FIRS has requested PSC Parties to start filing companies income tax returns

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In brief

The Federal Inland Revenue Service (FIRS) held a workshop on 6 June 2014 to discuss specific tax issues affecting parties to a Production Sharing Contract (PSC). Specifically, the FIRS requested that parties to a PSC file Companies Income Tax (CIT) returns going forward.

In detail

Background

Production Sharing Contracts (PSC) for acreage in the inland basins and offshore waters from 200m and above are regulated under the Deep Offshore and Inland Basin Production Sharing Contracts Act (PSC Act). The PSC Act together with the Petroleum Profits Tax Act (PPTA) serves as the taxing legislation for petroleum companies in deep offshore. Where there are conflicting provisions between the PSC Act and any other legislation, the former will prevail.

The PSC Act requires the Nigerian National Petroleum Corporation (NNPC) or the holder (of the license) to file tax returns and pay Petroleum Profits Tax (PPT) for each contract area on behalf of all parties in the PSC.

It is thus an established practice that once the lease holder files the PPT returns for the contract area on behalf of itself and the contractor, the statutory obligations of both parties have been fulfilled.

Position of the FIRS

The FIRS have confirmed that a contractor operating under a PSC has no further obligation to pay tax on the contract area, once the holder of the license has done so. This is in line with section 60 of the PPTA which exempts profits that have suffered PPT from further tax. However, the FIRS is now proposing that contractors should submit an additional return separate from the return filed by the holder.

The FIRS identified specific circumstances that would require a contractor under a PSC to file additional returns as follows:

- PPT returns for non-PSC lease
- CIT returns for non-petroleum/gas income
- CIT returns for PSC lease not yet producing
- PPT information with list of contract areas; parties to each contract area; profit oil and chargeable tax (average ratio) for each contract area; value of profit oil share on OML X, Y, Z; Total profit oil; chargeable tax on OML X,Y,Z and Total tax oil.
- The audited consolidated accounts of the contractor for all income generating activities.

The FIRS is of the view that a PSC contractor is not exempted from filing CIT returns with reference to section 55 of the CITA below:

"*Every company, including a company granted exemption from incorporation, shall, at least once a year without notice or demand therefore, file a return with the Board in the prescribed form and containing prescribed information together with the following information….."*

In effect, exploration and production companies that have not started production would now have to file CIT returns during the exploration stage .The FIRS further mentioned that with the necessary returns and accompanying information, the administrative bottlenecks encountered while processing Tax Clearance Certificates (TCC) for contractors under PSCs would be greatly reduced.

The FIRS is of the view that this would boost transparency and ensure that the contractor's activities are accurately captured in the tax files maintained by their offices.

Viewpoint of IOCs

Some oil companies in attendance did not fully agree with the Revenue's proposal based on the following points that were raised:

- The contractor cannot be responsible for tax filing and payments as the Deep Offshore Act releases it from such obligations and in fact overrules all other laws
- The referenced section should not be read in isolation but in conjunction with the requirements of the PSCs themselves
- Companies that had income liable to CIT were already filing CIT returns before this new proposal
- For PSCs, NNPC is responsible for providing the accounts for the contract area not the contractor.

The takeaway

It is obvious that the FIRS is seeking for more information on the activities of PSC contractors in Nigeria. Ultimately the objective would be to monitor and enforce compliance which should lead to more tax revenue.

CIT Filing: The requirement for PSC contractors to file CIT returns was taken to arbitration some years back. An arbitration panel is currently considering the questions "*whether the contractor is engaged in "petroleum operations" as defined in section 2 of the PPTA"* and *"whether the contractor is subject to PPT"*, while another panel had ruled that the PSC companies were engaged in petroleum operations in respect of crude production and thus liable to PPT and not CIT. This is supported by Clause 2.4 of most PSCs (3.4 in others) which explicitly states that *"The CONTRACTOR is engaged in Petroleum Operations pursuant to the Petroleum Profits Tax Act … and accordingly the Companies Income Tax Act … shall have no application."*

The Oil Companies are likely to continue to challenge the proposal by the FIRS based on the above clauses in the PSCs. It is difficult to predict how the proposal will eventually play out. Invariably, filing of CIT tax returns could have significant tax implications such as commencement, change of accounting dates, cessation rules. In addition, excess dividend tax may apply on further distribution of the petroleum profits by the contractors.

Given that the core issue is a question of law, it is necessary for affected parties to seek appropriate legal opinion or a judicial interpretation before changing their existing filing practice.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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