MODULE 3

PETROLEUM PROFIT TAX

OUTLINE

- Definition of Assessable Profit and chargeable profit
- Treatment of Losses
- Double Taxation Relief
- MOU applying to Petroleum Prospecting Companies
- Gas Incentives Objectives and Uses
- Implication of Joint Venture Contract

Definition of Assessable Profit and chargeable profit

- The first commercial production of oil is the World took place in Romania and the United States in the 50s.
- Commercial discovery of oil in Nigeria was not until 1950's although the Shell BP had earlier started some exploration work shortly before the Second World War.
- Nigeria is the largest producer and exporter of crude petroleum in Africa South of the Sahara.
- Nigeria is a member of the Organization of Petroleum Exporting Countries (OPEC).
- Nigeria's oil has technical and commercial advantages compared with some other major oil-exporting countries.
- Its good quality varies between light crude of 450 API and heavy crude of 21^{0} API with weighted average of 32^{0} API.
- The Nigerian oil has an incredibly low sulphur content averaging only 0.2%.
- Of all other major producers, only Libya and Indonesia have qualities which may be regarded as comparable.

- The following provisions are available to arrive at the appropriate amount of taxable profits of a company engaged in petroleum operations:
- (a) The adjusted profits of an accounting period is the profits of that period after the deductions allowed by S.10 (1) of PPTA 1990 and any adjustments made in accordance with S.12 of the same Act.
- (b) The assessable profits of an accounting period is the adjusted profit of that period after any deduction allowed by S.14.
- (c) The chargeable profit of an accounting period is the assessable profit of that period after the deduction allowed by S.15.

CHARGEABLE PROFITS

- 1. Companies assessed under the PPTA CAP 354 LFN 1990: only the profits of the oil producing companies are chargeable to tax under the petroleum profits tax act cap 354 LFN 1990 as amended.
- The oil producing companies could be classified into two namely: the old system known as the joint venture system and the new system known as companies having production sharing contracts (PSC).

- **Value of Chargeable Oil**
  The value of any chargeable oil that is disposed is the aggregate of:
- The value of that oil as determined for the purpose of royalty in accordance with the provisions of any enactment applicable thereto and any financial agreement between the Federal Government of Nigeria and the oil producing company
- Any cost of extraction of that oil deducted in determining its value; and
- Any cost incurred by the company in transporting and storage of the oil.

- **Value of Chargeable Natural Gas**
  The PPTA states that the value of all chargeable natural gas shall be the sum of gross proceeds from individual gas sales contract during the accounting period Less the G-factor Allowance at the appropriate rate per cent of such proceeds.

Table of G-Factor Allowance

Load-factor	G-factor
50	16.9%
60	15.5%
70	14.3%
80	13.6%

G-factor means Gas Production Cost Adjustment Factor

e.gTompolo boys petroleum unlimited sold 450,000 barrels of crude oil to one of its customers in the Pacific. The crude oil has an API gravity of 35^{0}. The standard API o crude is 30^{0} with a price of $16.50. it has been agreed that for every degree rise or fall in API, the price shall rise or fall by $0.50. the rate of exchange is N85 to $1. You are required to determine the value of oil sold if the actual price is N1,300 per barrel.

Treatment of Losses

- To arrive at the assessable profits, there shall be deductions from the adjusted profits:

i. The amount of any loss incurred by the company during the previous accounting year.

ii. For a new company, the amount of any loss incurred during the first accounting period.

Losses that cannot be fully deducted in any period can be carried forward to the next succeeding accounting period until fully relieved. The four years limit for the carry forward of trade loss under CITA is not applicable to losses incurred in petroleum operation as there is no provision in PPTA in that regard

The petroleum company has the right to defer utilization of any loss relief available to it.

MOU applying to Petroleum Prospecting Companies

- This is an agreement between the federal government of Nigeria through NNPC and the oil companies operating in Nigeria concerning some tax relief. The tax relief would be granted if certain sales and production targets are achieved. It contains a fiscal incentives offered by the government to the oil companies(joint venture partners) to encourage investments in oil exploration and development activities, enhance crude oil export, oil recovery and gas utilization.
- The MOU is designed to guarantee the oil companies a certain profit margin irrespective of market conditions. The MOU accords a minimum of notional margin of $2.50/bbl after tax
- **Review of the Non taxable income**
- a. Any profit on the disposal of fixed asset
- b. Any reversal into income of a previously disallowed expenses
- c. Income from the transportation of oil by an ocean-going oil tanker
- d. Income from refinery operation]
- e. Other income from downstream activities.

