THE PRACTICE OF LESSENING TAX BURDENS BY MULTINATIONAL COMPANIES AND ITS EFFECT ON THE TREATMENT OF PETROLEUM PROFIT TAX: THE NEED FOR FORTHRIGHTNESS.

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Abstract

In spite of the government's drive towards the diversification of the Nigerian economy, the Petroleum sector has remained the major source of revenue and a veritable tool for the establishment and sustenance of such a drive. However it's being the number source of revenue, there appear to be several leakages in the tax net that occasion huge loss of revenue annually that require urgent attention and ensure optimal revenue generation from the sector. While some of these losses can be attributed to the inefficiency of taxing authorities and corrupt practices in the sector, this paper focused on specific methods adopted by Multinational Companies (MNCs) to reduce their tax liabilities. These methods though mostly legal, are made possible by duplicities of incentives in various legislations, loopholes, and lacunas in the law, as well as fiscal arrangements available to MNCs with their attendant negative effect on revenue generation. These methods include transfer pricing, tax avoidance and evasion, and fiscal arrangements in the petroleum sector. This paper also considered the salient innovations to be introduced in the sector when the Petroleum Industry Bill completes the legislative process for its passage into law and therefore recommended speedy and wholesome passage of the Bill into law being the only instrument available to curb such leakages, stimulate the sector and ensure efficiency in revenue generation.

Introduction

Multinational companies usually adopt methods and practices that decrease the overall weight of their tax obligations. While most of these methods are legal and sometimes tend to increase investment in some sectors of the nation's economy or attract better investments, it nevertheless negatively impacts heavily the amount of revenue generated for national development. The actualization of the government's drive at generating revenue through taxation is primarily dependent on what the tax authorities are able to compute, assess and collect. The ultimate goal is to harness

as many profits as possible into the tax net. Though the tax laws make seemingly sufficient provisions for this, what profit is eventually computed, assessed, and collected as tax is not only a product of the relevant tax law but also the interplay of some tax planning by taxpayers and fiscal arrangements entered with the government through government establishments for that purpose. The tax planning methods are referred to here as methods of lessening tax burdens with a wider application to cover fiscal arrangements. The fiscal arrangements are the contracts entered into by the government and multinational companies engaged in the petroleum business. These practices have their respective impacts on the taxation of the sector and revenue generation.

Conceptual Understanding

The Concept of Computation and Assessment

Usually, the various tax legislation in Nigeria make provisions for the computation of taxes within its scope of application. But generally, the concept of computation entails the summation of all assessable profits of an individual or company, which is the aggregate of profits of the individual or company from all sources, less any deduction, exemption, incentive, and allowance granted by that legislation. Therefore, in computing profit generally, the aggregate of profits from all sources is added, less any deductions and allowance given or prescribed.

The Concept of Deductibility of Expenses

The principle of deductibility of expenses is a relevant concept to the computation of adjusted profits. Deductibility of expenses is guided by certain principles of law. And if an expense qualifies under any of the principles, such an expense will not form part of the aggregate of profits from all sources on which tax is computed. There are three basic principles that guide the application of the concept of deductibility.

This first principle is that any expense sought to be deducted must not be specifically disallowed as deductions by the relevant law. Once an expense is specifically disallowed, it cannot qualify as a deduction for the purpose of computation.

The second principle is that even where there is no express provision of a relevant law on the expense sort to be deducted, such an expense must still qualify

as that which is made wholly, exclusively, necessarily, and reasonably incurred in the production of the income of the fiscal year.

Thirdly, there is the tax classification of expenditure into revenue and capital. This classification can be described by the metaphor of 'the tree' and 'the fruit it bears.' While the tree is the capital invested, the interest is the fruit the tree bears as the return on the investment.[1] The application of this principle to what is allowable as a deduction is that only revenue expenditure or expenditure of a revenue character is allowed as deductible, while capital expenditure or expenditure of a capital nature is not deductible. The basic distinction between the two is that while revenue expenditure is recurrent, capital expenditure is made once and for all.

The Concept of Incentives and Exemptions

The payment of tax is fundamental to the administration of every government. It is created by law and levied on persons, income, commodities, and transactions to yield public revenue that affords the government the opportunity to offer protection and other socio-economic amenities to its citizens.

Tax incentives are usually a deliberate act of government established to reduce tax burdens and stimulate economic growth. They help encourage businesses for increased investment, production, employment, and savings. Achieving this objective demands that the tax system is equitable, certain, efficient, and levied at the time or manner that is most likely convenient for the taxpayer to pay.

Tax incentives in Nigeria are usually prescriptions of law and take the nature of tax relief or allowances and deductions for the benefit of taxpayers. It can also take the form of pioneer status or exclusion of gain from chargeable tax if it accrues to an ecclesiastical, charitable, or educational institution of a public character, statutory or registered friendly society, or registered cooperative society or trade union, provided the gain is not derived from any disposal of an asset acquired in connection with any trade or business, and the gain is applied purely for the purpose of objectives of the institution or society.

