

Tax deductible flare gas penalty payments in Nigeria – context, responsibilities and judicial interpretation

Adaeze Okoye*

Abstract:

The judicial interpretation of the Associated Gas Re-injection Act (Nigeria) with regard to the legality of tax deductions, which are based on the payment of gas flaring fees or penalties, illustrates some of the inconsistencies between the legality of tax action under the literal terms of the statute and the purpose of the statute to achieve a desired ethical environmental conduct.

This article will examine the context and cases of gas flaring fees, their interpretation for tax purposes and highlight the potential role of judicial interpretation which could take into account contextual factors, through purposive interpretation. The fees for flaring gas and its assessment for tax liabilities are an exemplar of potential contradictions that present a challenge for legal interpretation and (ir) responsible action. The use of relevant interpretation approaches may help deal with the issues, which arise from contradictory overlaps. Even if these approaches, may themselves be subject to dispute. The paper suggests a purposive two step test that takes into account the specific purposes of the legislation and the general context of gas flaring and corporate responsibilities.

* Senior Lecturer, University of Brighton, UK and Visiting Professor, Coal City University Enugu, Nigeria. The author wishes to thank the two anonymous reviewers for their excellent feedback. She also wishes to thank Maxwell Ukpebor, Editor-in-Chief, Tax Law Reports of Nigeria for access to the case reports.

1. Introduction

Gas flaring involves the burning off of associated gas produced with oil extraction into the atmosphere.¹ The release of associated gas is part of the process of extraction of oil,² although there are alternatives to flaring such gas. These alternatives include reinjection, liquefaction of natural gas, the use of pipeline network to distribute natural gas or power generation but this would require infrastructure investment which companies in developing countries are often unwilling to make³ The economic and technical justifications which are often given for continued flaring of associated gas include:⁴ the cost of recovery, the inadequacy of domestic infrastructure and least cogently the lack of domestic demand⁵.

Estimates in 2014 suggest that 75% of associated gas is flared and about 12% is re-injected in Nigeria.⁶ However a recent report by the Nigerian Department of Petroleum Resources (DPR) suggests, a significant reduction.⁷ It estimates 18.71% flare volume as a percentage of total

¹ See F I Ibitoye "Ending Natural Gas Flaring in Nigeria's Oil Fields" (2014) 7(3) *Journal of Sustainable Development* 13-22, "While non-associated gas can be left underground until needed, associated gas is unavoidably lifted together with crude oil, and must either be harvested or disposed of on site as an unwanted by-product of oil." P. 13 "Gas flaring is the burning of natural gas and petroleum hydrocarbons in flare stacks by upstream oil companies in oil fields during operations" E C Ubani I M Onyejekwe (2013) 4(2) *American Journal of Scientific and Industrial Research* 246-252

² "Associated gases released during oil-gas production mainly contain natural gas. Natural gas is more than 90 % methane (CH₄) with ethane and a small amount of other hydrocarbons; inert gases such as N₂ and CO₂ may also be present" see E A Emam "Gas Flaring in Industry: an Overview" 57(5) *Petroleum and Coal* 532-555 at p.534

³ "When you drill for oil, you also get gas. In an ideal world this associated gas would be sold to consumers, or it would be used to generate power and then resold as electricity. But this requires costly investment into pipelines, power plants, and other infrastructure. Therefore, in practice, some oil producers opt to sell the oil and burn the gas. This is known as gas flaring." See Z Ebrahim J Friedrichs *Gas Flaring: the Burning issue* September 3, 2013 <https://www.resilience.org/stories/2013-09-03/gas-flaring-the-burning-issue/>

⁴ Ibitoye (n1) points out: "firstly, domestic demand for natural gas was not large enough to utilise all the associated gas, if recovered; secondly, there was the price tag on recovery of associated gas, which happened to be much higher than that of non-associated gas ... and thirdly, inadequate domestic gas infrastructure to distribute gas to potential consumers." "p.13

⁵ Nigeria has a population of 200 million

⁶ KPMG *Nigeria's Oil and Gas Industry Brief* 2014 (June 2014, KPMG Nigeria) p.5 <http://www.blog.kpmgafrica.com/wp-content/uploads/2016/10/Nigerias-oil-and-gas-Industry-brief.pdf> p. 5

⁷ DPR 2018 Nigeria Oil and Gas Industry Annual Report <https://www.dpr.gov.ng/index.php> (11% of total produced gas).

