TAT nullifies Taxpayer's claim of downstream gas utilization incentives

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KPMG Nigeria

On Friday, 12 November 2021, the Tax Appeal Tribunal (TAT or "the Tribunal") Lagos Zone decided in *Seplat Petroleum Development Company Plc (Seplat or "the Company" or "the Appellant")* vs *the Federal Inland Revenue Service (FIRS or "the Respondent")*, that the Appellant's claim of five (5) years tax holiday (granted under Section 39 of the Companies Income Tax (CIT) Act Cap. C21, LFN 2004 to companies engaged in downstream gas utilization) was unlawful and invalid.

Facts of the case

Seplat had commissioned a natural gas plant for downstream gas utilization purposes in 2015. Subsequently, the Ministry of Petroleum Resources (MPR) through the Department of Petroleum Resources (DPR) issued a letter dated 8 April 2015 to Seplat directing the Company to introduce hydrocarbon to the new gas plant following a satisfactory completion of mechanical and pre-commissioning activities of the gas plant. Thereafter, the Company, on the basis that the letter from MPR satisfied the condition provided under Section 39(2) of the CIT Act, adopted a production date of 13 May 2015, and claimed the related tax incentives.

However, the FIRS disagreed with Seplat's position and issued additional CIT and Tertiary Education Tax (TET) assessments for 2016 and 2019 years of assessment (YOAs) following two desk reviews of the Company's tax returns for the relevant years. The Company duly objected to the FIRS' assessments noting that it had tax holidays for the years under review and, therefore, had no tax obligations to the FIRS. The Company further noted that its entitlement to the tax relief for the initial period of three years and extension for additional two years were automatic once the conditions provided under Section 39 of the CIT Act had been fulfilled. The FIRS disagreed with the Company's objection and issued Notices of Refusal to Amend (NORA) without further attempts to reconcile the disputed tax position. Aggrieved by the issuance of the NORA, Seplat appealed the assessments at the TAT.

Seplat argued that its upstream petroleum operations are irrelevant regarding the claim of incentives under Section 39 of the CIT Act, as the CIT Act does not limit the incentives to companies wholly and exclusively engaged in the business of downstream gas utilization. Furthermore, the incentives were never claimed on the same qualifying capital expenditure. Therefore, the Company was entitled to the tax incentives granted under the Industrial Development (Income Tax Relief) Act (IDA) and Section 39 of the CIT Act, respectively. Further, the Company maintained that Section 39 of the CIT Act does not empower the FIRS to determine what would amount to satisfactory performance, for the purpose of the renewal of the tax-free period for an additional two years.

The FIRS argued that Seplat is an upstream exploration and production company and the gas produced by the Company is associated gas, which is a complementary product to its oil, produced from the same oil well. Therefore, Section 11 of Petroleum Profits Tax (PPT) Act should be the applicable law for its related gas costs, and not Section 39 of the CIT Act. The FIRS further noted that it is responsible for administering the incentive, being the statutory agency for administration of tax laws, including the CIT Act. Consequently, based on its assessment of the support documents provided by the Company, the MPR's letter of 8 April 2015 was not a formal certification of production date as contemplated under Section 39 (2) of the CIT Act. Rather, it was a mere exchange of correspondence between an industry player and a regulator. Hence, the Company failed to fulfil the statutory requirements for the grant and the renewal of a tax holiday under Section 39 of the CIT Act, and should be liable to the additional assessments.

Issues for determination

Based on the arguments submitted by both parties, the Tribunal adopted the following two main issues for determination:

- Whether the Appellant fulfilled the conditions described under Section 39 (1)(a) and (2) of the CIT Act, C21 LFN 2004, for the enjoyment of tax-free period/holiday or tax incentives?
- Whether the Respondent lawfully raised the notices of additional assessment for CIT and EDT for 2016 and 2019 YOAs on the Appellant?

TAT's decision

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

(i). The MPR's letter of 8 April 2015 could not be regarded or described as the certification contemplated under Section 39 (2) of the CIT Act.

The Tribunal referred to Section 39 (2) of the CIT Act to emphasize that the tax-free period shall start on the day the company commences production as certified by the MPR. However, based on the TAT's review, the MPR's letter to Seplat did not constitute evidence of certification of production day. Rather, it represents a professional directive or advice to the Appellant on other steps the Company should take in respect of the gas plant to achieve certification. The Appellant's decision to write a letter to the DPR on 14 December 2018, requesting for confirmation of date of production of gas, further shows that the MPR's letter of 8 April 2015 neither stipulated nor confirmed a production date. Finally, the provision of Section 39(2) of the CIT Act does not provide for a retroactive confirmation of the first date of production.

Consequently, the TAT held that the Company failed to obtain a valid certification of its date of gas production. Therefore, the tax holiday claimed by the Appellant from 13 May 2015 was unlawful and invalid.

(ii). Based on Sections 2 and 8 of the FIRS (Establishment) Act, 2007, the FIRS is responsible for the assessment and collection of taxes due to Federal Government of Nigeria and its agencies. Further, Section 65 of CIT Act and Section 1 of the Tertiary Education Trust Fund (Establishment, etc.) Act, respectively, empower the FIRS to assess, collect, and enforce payment of CIT and TET on eligible taxpayers. The relevant Acts also recognize taxpayers' rights to object to any assessment based on cogent and credible reasons. However, having established that the Company had no valid certification as provided under 39(2) of the CIT Act for claim of the tax incentive for downstream gas utilization, it had no legal basis to object to the assessments issued by the FIRS. Therefore, the FIRS' assessments for 2016 and 2019 YOAs subsist and are legally binding.