[1] Joseph Ajibola Arogundade, *Nigerian Income Tax & Its International Dimension*: An In-Debt Analysis of the Taxation of Incomes from Local and Cross-Border Transactions in Nigeria. (Ibadan: Spectrum books, 2005.) p.183

Methods Of Lessening Tax Burdens

For the development and growth of any society, the provision of basic infrastructure is quite necessary. This perhaps explains why the government shows great concern for a medium through which funds can be made available to achieve their set goals for society. The government needs funds to undertake governance and discharge its social obligations to its citizens. These social obligations include but are not limited to the provision of infrastructure and social services. Meeting these needs calls for huge funds, which an individual or government cannot singly provide. It becomes the government's responsibility to source these funds that will enable her to provide these basic amenities to the citizenry as beneficiaries. One of the mediums through which this fund is derived is taxation.

While the government makes concerted efforts to harness as much as possible the required funds for development through the implementation of tax laws and policies, Multinational Corporations and other companies engaged in business in the oil and gas sector are conscious of finding ways of reducing their tax burdens and, actually so do, when the opportunity avails them. Some of the ways in which they achieve this include both legally accepted methods and non-legal methods. The legal methods include *inter alia* tax avoidance schemes and ensuring governments increased tax exemption policies and incentives by influencing tax policies and legislation. This also includes taking advantage of Exemptions and incentives and transfer pricing. The non-legally acceptable method is tax evasion.

Transfer Mispricing

Transfer pricing as a tax concept deals with determining the prices for goods and services transacted between associated entities. Multinational Corporations (MNCs) are the prominent actors in this practice, and they occupy a prominent position in global international business. MNCs are companies who, over time, expand their businesses beyond their local territories and own business branches or subsidiaries or own stakes in businesses across the globe. While carrying on business transactions with other companies or business organizations, MNCs find it necessary to transact business with their subsidiary or part of its vertically

integrated company(s) domestically or internationally. The prices set for such transactions are referred to as the transfer price determined for tax purposes.[2]

There is usually aggressive tax planning embarked upon by MNCs through the use of some potent tools, outstanding among which is transfer pricing. Transfer pricing is often predicated on an innate and persistent need to maximize business profit. This need is not unlawful in view of the fact that there exists no law criminalizing MNC's practice of transacting business with any of its subsidiaries, associates, or other corporations. Moreover, the general principle is that every taxpayer is entitled to structure its tax affairs in ways necessary to minimize its tax burden.[3] Though legal, transfer pricing, more often than not, impacts revenue generation negatively because its ultimate effect is to reduce the tax base and, consequently, the revenue of the government. This situation propelled Osadare[4] to maintain that the problem is so sophisticated that many governments of developing nations, including Nigeria, are far from finding a solution because of their slow legislative process. The MNCs are thus always a step ahead.

This problem is engendered by the fact that MNCs are allowed to determine the prices for the exchange of goods and services within their business unit. This is usually not a simple task, especially when goods, services, and intangible property are traded across borders from a high tax jurisdiction to low tax jurisdictions. Muchlinski[5] vividly described situations where transfer pricing manipulation occurs. He stated that where for example, goods and services are traded between a subsidiary in country 'A' with high tax rates and a parent company in Country 'X' with low tax rates, the price of goods and services bought and purchased could be misstated by over-invoicing or vice versa. When the parent company buys goods from the subsidiary, the price may be overstated to reduce the taxable profit of company 'A' and thereby cause a transfer of revenue to Country 'X,' where tax rates are low.[6] The same mechanism can be employed between the affiliate and

[2] Bernard J., & Weiner R. J., Multinational Corporations, Transfer Prices, and Taxes: Evidence from the U.S. Petroleum Industry in Razin, A., & Slemrod J., (eds) Taxation in the Global Economy, (Chicago & London: University of Chicago Press: 1990), p.123
[3]see Lord Tomlin In *IRC V. Duke of West Minster* (1935) All E.R. 259
[4]Babatunde Osadare, *Transfer Pricing and Conflict Resolution*: Issues for the Extractive Industry. Centre for Energy, Petroleum Mineral, Law and Policy,University of Dundee Journal.
[5]Muchlinski, P., Multinational Enterprises and the Law, (Oxford, Blackwell Publishers,1999), p.282
[6]Ibid

independent companies operating within the same jurisdiction, where tax rates vary according to sector types.

Most governments will usually guard against such practice through delegated powers to their tax authorities and adopt proactive measures to minimize transfer pricing, which depletes their tax base. One of these measures is the arm's length principle, which generally requires that a transferred prices between MNCs and their subsidiaries be set according to the arm's length principle. In Nigeria, this is provided for by the Income Tax (Transfer Pricing Regulation) Regulation No 1, 2012.

The Arm's Length Principle : The principle of arm's length insists that prices set by MNCs and their subsidiaries should be in accordance with the prices that would have been ordinarily determined and agreed between unrelated parties who are engaged in the same or similar transaction and under similar market conditions. Section 4(1) of the Income Tax (Transfer Pricing Regulation) Regulation that:

> *Where a connected taxable person has entered into a transaction or a series of transactions to which these regulations apply, the person shall ensure that the taxable profits resulting from the transaction is in a manner that is consistent with the arm's length principle*

Section 10 of the Regulation defines a connected taxable person as persons, individuals, entities, companies, partnerships, joint ventures, and trusts or associations. So all the above categories of persons are mandated to uphold and apply the arm's length principle.