associated gas production.⁸ Nevertheless there are questions over the accuracy of gas flare estimates, in view of varying sizes of flares, geographical location (offshore or onshore) and methods used (remote sensing) in estimation of the flaring rate of gas.⁹ The World Bank Global Gas Flaring Reduction Partnership (GGFR) statistics for 2014 -2018 still shows Nigeria as the 7th in the top 30 countries for gas flaring.¹⁰

Gas flaring is a waste of valuable energy resources that are necessary for economic development and growth. It also contributes to carbon emissions.¹¹ Paradoxically, Nigeria suffers from severe power shortages, while flaring gas which is more than its power consumption needs.¹² The visible and continuous flares generate noise and heat for the local environment.¹³ This has been termed: “the complex interactions of thermal pollution, organic and inorganic contaminants emission in the environment”¹⁴. Ologunorisa points to the specific effects in the Niger-Delta part of Nigeria and this includes:

“a decrease in agricultural yield, depression in flowering and fruiting in Okro and palm trees, deformities in children, liver damage and skin problems, increasing concentrations of airborne pollutants, acidification of soils and rainwater, corrosion of metal roofs and significant increases in concentrations of sulphates, nitrates and dissolved solids, with associated socio-economic problems”¹⁵

⁸ Ibid p.54

⁹ A R Brandt ‘Accuracy of Satellite-Derived Estimates of Flaring Volume for Offshore Oil and Gas Operations in Nine Countries’ (2020) 2(5) Environmental Research Communications 051006. They note: “In one case—Nigeria—no government geospatial data are available, so field outlines were generated from hand-produced geo-rectified composite of 3 maps obtained of the offshore Niger Delta region” p.3

¹⁰ Gas flaring volumes (2014-2018) billion cubic metres

See World bank document, Top 30 Flaring countries (2014-2018) ranked by 2018 volume

: <http://pubdocs.worldbank.org/en/645771560185594790/pdf/New-ranking-Top-30-flaring-countries-2014-2018.pdf> see also The World Bank (WB) Global Gas Flaring Reduction Partnership (GGFR) Global Gas Flaring Report July 2020 which features Nigeria as a case study:

<http://pubdocs.worldbank.org/en/503141595343850009/WB-GGFR-Report-July2020.pdf>

¹¹ Ibid ; A E. Ite & U J Ibok, “Gas Flaring and Venting Associated with Petroleum Exploration and Production in the Nigeria’s Niger Delta.” (2013) 1(4) *American Journal of Environmental Protection* 70-77

¹² “The volume of gas flared by Nigeria per annum is more than enough to power the nation’s energy demand. Despite Nigeria’s huge gas reserves, the country still suffers chronic energy shortages.” See Ubani & Onyejekwe n.1

¹³ Emam n.2 at p.533

• ¹⁴ A E Ite U J Ibok “Gas Flaring and Venting Associated with Petroleum Exploration and Production in the Nigeria’s Niger Delta.” (2013) 1 (4) *American Journal of Environmental Protection* 70-77

¹⁵ T E Ologunorisa “A review of the effects of gas flaring on the Niger Delta environment” (2001) 8(3) *International Journal of Sustainable Development and World Ecology* 249-255, 249

Gas flaring has been a part of the oil production process from the beginning.¹⁶ Nigeria is gas rich¹⁷ and the quality of gas is high¹⁸. There is evidence that the utility of this practice was queried, even in the run up to independence of the country¹⁹ and that the same practice was not widely adopted in the UK's North Sea.²⁰ The attempts to reduce flaring dates back to legislation from 1979 with attendant fees for permitted flaring.²¹ This is why the question: whether, gas flaring fees should be tax deductible is an interesting one. This is especially important when it is viewed in the context of a deterrence regime to eliminate flaring of gas.

The process of judicial interpretation, in the case of disputes about compliance, plays an important role in examining effectiveness of a legislation. Adequate interpretation could ensure that legislation is construed effectively, when a dispute arises. Even where new legislation is developed at a future date to correct past anomalies in legislation, interpretation will still play an important role in outlining what compliance means in practice. Therefore a key focus is on the cases about gas flaring fees and tax deductibility.

