

Court of Appeal rules on the inapplicability of investment tax credit to production sharing contracts executed after July 1998

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KPMG Nigeria



The Court of Appeal (COA or “the Court”) Lagos Division has overturned the judgement of the Federal High Court (FHC) in the appeal between the *Federal Inland Revenue Service (FIRS or “the Appellant”) and CNOOC Exploration and Production (CNOOC) and South Atlantic Petroleum Corporation (SAPETRO) collectively referred to as “the Respondents”, by ruling that Investment Tax Credit (ITC) is not applicable to Production Sharing Contracts (PSCs) executed after 1 July 1998, in line with Section 4 of the Deep Offshore and Inland Basin (Production Sharing Contract) Act, Cap D3, Laws of Federation Nigeria, 2004 (DOIBPSCA or “the Act”).*

Facts of the case

On 19 March 1998, SAPETRO signed a Farm-in Agreement with Total Upstream Nigeria Limited (Total) and Brasoil Services Company (Brasoil) for the joint exploration and production of oil from its Oil Prospecting License (OPL) 246. The Agreement, which was executed before 1 July 1998, qualified for ITC in line with Section 4(1) of DOIBPSCA. OPL 246 was subsequently converted to an Oil Mining Lease (OML) 130.

In 2005, the Federal Government (FG), pursuant to the Deep Water Block Allocation to Companies (Back-in Rights) Regulations, 2003 (“the Regulations”), acquired 50% participating interest through the Nigerian National Petroleum Corporation (NNPC). Consequently, the 50% interest held by NNPC would be governed by a PSC while the remaining 50% held by SAPETRO, Total and Brasoil would be governed by a Production Sharing Agreement (PSA).

Following the execution of the PSC in 2005, SAPETRO via its letter of 6 April 2009, sought clarification from the FIRS on whether qualifying capital expenditure (QCE) incurred on OML 130 would qualify for ITC or Investment Tax Allowance (ITA). The FIRS in its response of 13 July 2009, confirmed that ITC was applicable to the QCE incurred on OML 130. However, in a subsequent letter dated 13 June 2012, the FIRS reviewed its position and stated that the applicable fiscal incentive for the 2005 PSC should be ITA and not ITC.

Aggrieved with the FIRS’ revised position, the Respondents brought the matter before the FHC for resolution. The FHC in delivering its judgement in the case relied on the principle of legitimate expectation and the doctrine of *equitable or quasi estoppel* and ruled in favour of the Respondents. The FHC noted that *“while it is not the duty of the Ministry of Petroleum Resources to inform parties of the tax regime involved in their agreement, the Respondent (FIRS) have indeed endorsed the action of the Ministry by acknowledging and accepting the tax investment credit of the Applicants (SAPETRO & CNOOC) in 2009 and 2010. This is a complete waiver of responsibility, and acceptance of whatever representation made to the applicants in this case...”*

The FHC, therefore, prevented the FIRS from revising its initial representation of 13 July 2009 based on law and equity.

Dissatisfied with the FHC judgement, the FIRS appealed to the COA on the ground that the 1998 PSC and the 2005 PSC are distinct agreements, with the former attracting ITC and the latter ITA. The FIRS noted that the 1998 Farm-in Agreement was effectively terminated with the signing of the 2005 PSC. Therefore, ITA was the applicable fiscal incentive to the QCE incurred under the 2005 PSC.

The Respondents, on the other hand, argued that the conversion of OPL 246 to OML 130 and the subsequent exercise of the back-in rights by the FG did not create a new geographical (contract) area or separate set of petroleum operations out of OML 130. Further, that the 2005 PSC did not extinguish the Respondents vested rights to the ITC under the 1998 Farm-in Agreement. Consequently, OML 130 should be treated as a PSC executed prior to 1 July 1998, thus qualifying for ITC.

Issues for determination

Based on the arguments submitted by the parties, the COA adopted the Appellant's issue for determination, which was "whether Section 4 of the DOIBPSCA makes ITC applicable to this case?"

COA's decision

After considering the arguments of both parties, the COA held that:

1. The 2005 PSC is a distinct agreement from the 1998 PSC and cannot attract ITC based on Section 4(2) of DOIBPSCA. Rather the appropriate fiscal incentive should be the ITA.
In arriving at this conclusion, the COA referred to Section 17 of the DOIBPSCA which defines a PSC as "any agreement or arrangement made between the NNPC or the holder and any other petroleum exploration and production company or companies for the purpose of exploration and production of oil in the deep offshore or inland basin." Consequently, the COA concluded that the appellation or label given to any agreement by the parties is of no relevance. So far as such agreement falls within the definition of the PSC, it will be deemed as such.
Further, the execution of the 2005 PSC, which brought in the FG, affected the rights of the parties to OML 130 to enjoy ITC which they were entitled to prior to the conversion of OPL 246 to OML 130.
2. Section 4(1) and (2) of the DOIBPSCA did not create any exemption or limit the instance in which the tax incentives therein will be applicable. Thus, nothing in Section 4 of the DOIBPSCA suggests that the subsequent introduction of new parties, or participation by the FG, which led to the execution of a new PSC, will render the provision of the section inapplicable.
3. The provisions of Section 4(1) & (2) of the DOIBPSCA are plain and mandatory, and not open to any person or body to waive its applicability or otherwise where petroleum operations are carried out under the terms of a PSC. Therefore, the FIRS cannot by representation waive the compliance of the mandatory provision of the law and thereby create a state of things or facts that it is not legally empowered to create.
4. The FHC wrongly applied the principle of "equitable or quasi estoppel" against the FIRS and erred by preventing the FIRS from retracting its earlier erroneous position. The COA noted that no *estoppel* by representation should arise if the effect would undermine the express provisions of a statute. Therefore, the earlier representation made by the FIRS in its letter of 13 July 2009 that ITC was applicable to OML 130 being at variance with Section 4(2) of the Act has no legal effect.

Based on the above, the COA granted the appeal in its entirety.



Commentaries

The COA judgment has resolved a longstanding debate between the FIRS and taxpayers regarding the applicable fiscal incentive for QCEs incurred for petroleum operations in respect of PSCs signed with the FG pursuant to Section 35 of the Petroleum Act and the Back-in Rights Regulations. The COA clarified that the incentives stipulated in Section 4 of the DOIBPSCA are tied to the PSC and not the licence granted to the companies. Consequently, the date of execution of a PSC will be the key factor in determining whether ITC or ITA will apply to the QCE incurred therein for the purpose of the petroleum operations.

Further, the COA clarified that the principle of *estoppel* does not apply to statutes as equity must follow the law. Where a statute compels or prohibits certain type of action, *estoppel* cannot be used to achieve the same result. Therefore, to the extent that the FIRS' or any FG agent's representation is inconsistent with the provisions of an extant tax law, the principle of *estoppel* is inapplicable.

Lastly, the judgement reiterates the fact that government agencies have no legal authority to amend any law through regulations, publications or representations. Therefore, taxpayers must in their own interest exercise caution in relying on representations made by the FIRS, especially where such representations are contrary to the provisions of the tax laws.

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