The question now is how to determine whether a series of transactions carried out by MNCs is in consonance with the Regulation. Section 5 of the Regulation thus provides:

> *In determining whether the result of a transaction or series of transactions are consistent with the arm's length principle, one of the following transfer pricing methods shall be applied – the Comparable Uncontrolled Price (CUP) Method, the Resale Price Method(RPM), the Cost Plus Method (CPM), the Transaction Net Margin Method or the Transactional Profit Split Method.*

Under the CUP method, the prices charged for the goods or services under controlled situations are compared with the prices charged for such goods or services in a comparable situation in the open market.[7] Similar in character is the RP method or the Re-Minus Method (RMM), which is based on the open market resale value of a product purchased by an MNC from an associated entity. The difference in upside is then used to calculate the arm's length price.

The CPM is used in determining the arm's length price by using the cost a supplier of goods would have incurred under a controlled transaction and adding a cost-plus mark-up to provide for normal profit. It has been argued that this method may be very useful in preventing aggressive profit shifts out of high tax jurisdiction.[8] This method, however, is not without its criticisms.[9] It is said, for instance, that the method fails to take into account the likely price of a final product and the fact that the mark-up price is to be determined haphazardly.[10]

The punishment for not upholding the arm's length is provided for in section 13 of the Regulation. It provides that a taxable person who contravenes any of the provisions of the regulations shall be liable to a penalty as prescribed in the relevant provision of the applicable tax law. But it is interesting to note that this provision is not specific but appears to be indolent and tends to encourage MNCs to continue with their normal attitude towards their transfer pricing practice. One would expect that since transfer pricing is a specialized type of tax avoidance with much more capacity to deplete revenue from Nigeria's economic gold mine in the oil and gas sector, the Regulation would have made adequate provisions for sanctions that will ensure strict adherence to the arm's length principle. Notwithstanding this absence, the Regulation empowered the FIRS to establish a Decision Review Panel (DRP) for the purpose of resolving any dispute or controversy arising from the application of the Regulations.[11] A taxpayer who disagrees with the ruling of the DRP on any transfer pricing matter may have recourse to the court of competent jurisdiction in the first instance, which includes

[7]United Nations Commission on Trade and Development (UNCTAD) Transfer Pricing (UN, New York and Geneva, 1999), p.10
[8] Gresik, T., & Osmundsen, P., Transfer Pricing in Vertically Integrated Industries, Journal of International Tax and Public Finance, Vol. 15, No. 3, (2008), p. 234.
[9]Plasschaert, S., Transfer Pricing and Multinational Corporations: An overview of Mechanisms and Regulations (England, Saxon House, 1979), p. 33
[10] Ibid.
[11] See Section 14 of Income Tax (Transfer Pricing Regulation) Regulation No 1, 2012

the tax tribunals. But it is also instructive for the taxpayers to note that the provisions that relate to fraudulent filings are stringent in Nigeria. To that extent, a taxpayer who makes a false declaration on a tax return which includes indicating on a transfer pricing disclosure form that proper documentation is in place when it is not, the FIRS may impose fines, penalties, and in some cases, jail time for company officials.

Tax Avoidance

Tax avoidance here refers to international tax avoidance. International tax avoidance, as used here, refer to the schemes, arrangements, plans, or manipulations to gain a tax advantage.[12] It is simply taking advantage of the loopholes or lacunas in the law in order to gain tax advantage or reduce tax burdens.[13] Tax avoidance in the oil and gas sector would therefore imply all schemes and plans by MNCs or enterprises to gain tax advantage and minimize tax liabilities, usually through the express provision of the law or through inadequacies or loopholes in the law.

Tax avoidance takes place when facts of a transaction are admitted but are however arranged or presented in such a way that the resulting tax treatment differs from what is intended by the relevant legislation. It is the legal reduction in tax liabilities through practices that take full advantage of the tax code, such as income splitting, postponement of taxes, and tax arbitrage across incomes that face different treatments.

International tax avoidance appears to be a wider concept because it is used to cover all tax planning schemes employed by MNCs to minimize tax liability. For this reason, thin capitalization is sometimes used as a tax avoidance scheme. It usually arises for instances in transactions between an MNC and a Nigerian subsidiary or between a multinational enterprise group and an associated recipient in Nigeria. Usually, the head office or the group lends a loan to the Nigerian subsidiary or affiliate but charges interest that is in excess of the interest rate as will normally apply between unrelated persons operating on a regular commercial basis.

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[12]Joseph Ajibola Arogundade op cit. at p. 73

[13] Definition as given by Prof. D.S. Asada of the Faculty of Law, University of Jos in his LLM. (Law of taxation) class on the concept of tax avoidance. April, 2014

Avoidance in the oil and gas sector may also include taking advantage of a plethora of tax incentives (deductions, exemptions, or expressly provided incentives) provided for by the government through the various tax laws regulating the sector. For instance, investing in a specific field in the gas subsector may be regarded as pioneer and accorded such status; or investing in the utilization of associated gas for which incentive is provided for under section 11 of the Petroleum Profit Tax Act.

