Tax Appeal Tribunal Supports Tax Deduction of Modified Carry Arrangement Costs

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Overview of the case

The contention was whether an oil company can claim tax deductions for cost incurred under a Modified Carry Arrangement (MCA). The case was brought before the Tax Appeal Tribunal (TAT) by an International Oil Company ("IOC" or "Appellant") against the Federal Inland Revenue Service ("FIRS" or "the Respondent"). The TAT ruled that the IOC was entitled to make deductions in computing its adjusted profit in accordance with the provisions of the Petroleum Profits Tax Act (PPTA), despite the non-execution of a standard MCA.

The Appellant entered into a joint venture agreement with the Nigerian National Petroleum Corporation (NNPC) in which the NNPC held 60% equity participation and the Appellant held 40%. The Appellant filed its 2010 – 2011 tax returns in which it took deductions for intangible drilling costs, as well as, capital allowances. The Appellant relied on section 10 and 20 and the Second Schedule to the PPTA in maintaining that it was entitled to make deductions as the expenses were incurred by it in the course of its petroleum operations.

The FIRS however, disallowed the NNPC's 60% portion of the intangible drilling costs as deductible expenses, as well as the tangible portion incurred as qualifying capital expenditure on the basis that there was no standard MCA.

The TAT ruled in favour of the Appellant and discharged the assessments. It opined that the FIRS in implementing tax laws must first look to the requirement of the tax laws and not the agreement between parties. It further stated that the FIRS' power to tax companies arises not from the provisions of the MCAs or any agreement between parties but from the provisions of the current tax laws, which in this case were unambiguous.

The takeaway

It is noteworthy that, the TAT's decision is similar to that of a previous case similarly involving an IOC and the FIRS. We had published a tax alert on this previously (Link). The general consensus is that tax statutes especially when unequivocal, should be the main point of call rather than any agreement between parties.

The rulings by the TAT on the subject matter has so far been consistent and in line with sound common law principles. This is certainly a step in the right direction.