



An exposé of some Commercial & Legal Aspects of the Nigerian Petroleum Industry Bill Part2-Rejigging the Fiscal Toolbox

Indeed, one of the three issues considered the “pillars” upon which upstream oil and gas investments are based is the fiscal regime of the host State. In other words, an investor in an international petroleum transaction intending to invest in a petroleum regime would conduct its due diligence before committing risk capital by looking at, amongst other things, the issue of ‘government take’ versus ‘investor take’.

The Nigerian upstream fiscal tool box consists of taxes, bonuses (signature and production), rents, fees and royalties. Currently, in the Nigerian upstream oil and gas sector, taxes are paid upon profits derived from petroleum operations after making some allowable deductions, rents are also paid based on factors including size of the contract area and whether production has begun or not.

The signature bonus is paid when the instrument of grant/ the Host Government Contract such as the Production Sharing Contract (PSC) is signed or the letter of award is issued. A production bonus may also be payable when a production threshold is reached or a pre-determined cumulative production is achieved.

Royalties which are a part of production and are payable in actual production(crude oil) or cash equivalents are calculated based on a sliding scale depending on certain factors which include the location of the contract area (whether it is deep offshore or onshore/shallow offshore and the depth of the contract area if deep offshore), whether it is a marginal field or an Oil Mining Lease/Oil Prospecting Licence and with modern trends, recent Nigerian PSCs have introduced the concept of an R-Factor. International market prices and volume of production also determine the Royalties payable.



Additionally, PSC Holders get tax rebates in form of Investment Tax Credits or Investment Tax Allowances depending on whether the PSCs were signed prior to or after July 1st 1998. The difference in practice is that an ITC creates a much lower tax liability on the part of an investor, than an ITA.

The gazetted version of the PIB proposes to maintain the current tax rates for crude oil operations applicable while increasing tax rates for gas operations by 5-10%. Interestingly, during the July 2009 public hearing on the PIB, an interagency committee comprising of the NNPC, tax authorities and the Ministry of Petroleum amongst others submitted a memo promoting the idea that upstream companies be charged a flat corporate tax rate as well as an additional "hydrocarbon tax" and/or "windfall tax" thereby significantly increasing taxes payable on upstream activities.

The interagency version also makes provision for the payment of Royalty based on value and production in order for the government to cream off windfall profits. This structure, which creams-off windfall profits is regarded by international petroleum transaction experts as a 'progressive fiscal regime system' because government take increases as crude oil prices increase in the international market.

Importantly, the PIB also seeks to alter the current cost recovery mechanisms now in practice by reducing the quantum of recoverable expenses by as much as 20% by for example reducing foreign related costs recoverable to 80%.

To further tighten the screws, the PIB also proposes to discard the use of Investment tax Credit and Investment Tax Allowances which were key fiscal incentives in getting the IOCs to consider exploring ultra deep water acreages. In its stead, the PIB seeks to introduce a petroleum investment allowance which rates are currently uncertain.



The fiscal regime as proposed is likely to challenge the viability of smaller discoveries particularly considering that these fields are marginally economic under existing terms due to the high development costs in Nigeria.

The members of the Oil Producers Trade Section of the Lagos Chamber of Commerce and Industry (the "OPTS"), have argued that the overall effect of the changes in the PIB would be to make investment in Nigeria's upstream oil and gas unattractive and could increase government take from its current 92% to 98% thereby reducing investor take to 2% from 8%. This they argue would make Nigeria's already onerous fiscal regime worse. The OPTS is therefore engaging the government in this regard.

It should be noted that the provisions reviewed above are proposals contained in draft legislation. These provisions may remain unchanged, be altered or even removed when the final version is passed into law as the industry stakeholders are currently engaging the Nigerian parliament in this regard.

In spite of the caveat above, the Nigerian government has expressed (and demonstrated) its intention to push through the new law; so notwithstanding that there is an expectation that the stakeholders input will be reflected in the final version of the law, the Nigerian petroleum industry will never be the same again.