In order to check these cases of tax avoidance, anti-avoidance measures are usually taken. An example is the anti-avoidance measure included in the Nigerian Model double Taxation Agreement. They include the following:[14]

i. Facilities that would normally be exempted from being a Permanent Establishment (PE) but which are used as sales outlets would be deemed to be a PE
ii. The insertion of the concept of "bona fide commercial transactions" under Articles 10, 11, and 12 to ensure that rights assigned or created to gain tax advantage would be denied the treaty benefits.
iii. The inclusion of "beneficial ownership" under Articles 10, 11, and 12 ensures that treaty benefits flow only to the intended recipient and not to intermediaries, proxies, or nominees.
iv. Dividends, interest, rent, and royalties effectively connected to the business of a PE in a source country are to be taxed as part of the profits of the PE; and
v. Interest, rent, and royalties payable between related persons to be limited to what would be applicable under the arms' length situations, and the balance to be disallowed.
vi. Treaty partners are also to exchange such information as is necessary to prevent fraud or for the administration of statutory provisions against legal avoidance.

Tax Evasion

Whenever any form or act of tax planning falls within the realm of illegality, then it is tax evasion. So whether a tax planning action by a taxpayer is evasion or not will depend on whether the action is legal or otherwise illegal. Tax evasion may

[14] Joseph Ajibola Arogundade op cit. at p.77

therefore be described as a deliberate and willful practice of not disclosing full taxable income in order to pay less tax. It is a violation of tax laws whereby the tax due by a taxable person is unpaid after the minimum specified period. It may also be evident in situations where tax liability is fraudulently reduced, or false claims are filled on the revenue tax form. It is the general term for efforts by individuals, firms, trusts and other entities to evade taxes by illegal means. Some of the ways of evading tax liabilities under the PPTA include the following:[15]

i. Non-compliance with the provision of an enabling legislation
ii. Failure to comply with the requirements of a notice
iii. Failure to answer a query
iv. Making incorrect returns by omitting or understating any profits assessable to tax
v. Giving false statements and returns for the purpose of obtaining any deductions, set-offs, relief or refund
vi. Intentionally and knowingly making false representations in a return, account or particulars made or furnished with respect to tax
vii. Any form of under-declaration of income and inflation of claims
viii. Forgery, fraud, willful default or neglect in matters relating to tax.

Tax evasion, therefore, usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability. It also includes, in particular, dishonest tax reporting such as declaring less income, profits or gains than actually earned; or overstating deductions.

An example of a case of evasion by some of the MNCs in Nigeria was reported in *'Thisday Newspaper of 15 November 2006'* over what was called *'the $500 billion question.'* It was reported that using the final tax returns submitted to the Federal Inland Revenue Service (FIRS) by Shell, Mobil, Chevron Nigeria, Nigeria Agip Oil Company (NAOC), Texaco and Elf, the Okonjo led team started by conducting a study on the margin of profit allowed to oil companies under the Memorandum of Understanding (MOU) based on the existing fiscal regime. The study eventually revealed very clearly that the oil majors were shortchanging Nigeria, and there was a $340 million shortfall by the calculations done. The amount of shortfall was eventually recovered and returned to the Nigerian treasury

[15] ibid

by the oil companies when President Obasanjo made out a letter to the companies involved.

Distinction between Tax Avoidance and Tax Evasion

Though both tax evasion and tax avoidance lead to leakages in tax revenue, the legal and policy implications make it pertinent to distinguish between the two concepts. The black's law dictionary[16] defines the term "tax avoidance" as the minimization of one's tax liability by taking advantage of legally available tax planning opportunities. The same dictionary defines tax evasion as the act of illegally paying less in taxes than the law permits or committing fraud in filing or paying taxes. This simply means that tax avoidance is a scheme that exploits or takes advantage of the weaknesses or ambiguities in the tax laws to reduce or escape tax liability.[17] Conversely, tax evasion is any form of fraud, willful default or neglect by a taxpayer to reduce his tax liability or completely escape tax payment.

In tax evasion cases, the law usually provides for prosecution, and upon conviction, the penalties are usually in the form of fines. But it is obvious that the fines imposed upon conviction are rather too low in relation to the current economic realities in Nigeria to serve as a deterrent. It, therefore, encourages tax defaulters who would rather evade and pay fines that are lower than the taxes required to be paid while sending wrong signals to taxpayers who willingly comply with tax laws. This may account for the plethora of incidences of tax evasion in Nigeria.

The classic distinction between avoidance and evasion is that which was given by Oliver Wendell Holmes, who wrote:[18]

> *When the law draws a line, a case is on one side of it or the other, and if on the safe side is none the worse legally that a party has availed himself to the full of what the law permits. When an act is condemned as evasion, what is meant is that it is on the wrong side of the line…*

[16] Black's Law Dictionary, 6th Edition. P. 1473
[17] Ibid at p.1474
[18] *Bullen v Wisconsin* (1916), 240. US. 625 at p. 630

So the fundamental distinction between tax avoidance and evasion is the legality or otherwise of the method adopted by a taxpayer. While tax avoidance methods are generally seen as legal, tax evasion is illegal and criminal in nature.