- **Review of some of the allowable expenses**
- a. Any interest on loan obtained for the purpose of petroleum business
- b. Bad debt written off
- c. Education tax
- d. Any cost of drilling the first two well
- e. Royalties both on local and export sales
- f. Productive and non productive rent
- g. Custom duties whether on essential or non-essential items.
- h. Any expenses wholly reasonably exclusively and necessarily incurred.

Double Taxation Relief

Section 62 of PPTA 2004 makes provision for the method of calculating relief to be allowed for double taxation as follows:

- Foreign tax payable in respect of any income in the country with whom the arrangements are made is to be allowed as a credit against tax payable in respect of that income in Nigeria. Foreign tax means any tax payable in that country which, under the arrangements, is to be so allowed, and income means that part of the profits of any accounting period which is liable to both tax and foreign tax, before deducting of any tax, foreign tax, credit therefore or relief granted.
- The amount of credit admissible to any company under the terms of any such arrangements shall be set off against the tax chargeable upon that company in respect of the income, and where that tax has been paid the amount of the credit may be repaid to that company or carried forward against the tax chargeable upon that company of any subsequent accounting period.
- The credit of an accounting period shall not exceed whichever is the lesser of the following amounts:

  i. the amount of the foreign tax payable on the income, or

  ii. The amount of the difference between the tax chargeable and the tax which would be chargeable if the income were excluded in computing profits.

Gas Incentives Objectives and Uses

Section 11(1) of PPTA 2004 provides that the following incentives shall be apply to a company engaged in the utilization of associated gas:

- Investment required to separate crude oil and gas from the reservoir required into usable products shall be considered as part of the oil field development;
- Capital investment on facilities equipment to deliver associated gas in usable form at utilization or designated custody transfer points shall be treated, for tax purposes, as part of the capital investment for oil development;
- Capital allowances, operating expenses and basis of tax assessment shall be subject to the provisions of this Act and the tax incentives under the revised memorandum of understanding.

Implication of Joint Venture Contract

Joint venture is an arrangement between the NNPC, on behalf of the Federal Government of Nigeria, and the oil company (ies), whereby both parties become partners in the exploration and development of petroleum resources. There are typically two variants of this type of arrangement, the equity share participation and the non-equity share participation.

- Under the equity share participation agreement, a separate legal entity in the form of a limited liability company is formed by an oil company and the federal government, through the NNPC. The new company draws, as may be agreed, from the financial and human resources of the shareholders. The parties are entitled to dividends to the extent of their equity interest in the company.
- Under the Non-equity share participation agreement, the federal government, through the NNPC, enters into a joint operating agreement with oil companies. No new company is formed, however, the joint venture partners agreed to jointly hold all rights and interest under the joint venture, and to meet expenses in the proportion of their participating interest. One of the partners is designated the "operator".

Illustrations

ILLUSTRATION 1

The following information relate to the operating result of an entity:

Adjusted profit for the accounting period ended 31st December, 2013	N75,000,000
Unrelieved losses of the previous year brought forward	N12,000,000
Capital allowances agreed with the FIRS	N15,000,000
Tax rate – 85%	

Required:

Compute the assessable tax assuming that:

(a) the company has not applied for the deferment of loss deduction.

(b) the company has applied for the deferment of loss deduction.

SOLUTION 1

COMPUTATION OF ASSESSABLE TAX FOR THE YEAR ENDED 31ST DECEMBER, 2013

(a) Where no election has been made

	N
Adjusted profit	75,000,000
Less loss relief	12,000,000
Assessable profit	63,000,000
Less capital allowance	15,000,000
Chargeable profit	48,000,000
Assessable tax (85% x N48,000,000)	40,800,000
Unrelieved losses carried forward	Nil

(b) Where an election has been made N

Adjusted profit	75,000,000
Less loss relief	-
Assessable profit	75,000,000
Less capital allowance	15,000,000
Chargeable profit	60,000,000
Assessable tax (85% x N48,000,000)	51,000,000
Unrelieved losses carried forward	12,000,000

ILLUSTRATION 2

Wuse Petroleum company Limited is in Joint Venture with NNPC. The following information has been made available in respect of the company's operations for the year ended 31/12/2013.