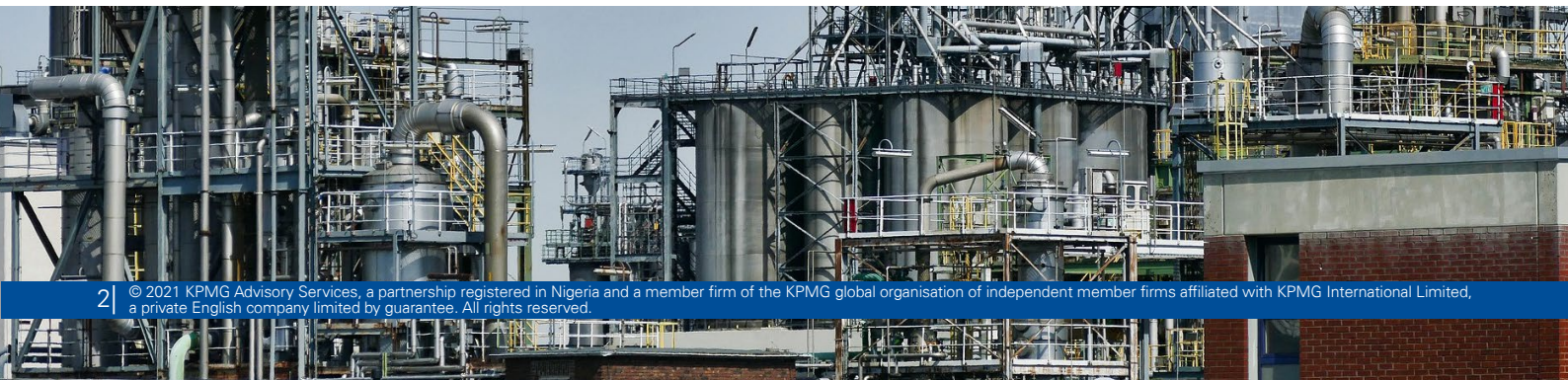
Consequently, the TAT restated that Seplat is liable to pay the assessed CIT and TET liabilities of US$31,544,079.32 and US$1,884,635.06, respectively, for 2016 YOA, and US$56,963,514.60 and US$3,797,567.64, respectively, for 2019 YOA, including associated interests and penalties.

Commentaries

The issue of claiming tax incentives under the IDA, Section 11 of the PPT Act and Section 39 of the CITA has been an ongoing debate between taxpayers and the FIRS. However, Finance Acts, 2019, and 2020 have resolved this controversy by providing that eligible companies could enjoy pioneer status incentive granted under the IDA and additional tax-holiday incentives granted under Section 39 of the CITA, if the incentive claims are not on the same qualifying capital expenditure and they fulfill the conditions provided under the relevant Acts.

It is important to note that the Tribunal did not dispute the Company's eligibility to claim the incentive under Section 39 of the CIT Act for downstream gas utilization, having enjoyed tax holiday under the IDA. However, it did not address the issue of whether the approval of the FIRS is required before any downstream gas utilization company can claim the incentive stipulated in Section 39 of the CITA. Hence, this issue would remain a source of dispute between taxpayers and FIRS until judicial pronouncement on it.

The TAT's decision to void the incentive claimed by the Company was on the basis that the Company failed to obtain a valid certification of its date of production of gas as the DPR's letter was not a certificate. The TAT also noted that the letter did not specifically state a production date and, therefore, could not be construed as a valid certificate for the purpose of Section 39(2) of CITA. However, this provision does not refer to the issuance of a certificate as stated by the TAT. In fact, it only states that the tax-free period shall start on the day the company commences production as certified by the MPR. Simply put, a company can communicate a production date, but the date that matters is the one certified by the MPR or its delegate. It is not clear why the TAT limited the definition of 'certify' to issuance of certificate as 'certify' could also mean *"to state that something is correct or true, especially after some kind of a test".* The DPR letter, which was clearly a response to the Appellant's application for a production day, gave the approval for the introduction of hydrocarbon into the gas plant after confirming its satisfaction with certain steps that the Company had taken. The DPR did not have to state a specific date other than the date the Company had proposed. Thus, it is easy to understand why the Appellant adopted the date proposed to the DPR as its production date in the absence of any other date to the contrary. Interestingly, the extant legislation does not specify how the MPR should certify the production date. It is, therefore, not clear why the TAT did not adopt the principle of *'contra fiscum'*, which states that when, in doubt, do not tax. In other words, if there is any ambiguity in the law, it must be interpreted in favour of the taxpayer. It also appears that the TAT did not give any consideration to the meaning of *'introduction of hydrocarbon into a gas processing plant'*, a technical term that means commencement of production.



For further enquiries, please contact:

Wole Obayomi
NG-FMTAXEnquiries@ng.kpmg.com

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Ajibola Olomola: *Ajibola.Olomola@ng.kpmg.com*
Ijeoma Uche: *Ijeoma.Uche@ng.kpmg.com*
Olatoye Akinboro: *Olatoye.Akinboro@ng.kpmg.com*

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