



**TAX POLICY AND LEGISLATION DEPARTMENT
STANDARDS & COMPLIANCE GROUP**

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Date: 6th September, 2013

KPMG Advisory,
KPMG Tower,
Bishop Aboyade Cole Street,
Victoria Island
Falomo, Lagos.



Attention: Adewale Ajayi

Dear Sir,

RE: CLARIFICATION ON THE APPLICABLE TAX REGIME FOR A STRATEGIC ALLIANCE AGREEMENT INVOLVING PRODUCTION SHARING

I am directed to acknowledge receipt and respond to your letter dated 26th August, 2013 on the above subject matter.

In the said letter, you stated that your client, Atlantic Energy Drilling Concept Ltd (AEDCL) whose main business activity is exploration and production of oil and gas signed four (4) Strategic Alliance Agreements (SAAs) with the Nigeria petroleum Development Company (NPDC) for the provision of finance and technical support agreement, which entitles your client to receive consideration in kind for financing and project management services rendered to a classical risk service contract arrangement.

You further sought clarification on the applicable tax regime of your client and FIRS response to the following specific issues:

- I. Whether the entry fee paid by your client amounts to signature bonus;
- II. That your client is carrying on petroleum operations and should therefore be subject to tax under PPTA and not Companies Income Tax Act (CITA), 2004 as amended;
- III. Whether the PPT payable under the arrangement represents the tax obligations of both NPDC and Atlantic Drilling Energy Limited;

- IV. Whether the Company is liable to further tax given that its share of profit oil is determined only after the PPT has been paid in respect of the concession; and
- V. Whether FIRS will issue separate tax receipts representing each party's obligations on the strength of the agreement; in spite of the article relating to tax included in the SAA.

FIRS RESPONSE

We seek to respond to the stated issues in their order as outlined above:

i. Whether the entry fee paid by your client amounts to signature bonus

We answer this question in the negative.

Signature bonus is a payment in advance of exploration activities for the right to develop an exploration area. It is paid by the oil company to the government of the host country. It is a company wishing to go into petroleum operations in Nigeria that pays signature bonus to NNPC. It constitutes a prerequisite to the right of an oil company to develop an exploration area.

From the copy of the SAA made available to us, the position of your client in the SAA and in the OML in question is that of an independent contractor engaged to render technical and financial services to NPDC. The entry fee paid (or to be paid) by your client does not give it a right to develop an exploration area, and does not entitle it to any part of the OML. The entry fee is only one of your client's obligations to NPDC in the SAA. It does not make your client a co-holder of the OML.

Therefore, the entry fee is not signature bonus.

ii. Whether your client is carrying on petroleum operations and should therefore be subject to tax under PPTA and not Companies Income Tax Act (CITA), 2004 as amended

Section 2 of the Petroleum Profits Tax Act defines Petroleum operations as:

"The winning or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a company **for its own account** by any drilling or mining, extracting or other like operation or process, not including refining at a refinery in the course of business carried on by the company engaged in such operations and all operations incidental thereto and any sale of or any disposal of chargeable oil or on behalf of the company" (emphasis ours).

The pertinent question here is whether your client wins or obtains and transports petroleum or chargeable oil **for its own account** under the SAA in line with Section 2 of

PPTA above. It is the answer to this question that would determine whether or not your client carries out petroleum operations.

From your letter under reference and the SAA, your client is engaged to render technical and financial services to NPDC under the SAA. Therefore, whatever your client does under the SAA, it does for and on behalf of NPDC and not for itself. Thus, whatever petroleum or chargeable oil that your client may win or obtain and transport under the SAA is not for its own account, but for the account of NPDC. That your client agreed to receiving consideration for its services by recovering its costs through cost oil and also sharing in the profit oil does not change its status from that of a mere contractor to that of a co-owner of the OML with NPDC. Your client could have opted to have its consideration in any other form than cost oil and profit oil. Its choice of cost oil and profit oil as consideration does not bring its activities in the SAA under the ambit of petroleum operations.

We therefore reach the inevitable conclusion that your client is not carrying on petroleum operations within Section 2 of PPTA. Ipso facto, your client should be subject to tax under Companies Income Tax Act (CITA) and not under PPTA.

iii. Whether the PPT payable under the arrangement represents the tax obligations of both NPDC and Atlantic Drilling Energy Limited.

As stated under issue (ii) above, your client does not bear any petroleum profit tax obligation under the SAA as its activities in the SAA do not amount to petroleum operations. It is NPDC which alone carries out petroleum operations under the SAA that solely and exclusively bears the liability of petroleum profits tax.

In this agreement, the royalty oil, cost oil and tax oil would be deducted before the remaining profit oil is split between NPDC and your client. The tax oil is allocated to NPDC as the holder of the OMLS which is to pay all royalties rental fees and the petroleum profit tax from the tax oil, and the tax so paid fulfills the tax obligation of NPDC only, and not that of your client. Whatever loss, if any, your client suffers from the payment of the petroleum profit tax from tax oil is a self-imposed loss which it brought upon itself by opting for consideration in the form of profit oil under the SAA.

iv. Whether the Company is liable to further tax given that its share of profit oil is determined only after the PPT has been paid in respect of the concession

It is clear from all the issues resolved above that your client's tax obligation is company income tax under CITA and not petroleum profits tax. Your company should therefore pay its tax under CITA in spite of the petroleum profit tax paid by NPDC. This, contrary to your position, would not result in double taxation against your client because the petroleum profit tax paid by NPDC is the tax obligation of only NPDC and not that of

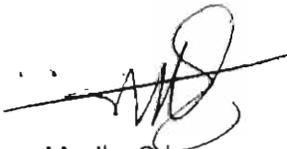
your client. As stated under issue (iii) above, any loss incurred by your client from the tax oil is self-inflicted.

- v. ***Whether FIRS will issue separate tax receipts representing each party's obligations on the strength of the agreement; in spite of the article relating to tax included in the SAA.***

FIRS will issue separate tax receipts representing each party's obligations under the SAA. The parties' tax obligations under the SAA are separate and independent. NPDC is to pay petroleum profit under PPTA while your client is to pay companies income tax under CITA. Therefore, FIRS would issue two separate tax receipts reflecting the distinct payments.

The article relating to tax in the SAA cannot override the provision of the law on the tax obligations of the parties to the SAA. It is trite law that parties cannot contract outside the provisions of a statute. Hence, the tax clause in the SAA is vitiated and void to the extent of its inconsistency with PPTA and CITA.

We hope the foregoing satisfactorily addresses your enquiry.

A handwritten signature in black ink, appearing to be 'Ike Odume', written over a horizontal line.

Mr. Ike Odume

Deputy Director (Legal), Tax Policy & Legislation Department

For: Director, Tax Policy & Legislation Department,
Federal Inland Revenue Service.