Fiscal Arrangements

Tax treatment of the oil and gas sector in Nigeria is regulated by the Petroleum Profits Tax Act (PPTA) 2007. But the PPTA is not the only taxing Regulation in the industry. The relationship and operation of an operator in the industry with the Nigerian National Petroleum Corporation (NNPC) and the oil fields vary, and what standard would apply to an operator would certainly be determined by the type of agreement the operator executed with the NNPC. Thus while the PPTA provides the legal framework for the tax treatment of profits from the sector, what goes into the computation is determined by the terms of these agreements. The Agreements, therefore, specifically modify the application of the provisions of the PPTA.[19] These fiscal arrangements or contractual agreements are the Joint Venture Contracts (JVC), the Production Sharing Contracts (PSC), and the Sole Risks (Independent Operators).

Joint Venture Contracts (JVC) Tax Regimes

Under the JVC arrangement, the Federal Government, through the Nigerian National Petroleum Corporation (NNPC), enters into a joint operation agreement with MNCs as joint venture partners. The foreign technical partners are usually designated as "Operators". The operator's duties include the implementation of the work program and budget.[20]

Each partner is expected to make contributions to cash calls through exploration, development and production activities and separately lift and dispose of its share of crude oil based on their equity contribution, usually in the ratio of 60:40, and separately account for petroleum profit tax and royalty.[21] This arrangement has been viewed by critics as a disincentive to cost minimization on the part of the Federal Government, and several attempts have been made to

[19]Joseph Ajibola Arogundadeop. cit. at 226

[20]Lawal, K. T. *Taxation of Petroleum Profit under the Nigeria's Petroleum Profit Tax Act.* International Journal of Advanced Legal Studies and Governance, Vol. 4, No. 2, August 2013 p.5

[21] ibid

correct this view. Consequently, the Tax inversion Penalty (TIP) clause was introduced in the 2000 MOU agreement. However, transfer pricing and tax avoidance schemes which are the consequences of this arrangement in the oil and gas industry, seem to obviously counter any savings the Federal Government stands to gain.

The 2000 MOU**:** Generally, an MOU is a package of fiscal incentives to enhance crude oil export, encourage investment in the oil industry's upstream sector, and ensure cost-effectiveness.[22] Historically, MOU was first introduced in 1986 as a necessity when the world price of crude oil fell very low. This fall greatly affected the returns on investments of the companies and, conversely, on the revenue generated by the Nigerian government. The government, therefore, introduced the 1906 MOU as an intervention to stimulate investment in exploration and production activities and encourage crude oil exportation. Subsequently, it was revised by the 1991 MOU and then the 2000 MOU.

During the period of the lapse of the 1991 MOU and its revision in 2000, there was a heavy reliance on the 'Side Letters' from the NNPC/Minister of Petroleum Resources. The major highlights of the 2000 MOU are as follows:[23]

i. A minimum guaranteed notional margin of $2.50/bbl after-tax and royalty to the company on its equity crude;
ii. A minimum of $1.25/bbl after-tax and royalty on the NNPC equity crude lifted under the MOU;
iii. The margin is premised on the operational, technical cost (T1 & T2) not exceeding the notional technical cost (TC) of $4.00/bbl;
iv. When a company's actual capital investment cost (T2) exceeds $2.00/bbl on average, the margin shall be increased to $2.70/bbl for the company and $1.35/bbl for NNPC equity crude lifted.
v. The penalty threshold for tax inversion penalty (TIP) of $3.00/bbl and $2.30/bbl for small and big companies, respectively, are provided for

The objectives of the 2000 MOU includes the provision of incentives for enhanced crude oil exports, encourage investment in oil exploration and development activities, encourage gas utilization activities, encourage enhanced oil

[22]Joseph Ajibola Arogundade op. cit. at 228
[23] ibid

recovery and cost efficiency, and to provide assistance in the achievement of Nigeria's long-term growth objectives. Accordingly, the applicable rates are the normal PPTA 85% of chargeable profits and 65% for companies that have not fully recovered their pre-production expenditures.

The benefit a JVC operator derives from this arrangement through the MOU will depend on three important factors – the capital investment expenditure, realizable price, and the cost of operation. It will generally appear that an increase in the price of the price of crude oil and an increase in capital investment will increase the profit margin of the operator.[24] Conversely, an increase in operating cost will increase the penalty payable by the operator and therefore follows that an operator will be more concerned with the world market price, the marginal expenditure on capital investment and the operating costs for tax purposes.[25]

Production Sharing Contracts (PSC) Regimes.

