TAT says sole costs for petroleum operations are tax deductible

"...when dealing with matters of tax, the first port of call should always be the tax laws..."

For a deeper discussion, please contact any of the persons below or your usual contact with PwC Nigeria:

Taiwo Oyedele
+234 1 271 1700 Ext 50002
taiwo.oyedele@ng.pwc.com

Ugochukwu Dibia
+234 1 271 1700 Ext 50008
ugochukwu.dibia@ng.pwc.com

Babatunde Akin-Moses
+234 1 271 1700 Ext 50029
babatunde.akin-moses
@ng.pwc.com

Summary of the case

In May 2016, the Tax Appeal Tribunal (TAT) sitting in Lagos ruled that parties in Production Sharing Contracts (PSCs) with the Nigerian National Petroleum Corporation (NNPC), can take tax deduction for sole costs, where the deduction of such expenses are permissible under the Petroleum Profits Tax Act (PPTA), regardless of the provisions of any contractual agreement.

The Appellants (upstream oil companies in PSCs with NNPC) filed their PPT returns for the 2009 to 2011 tax years and took tax deduction for sole costs. The Respondent (the Federal Inland Revenue Service [FIRS]), disallowed the sole costs upon reviewing the tax computations, and issued additional assessments to the Appellants for the period covered. The Appellants objected to the assessments leading to the appeal at the TAT.

The Appellants argued that the sole costs were part of its valid operating expenses, and should therefore be tax deductible in line with the PPTA. The FIRS countered by submitting that the sole costs could not be tax deductible, since they were not part of "cost oil" allocation as envisaged by the Deep Offshore and Inland Basin Production Sharing Contracts (Deep Offshore) Act, and also because the PSC itself does not provide for sole costs to be recovered.

The TAT ruled in favour of the Appellants and discharged the assessments on the basis that the PSC and the Deep Offshore Act only govern the cost recovery process while matters relating to tax should be decided in line with the PPTA.

The takeaway

This decision is consistent with earlier cases. When dealing with tax matters, the first port of call should always be the tax laws, and not contractual agreements or other rules that govern the industry. The TAT and the taxpayers seem to be on this same page with respect to this issue as evidenced by recent decisions (see link to another case here).

Unfortunately, the FIRS appears unconvinced of this principle, and continues to treat sole costs as disallowable expenses, despite evidence (and precedence) suggesting otherwise. With more cases like this, we hope that the debate about tax laws versus contractual provisions would soon be a thing of past, in favour of the tax law.