a.	production and lifting data:	
	Crude oil produce	5,400,000 barrels
	Crude oil exported	5,000,000 barrels
b.	Cost:	₦
	Intangible drilling expenses	17,000,000
	First two appraisals wells expenditure	36,000,000
	Exploration costs	25,000,000
	Administrative expenses	32,000,00
	production expenses	45,000,000
	Education tax	5,000,000
c.	Qualifying capital expenditure incurred in 2013	50,000,000
	tax written down value of Qualifying Capital expenditure incurred in 2010	20,000,000
d.	The company operates within 101 and 200 meters of water depth	

e. The company has paid 12 monthly installments amounting to 120,000,000

f. the realizable price of the period as advise by the NNPC N100

Note:

Royalty rates are as follows:

Onshore	20%
Inland basin	10%
Offshore:	
Up to 100 meters of water depth	181/2%
100 – 200 meters of water depth	162/3%
201 – 500 meters of water depth	12%
501 – 800 meters of water depth	8%
801 – 1000 meters of water depth	4%
Beyond 1000 meters of water depth	0%

Required:

(a) Compute the annual allowance and the petroleum investment allowance

(b) Compute royalties payable.

(c) Compute the petroleum profit tax payable.

(d) Compute the final (13th installments) of petroleum profit tax payable by the company.

WUSE PETROLEUM COMPANY LIMITED

(a) COMPUTATION OF ANNUAL ALLOWANCE

		₦
Capital allowance on 2013 QCE (20% x ₦50,000,000)	=	10,000,000
Capital allowance on TWDV of 2010 QCE (₦20,000,000) / 2	=	10,000,000
		20,000,000

Computation of Petroleum Investment Allowance (PIA) ₦

QCE at water depth 101 – 200 meters = 15% x ₦50,000,000 = 7,500,000

(b) COMPUTATION OF ROYALTIES PAYABLE

Royalty = royalty rate x realizable price x crude oil production

= 162/3% x N100 x ₦5,400,000 = ₦90,000,000

(c) COMPUTATION OF PETROLEUM PROFIT TAX FOR 2013 YEAR OF ASSESSMENT

	₦	₦
Value of crude oil exported (N100 x N5,000,000)		500,000,000
Less allowable expenses:		
Royalties	90,000,000	
Intangible drilling expenses	17,000,000	
First two appraisal wells expenditure	36,000,000	
Exploration cost	25,000,000	
Production expenses	45,000,000	
Administrative expenses	32,000,000	
Education tax	5,000,000	250,000,000
Adjusted/Assessable profit		250,000,000
Less Capital Allowance:		
Lower of:		
Petroleum Investment Allowance	7,500,000	
Annual Allowance	20,000,000	
	27,500,000	27,500,000
And:		
85% of Assessable profit (85% x ₦250,000,000)	212,500,000	
Less 170% of PIA (170% x ₦7,500,000)	12,750,000	
	199,750,000	

Chargeable Profit	222,500,000
Petroleum Profit Tax Payable (85% x ₦222,500,000)	189,125,000

(d) Final (13th Installments of PPT payable by the company

	₦
Petroleum profit tax payable	189,125,000
Less installment already paid	120,000,000
Final (13th installment) of PPT due	69,125,000

Review Questions

1. Danladi Ltd and Danlami are Nigerian companies. Their profits for 2014 year of assessment are as follows:

	Danladi Ltd	Danlami Ltd
	₦	₦
Nigerian profits	80,000,000	150,000,000
Foreign profits (gross)	20,000,000	60,000,000
Nigerian tax	30%	30%
Foreign tax	25%	35%

Required:

Calculate the credit to be given to the companies in respect to the tax paid on their foreign profits.

2. Compare the treatment of losses under Petroleum Profits Tax Act (PPTA) and Company Income Tax Act (CITA).

3. ABC Limited bought a motor vehicle on 1st January, 2010 for N1,000,000. The asset has an expected useful life of four years. The rates of capital allowances are: 50% initial allowance and 25% annual allowance. The companies income tax rate is 30% and the profit after charging depreciation is N1,250,000 in each of the years 2010 to 2013.

Required:

a) Calculate the timing difference and the annual transfers to (from) the deferred tax account.

b) Calculate the company's income tax for each of the years 2010 to 2013.

c) Prepare the profit and loss appropriation account and the balance sheet for each of the years 2010 to 2013 based on the information provided.

Assume that income tax for each accounting year is payable in the accounting year.

References

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