This is an arrangement where the NNPC holds the license while the companies are regarded as contractors to the NNPC. The company finances the operation, including the cost of exploration, prospecting, development, extraction and production of the crude oil. Major highlights of this arrangement include:

a) The applicable PPT is a flat rate of 50% of chargeable profits;
b) Areas of operation are the deep offshore and the inland basin;
c) An investment tax credit of 50% of qualifying expenditure for contracts executed prior to 1st July 1998 and investment tax allowance for subsequent contracts;
d) Ring-fencing of oil blocks to prevent losses from one oil-block form from being set off against profits from another block;
e) Allocation of royalty oil to NNPC, the holder, for the payment of monthly royalty and annual rentals on behalf of both parties;
f) Allocation of profit oil, which is the balance of total production after deductions for royalty oil and cost oil to each party in accordance with the terms of the PSC arrangement between the NNPC and each contractor;
g) Allocation of tax oil to NNPC for the payment of PPT on behalf of both parties;

[24] ibid
[25] ibid

h) Royalty is payable as follows:

i.	201 to 500m water depth	12%
ii.	502 to 800m water depth	8%
iii.	801 to 1000m water depth	4%
iv.	Areas in excess of 1000m water depth	0%
v.	Inland basin	10%

The Sole-Risk (Independent Operators) Tax Regime

This arrangement encourages indigenous participation in the sector as operators or license holders as against the JVC and PSC arrangements. Its distinctive feature is that operators in this arrangement operate independently and individually. Though this appears to be an advantage, in practice, however, it constitutes a significant burden and difficulty for operators. As a result, many operators under this arrangement have not been able to produce a single barrel since they got the license, and most of those who have started production are not able to meet what is regarded as commercial quantity, which is a production capacity of at least 10, 000 barrels per day. The reason for this problem is not farfetched. This is because the industry is capital intensive and has a high-risk factor as oil may not be discovered at all or may not be discovered in commercial quantity, and even when oil is discovered, there may not be income against which to write off the pre-production expenses.[26]

Since huge capital is required, operators of this arrangement usually go into operating agreements with foreign technical partners in order to meet the capital requirement. Such agreements are similar to the PSC agreements, which the NNPC enters into with the contractors in which the technical partner funds the operation and recoups its costs with cost oil. Others operate the stand-alone operational and filing arrangements with technical partners, while others have a joint business in order to meet the tax filing requirements.

The natures of the above arrangements pose some problems for tax administration in Nigeria, similar to those experienced with small and medium scale enterprises. This is because it appears that the main preoccupation of some operators is winning the license, and no consideration is given to the tax aspect, which later becomes a huge burden. Secondly, the agreements with the foreign

[26] Ibid at p.249

technical partners leave the partners free to insert clauses that would ensure the recovery of their investments, which would create abuses of the tax system. The main effect of this is the shifting of income from Nigeria to the country of the foreign technical partner.[27]

Effects Of Lessening Tax Burdens By Multinational Companies On Treatment Of Petroleum Profit Tax

Effect of Transfer Pricing on Treatment of Petroleum Tax and the Economy

To buttress the effect of transfer pricing on the treatment of petroleum tax, it may be necessary to look at a scenario between a parent company and its subsidiary engaged in transfer pricing. In doing this, it may be needful to recast the earlier example given above. When goods and services are traded between a subsidiary in country 'A' with high tax rates and a parent company in Country 'X' with low tax rates, the price of goods and services bought or purchased could be misstated by over-invoicing or vice versa. When the parent company buys goods from the subsidiary, the price may be overstated so as to reduce the taxable profit of company 'A' and thereby cause a transfer of revenue to Country 'X,' where tax rates are low. Thus if the total value of the goods or services of the subsidiary is ₦20 000 000, and ₦7 000 000 is realizable as profit after the sale of the goods or services, the subsidiary company may state a sale or cost of service as ₦17, 000 000 thereby reducing the profit that will be assessable to tax to ₦4, 000 000 as against ₦7, 000 000. So the effect of transfer pricing on the treatment of profits for petroleum transactions is that the profit that is assessable to tax is far less than what the real profit should be.

The implication of the above analysis is that if less profit is stated in consequence of either an over or under-invoicing by MNCs, less profit will be assessable to tax, and therefore, less revenue will be generated by the government. This is different from tax evasion cases in the sense that invoices are duly made out for every transaction done. So, the lesser the revenue generated from the sector, the less the revenue that will be available for economic development by the government. This is particularly so because petroleum oil is the all-in-one financial

[27] Ibid at p.250

source of the Nigerian economy. The Premium Times Newspaper[28] reported while quoting the Report of the African Union that about $138 billion is lost annually by governments in developing countries vie the loopholes in corporate income tax. The MNCs are depriving some of the world's poorest countries of money vitally needed to pay for schools, hospitals and other essential services. According to the report, some of the mechanisms used by multinationals to defraud countries of tax revenues include trade or transfer mispricing, exploitation, and tax treaties to stash their profits in places offering very low tax rates or harmful tax incentives. It is no longer news that Nigeria is the most populated nation and the largest producer of oil in Africa and a chunk of the amount lost annually to these MNCs comes from Nigeria.

But the revenue problem created by transfer pricing is more than just a reduction in revenue generated by the Nigerian government. The implication of such a loss in reduction naturally implies that it is also a transfer of the profit base from the Nigerian economy to the parent country of MNCs.

