

Valuation of Crude Oil for Petroleum Profits Tax Purpose in 2007 and 2008 tax years.



Newsletter

The Tax Appeal Tribunal (TAT), sitting in Lagos, recently ruled in the case between Chevron Nigeria Limited (the Appellant) and the Federal Inland Revenue Service (the FIRS or the Respondent) that realisable price (RP) is the appropriate basis for determining the fiscal value of crude oil in 2007 and 2008 tax years.

Background

Sections 9 (2) (a), 23 (3) and 23 (5) of the Petroleum Profit Tax Act (PPTA) provide for the methodology to be adopted in determining the appropriate fiscal value of crude oil for tax purposes. Based on these Sections the fiscal value of crude oil should be as determined by any financial agreement or arrangement between the Federal Government of Nigeria (FGN) and the company.

Accordingly, the FGN and its International Oil Companies (IOCs) JV partners agreed on a pricing mechanism, via a Memorandum of Understanding (MOU or "the Agreement"), in 2000. The MOU, amongst other things, provides that RP should be used in determining the fiscal value of crude oil for a minimum of three years, unless expressly extended by mutual consent. However, the MOU provides that upon termination, a new fiscal regime shall be provided by the FGN. Based on clause 7.3 of the MOU, in the event that the FGN fails to provide a new fiscal regime, the MOU will continue to apply.

Following the expiration of the MOU in 2002, the FGN was silent on the new fiscal regime to be applied. Consequently, the IOCs continued to adopt RP in determining the fiscal value of crude oil for tax purposes. In a letter dated 17 January, 2008, the Department of Petroleum Resources (DPR) communicated that the MOU had expired and would be replaced by the fiscal regime contained in the PPTA¹. The DPR also suggested that the Official Selling Price (OSP) should be adopted in determining the fiscal value of crude oil going forward. However, following deliberations between the Oil Producers Trade Section (OPTS) and the FGN, it was agreed that RP should be adopted between January 2008 and June 2010. This was communicated via a DPR letter dated 19 June, 2013.

Based on the above, industry operators adopted RP in determining the fiscal value of crude oil between January 2000 and June 2010. However, the FIRS held the position that, in the absence of a new fiscal regime, the provisions of the PPTA should apply and that section 23 of the PPTA only contemplated OSP as the posted price.

Facts and Judgment

The Appellant filed its Petroleum Profit Tax returns for 2007 and 2008 tax years using RP to determine the fiscal value of crude oil. However, following an industry-wide audit carried out by the Nigeria Extractive Industries Transparency Initiative, the FIRS issued notices of additional tax assessments to the Appellant based on OSP.

Dissatisfied with the additional assessments, the Appellant filed an appeal at the TAT for determination of the following issues:

- (i) whether, based on the provisions of the PPTA and not the MOU, the RP is the appropriate pricing methodology for determining the fiscal value of crude oil in the year ended 31st December, 2007
- (ii) whether based on the provisions of the PPTA, the MOU and the letter written to members of the OPTS by DPR dated 19th June, 2013, the RP is the appropriate pricing methodology for determining the fiscal value of crude oil in the year ended 31st December, 2008.

The Appellant argued that the procedures outlined in the MOU are consistent with section 23 (5) of the PPTA, The Appellant also argued that, because the FGN failed to replace

the MOU with a new fiscal regime it remained valid by virtue of clause 7.3 of the MOU, up to 2007. Therefore, RP should be the appropriate pricing mechanism for 2007 tax year.

On the second issue for determination, the Appellant argued that the DPR's letter of 19 June 2013 satisfies the requirements of Sections 9 and 23 (5) of the PPTA, which states that the pricing methodology must be based on an agreement between the parties. It also submitted that the parties had agreed that RP should be the appropriate pricing methodology for determining the fiscal value of crude oil in 2008.

The Respondent argued that the MOU was only valid for three years. Therefore, RP which is provided for in the MOU, is not valid beyond 2002. Furthermore, the Respondent argued that the termination of the MOU was also communicated to the IOCs via the DPR letter of 17 January 2008. In the letter, the DPR stated that the PPTA would be the new fiscal regime, and that OSP should be used going forward. In its opinion, payment of tax should be a matter of statute and not of any agreement or contract.

Therefore, the DPR's letter should not be substituted for the PPTA, which contemplated OSP as the posted price.

After considering the argument of both parties, the TAT ruled that:

- (i) the MOU was terminated in 2008 by the DPR via its letter dated

The question, therefore, is how the TAT or the Court would rule in the event of a dispute over the determination of fiscal value between July 2010 and December, 2012.

17 January 2008. In addition, RP is the appropriate pricing methodology for determining the fiscal value of crude oil in 2007, given that the MOU was still in force at that time and that the

MOU provisions were in alignment with the PPTA.

- (ii) the DPR letter of 19 June 2013 to the OPTS is an agreement with the FGN and it establishes the RP as the applicable pricing methodology for the year 2008 in line with Sections 9(2) (a) and 23 (1), (2), (3) and (5) of the PPTA.
- (iii) the Appellant is therefore not liable to pay any additional tax for the years in question.

Conclusion

This ruling affirms the position of the Federal High Court (FHC) and the TAT to the effect that the MOU has terminated, effective 17 January 2008. It also clarifies that the DPR letter of 19 June 2013 is a valid agreement between the FGN and OPTS, in line with Sections 9 and 23 of the PPTA. In the Mobil case², the TAT had ruled that OSP was the appropriate price for 2008 solely because Mobil did not provide satisfactory evidence to the contrary. It implies that the decision might have been different if Mobil referred to the



DPR letter as a binding agreement between both parties with respect to RP as the appropriate pricing methodology for that year.

The ruling in the Chevron case, however, raises a fundamental issue with respect to the appropriate pricing methodology to adopt for July 2010 to December 2012. Although the DPR letter of 19 June 2013 suggests that there is an agreement on the appropriate pricing methodology to adopt between 2008 and 2012, we are aware that the FGN and OPTS disagree on the adoption of OSP as the appropriate pricing methodology between July 2010 and December 2012.

The question, therefore, is how the TAT or the Court would rule in the event of a dispute over the determination of fiscal value between July 2010 and December, 2012. Would the TAT still maintain that the DPR letter constitutes an agreement and therefore accept OSP as the appropriate pricing methodology, or take the view that Section 9 of the PPTA requires an agreement between both parties as a prerequisite for determining the value of crude oil for tax purposes? And in the absence of a judicial pronouncement on the appropriate pricing methodology for this period, would RP continue to apply? Only time will tell.

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¹The Federal High Court has subsequently ruled in the case between Mobil Producing Nigeria Unlimited and the FIRS that the MOU expired effective 17 January, 2008.

²Mobil Producing Nigeria Unlimited and Federal Inland Revenue Service (Appeal No: TAT/LZ/032/2013)

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