associated gas field produced upstream of the measurement point

- **Excludes:**
- Associated Natural gas, including Gaseous NGLs produced in the field
- Condensates and NGLs from Non-associated gas in fields or gas processing plants,
- Condensates and NGLs from associated gas at gas processing plants

Fiscal Regime Upstream Sector

A. **Hydrocarbon Tax-** Upstream petroleum operations in relation to crude oil, condensates and natural gas liquids produced from associated gas

PPT Act – Section 22 of PPTA	PIA- Section 267 of PIA
The applicable PPT rates on chargeable profits are as follows for OML ❖ 65.75% (within five years of commencement of petroleum operation); and ❖ 85% . ❖ CIT 30%. ❖ EDT 2%	The applicable HT rate on chargeable profits for onshore and shallow water areas are; PML 30% plus CIT 30% PPL 15% plus CIT 30% There is no clarity with respect to charging of EDT either under CIT or HT

Payment of Hydrocarbon Tax and CITA Cont'd

Fiscal Regime Upstream Sector

HT Rates – S.267	
PML for Onshore and Shallow water areas	30%
PPL for Onshore and Shallow water areas	15%
Frontier basins (After convertion to PPL)	15%
Marginal Fields (declared prior to 1 January 2021)	15%
Existing OML (Opted-out of conversion and until Renewal date)	PPTA rates
CIT Rate	
All	30%

Host Communities Fund and other ancillary issues

- ✓ Mandatory Contribution from the Settlor – 3% of OPEX for the preceding year [OPEX is the ongoing day to day cost or expense of running a business for a period of time].
- ✓ To foster sustainable prosperity within host communities
- ✓ Provide direct social and economic benefits from petroleum operations to host communities
- ✓ Enhance peaceful and harmonious co-existence between licensees/lessees and host communities.
- ✓ Create a framework to support the development of host communities

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Conclusion/Recommendations

- ✓ The PIA has made slight modifications to the governance and institutional framework for the Industry.
- ✓ Whilst clear legislation is required to put the petroleum industry on a sustainable path of wealth creation for all Nigerians through an enhanced investment framework, legislation alone will not do the work.
- ✓ Transparency, accountability and a strong political will are essential for the implementation of the new law and policy directives.
- ✓ There is still more to be done on the Act to make exploration of crude oil more attractive for investment.

THANK YOU