Effect of Tax Avoidance and Tax Evasion on Petroleum Profit Tax and the Economy

Tax avoidance and tax evasion have a number of undesirable consequences both on the tax treatment of profits from oil and gas transactions and on the economy. Both concepts result in a loss of revenue to the government at given tax rates. According to Famakinwa[29]

> *If we assume that governments first determine their expenditure and then raise the revenue to meet it, evasion and avoidance mean higher tax rates. If we make the alternative and less plausible assumption that government can spend only what they raise, then avoidance and evasion mean government expenditure for given tax rate. Either way they affect distribution of income.*

This means that if the government imposes higher taxes to make good its revenue cost, then, in effect, there is a redistribution of income or wealth. However, since it is the obvious or at least implied intention of evasion and

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[28]Bassey Udo: *Oil Multinationals, others stash Africa's tax billions yearly-AU*. Premium Times Nigeria, March 30, 2014. https://www.premiumtimesng.com/business/157767-oil-multinationals-others-stash-africa's-tax-billions-yearly-au.html>accessed 23rd November, 2017.

[29]Famakinwa VBA. *The socio economic and legal foundations of tax evasion and avoidance:* NIALS 1991. Ed. Akanle O. *Tax Law and Tax Administration in Nigeria*, p.339

avoidance to curtail or reduce government expenditure, then it is without a doubt that the transfer of income or wealth is in effect to the evaders and avoiders from those who would have benefitted from the extra expenditure through economic growth or development in general. But the transfer of this income through avoidance and evasion is because of its impact on computation and assessment. The taxing authorities cannot compute or assess any profit that has been evaded or avoided. Thus these twin evils negatively impact the tax treatment of profits from the oil and gas sector because whatever profit is evaded or avoided cannot be computed or assessed. This, in turn, reduces the actual revenue assessable to the government for socio-economic development or any prospect of increased development.

Effect of Petroleum Contracts on Treatment of Petroleum Profit Tax

Generally, all contractual agreements in the oil and gas sector affect what is to be computed and assessed, but more particularly, the MOU in the JVC arrangement has a profound effect not just on the treatment of profits from oil and gas transactions but also on the provision of the Act. This is so because terms in the MOU override the provision of the Act, especially where there are conflicts in the application. Thus the effect of MOU on JVC is that a company under the JVC has the option of computing its tax liabilities both under the MOU and the PPTA and to choose whichever is lower for the purpose of tax returns. This, the tax authorities have no power to determine. In any case, it will be recalled that these arrangements, especially the MOU, was first introduced in 1986 as an intervention to stimulate the production and exportation of cost oil in the face of a global fall in prices. The question that begs the answer here is, “what is the relevance of MOU in the current Nigerian situation in view of the fact that the reason for its existence which was the low price of oil, has ceased to exist. It is submitted here that since the reason for introducing the MOU has ceased in practice, there may not be the need for it again since it deprives the government of the opportunity to take full advantage of the amount of revenue it can generate from the industry.

THE NEED FOR FORTHRIGHTNESS: Petroleum Industry Bill (PIB) In Perspective

History of the PIB

The Federal Government of Nigeria in the year 2000 set up the Oil and Gas Sector Reform Implementation Committee (OGIC) to carry out a comprehensive reform of the oil and gas industry. This was followed by the establishment of the 2003 Study Group led by Professor Dotun Phillips. There was also the Working Group led by Mr. Seyi Bickestet that was set up to review the works of the Study Group. Both groups identified the fact that many of the tax laws regulating the industry needed urgent review, one of which was the Petroleum Profits Tax Act. This was hinged on the fact that the subsisting laws regulating the sector are obsolete for their being at variance with international best practices and lack of transparency. But, more importantly, the existing regime is not in the interest of Nigeria.

Based on the above defects, a new legislation was proposed called the Petroleum Industry Bill (PIB), which is to introduce a new legal, regulatory and fiscal framework for the organization and operation of the entire oil and gas industry in Nigeria. This Bill was sent to the National Assembly to be passed into law but remained in abeyance from 2005 to 2012.

The PIB is meant to be a 'one time stop shop' enactment to regulate the sector. It is intended, when passed into law, to repeal the PPTA (1959), Petroleum Act (1969), Petroleum (Drilling & Production Regulations (1969), Deep Offshore and Inland Basin PSC Decree (1999) and Memorandum of Understanding (MOU) 1986, 1991, and 2000

Major Highlights of the PIB 2012 draft

The PIB stipulates that all companies engaged in the upstream petroleum operations are to pay companies income tax under CITA at 30%, and there is an introduction of hydrocarbon tax (NHT) at 50% for onshore and shallow areas of up to 200 metres depth or 25% for bitumen, frontier acreages, deep water areas where operations fall in geographical areas that are subject to different tax rates. NHT will therefore be levied on the proportionate parts of the profit arising from such operations.

Some deductions that are now allowed in the Bill include sums set aside in a fund for decommissioning and abandonment expenses and interest upon any loans, including intercompany loans on capital employed for upstream operations, except interest incurred under a PSC operation. The Bill, when passed, will also disallow deductions on all general, admin and overhead expenses incurred outside Nigeria in excess of 1% of capital expenditure and 20% of any expenses incurred outside Nigeria except for goods and services not available domestically

Other highlights include the following:

i. The regime of tax incentives that will be available to upstream gas operations will be restricted to tax holidays under CITA, provided that the ultimate destination is solely domestic;

ii. Nigerian Hydrocarbon Tax and Company Income Tax will be computed and paid on a current year basis. Payments will be made monthly from the end of February every year, and the final instalment is payable not later than a day after filling self-assessment;

iii. Production Allowance (PA) will be introduced to replace the investment tax credit (ITC) or Investment Tax Allowance (ITA) as may be applicable. The PA is to encourage investment in crude oil and gas production with specified rates per barrel, either as a fixed amount per barrel or a percentage of official selling prices (OSP) subject to cascading thresholds. This is to reward results in the form of production rather than efforts in terms of capital expenditure;

iv. The conversion of the existing PPT into a Nigerian Hydrocarbon Tax, which is not deductible for Company Income Tax purposes;

v. the current PPT rate for onshore and shallow water operations of 85% & 50% with uplifts for capital costs is replaced by a combined tax of 80%(50% Nigerian Hydrocarbon Tax and 30% Company Income Tax) with production allowances;

vi. The current PPT rate for deepwater of 50% with uplifts for capital costs is replaced by a combined tax of 55% (25% Nigerian Hydrocarbon Tax and 30% Company Income Tax);

vii. The concept of replacing the uplifts with production allowances on new leases encourages investment in new production and simplifies cost administration.

A cursory look at the PIB will reveal that it subjects petroleum companies to the payment of Companies Income Tax from which they are currently exempted. It also introduced the Nigerian Hydrocarbon tax, which replaced the PPTA and increased the royalty rates based on acreage size, cost of separating oil from gas, and onshore from offshore operations for the purposes of taxation. These changes indicate a more stringent fiscal regime under which tax exemptions and incentives are to be reduced or lost, and invariably, profit margins may decrease. The Bill was edited in 2015 with few modifications but kept in limbo.

However, in what may be referred to as 'taking the bull by the horn', the Senate, on the 26th of May, 2017, passed the Petroleum Industry Bill in part tagged Petroleum Industry Governance Bill (PIGB), about 17 years after the process started with few modifications. The PIGB will need the legislative blessings of the House of Represents and assent by the President to become operative. The Bill unbundled the NNPC into the Nigeria Petroleum Assets Management Company and National Petroleum Company. It also established a new regulatory agency, known as the Nigeria Petroleum Regulatory Commission(NPRC), which would take over the functions of the Petroleum Inspectorate(PI), the Department of Petroleum Resources (DPR), and the Petroleum Products Pricing Regulatory Agency (PPPRA). The PIGB vests more powers on the Commission, substantially taking over the powers of the President and the Minister of Petroleum Resources exercised in the oil and gas sector.

In the Bill, the annual JV cash call obligations currently practiced at about $5b per annum will be eliminated and available to be channelled to the development of other sectors of the Nigerian economy. Currently, an estimated $5-10bln funding shortfall is experienced yearly due to the government's inability to fully fund its JV investment requirements. Thus, removing this constraint from the Bill will enable more investment in JV operations and increase production. This increase will lead to increased revenue for the government through higher royalty and tax receipts.

Moreover, the President of the Senate, Bukola Saraki, reportedly remarked after the passage that the Bill is for the good of Nigerians and investors alike, given the fact that corrupt practices in the sector would be reduced to the barest minimum, stimulate the oil and gas industry and reduce inefficiency.[30]

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[30]Henry Umoru, and others, Senate Passes Petroleum Industry Bill, PIB. *Vanguard*https://www.vanguardngr.com/2017/05/senate-passes-petroleum-industry-bill-pib/>accessed 15th November, 2017.

TheBillis split into smaller pieces for speedy passage into law, being a complete departure from all prior efforts. Thus where amendments of any part of the Bill are subsequently required, only that part will be considered without having to look at all the other composite independent parts. The parts include the petroleum Industry (Governance & Institutional Reforms) Bill, Petroleum Industry (Upstream Petroleum Administration Reforms) Bill, Petroleum Industry (Downstream Petroleum Administration Reforms) Bill, Petroleum Industry (Fiscal Framework & Reforms) Bill, Petroleum Industry (Revenue Management Reforms) Bill, Petroleum Industry (Governance & Institutional Reforms) Bill.

Conclusion And Recommendations

It has been seen that while all except tax evasion are legal means lessening tax burdens and, in most cases, enjoy statutory support for their practice by Multinational Corporations or companies; other opportunities avail these MNCs by duplicities of incentives, loopholes or lacunas in the law. Other available channels are as inherent in agreements relating to business in the sector as clearly provided in the fiscal arrangements. Though most of these methods are legal, they negatively impact revenue generation and funds available to the government for national development. But beyond their impact on the quantum of available revenue, they engender revenue transfer from Nigeria to the country where the MNCs were originally established. The Petroleum Industry bill appears to be the only forthright legislation with an all-inclusive approach to tighten or fill the present lacunas. Therefore, it is strongly recommended that the PIGB be given speedy attention by both the House of Representatives and the President and for all other bits of the PIB be given urgent legislative attention. While total and complete passage into law of the PIB is awaited, it is recommended that the government should, through appropriate authorities, review the gateway provisions giving life to these methods.