¹⁶ Environmental Rights Action (ERA) & Friends of the Earth, *Gas Flaring in Nigeria – A Human Rights, Environmental and Economic Monstrosity* (Netherlands, June 2005) see also <https://www.foei.org/resources/publications/publications-by-subject/climate-justice-energy-publications/gas-flaring-in-nigeria> The Friends of the Earth point to the apparent double standards in the writings of the British Trade Officials see p. 6-7. For an interesting overview of oil exploration in colonial Nigeria see P Steyn 'Oil Exploration in Colonial Nigeria, c. 1903–58', (2009) 37(2) *The Journal of Imperial and Commonwealth History*, 249-274

¹⁷ BP Statistical Review of World Energy 2019 p.30 see <https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2019-full-report.pdf>

¹⁸ "Estimates of Nigeria's undiscovered gas reserves range from 300 – 600 TCF. Nigeria has therefore been described largely as a gas province with some oil. The gas quality is high – particularly rich in liquids and low in sulphur" KPMG n6 at p. 5

¹⁹ Question contained in Memorandum of 21st June 1960 given to the then Secretary of State to the Colonies, Lord Home by Mr Edmund de Rothschild- "There might be wastage of energy and resources going on which one day those giving advice to Nigeria (i.e. the British could be reproached" This was cited in the Friends of the Earth report above and source given as : " Natural Gas in Nigeria" File DO35/10500 UK National Archives

²⁰ Friends of the Earth n12 at p.7

²¹ AGRA 1979

Overall the paper is structured as follows: firstly, it examines the gas context in Nigeria identifying the key actors and legislation. Then it highlights the relevance of the wider context of corporate responsibility by examining transparency regulation and environmental regulation linked to gas flaring. Then next section focuses on the recent cases about the deductible status of gas flaring fees or penalties. Finally the paper suggests the potential of a purposive test in interpretation being used to tackle creative tax compliance while driving for environmentally responsible objectives. The paper suggests a purposive two step test that takes into account the specific purposes of the legislation and the general context of gas flaring and corporate responsibilities.

2. The gas context: actors and legislation

The associated gas flared in Nigeria is done in the context of the petroleum industry.²² Petroleum is defined in the Petroleum Act 1969 to include natural gas.²³ The Nigerian petroleum sector has the upstream, midstream and downstream sectors.²⁴ Gas flaring occurs mainly within the petroleum upstream context.²⁵ This context involves government agencies, the national oil company and private companies including the international oil companies (IOC) and indigenous operators (IO)²⁶

2.1 Key actors:

The federal government is a key actor in the oil and gas industry in Nigeria by virtue of Section 44(3) of the Constitution of the Federal Republic of Nigeria, which vests entire property rights in and control of, all minerals, oil and gas in, under or upon the land, territorial waters or exclusion economic zone (EEZ) in the government of the Nigerian federation. This is also reinforced by section 1(1) of the Petroleum Act 1969²⁷ which also states that “the entire ownership and control of all petroleum in, under or upon any lands to which this section applies shall be vested in the state”. The Minister of Petroleum Resources has the sole power to grant the oil exploration licences, oil prospecting licences (OPL) and oil mining licences (OML) by virtue of s. 2 of the Petroleum Act 1969.²⁸ The relevant regulatory government agencies

²² Y Omorogbe, 'The Legal Framework for the Production of Petroleum in Nigeria' (1987) 5 J Energy & Nat Resources L 273 -291

²³ S 15 Petroleum Act 1969 Cap. P10 Laws of the Federation of Nigeria (LFN) 2004

²⁴ DPR 2018 Oil and Gas Industry Annual Report p.10-11 <https://www.dpr.gov.ng/index.php>

²⁵ CD Elvidge & Others, 'The Potential Role of Natural Gas Flaring in Meeting Greenhouse Gas Mitigation Targets' (2018) 20 Energy Strategy Reviews 156 -162

²⁶ DPR 2018 Oil and Gas Industry Annual Report p.11 <https://www.dpr.gov.ng/index.php> Figure 1 – The Nigerian oil and gas industry

²⁷ Cap. P10 Laws of the Federation of Nigeria (LFN) 2004

²⁸“ 2. (1) Subject to this Act, the Minister may grant— (a) a licence, to be known as an oil exploration licence, to explore for petroleum; (b) a licence, to be known as an oil prospecting licence, to prospect for petroleum; and (c) a lease, to be known as an oil mining lease, to search for, win, work, carry away and dispose of petroleum” The current minister of petroleum Resources is the President - As he vested that office in himself

include the Department of Petroleum Resources (DPR) which handles the regulation of oil and gas sector and the Federal Inland Revenue Service (FIRS) which is responsible for collection and assessment of revenues accruing to the federal government.²⁹

In addition, Nigeria has a national oil company, the Nigerian National Petroleum Corporation (NNPC), which was created in 1977.³⁰ The company, NNPC straddles the entire spectrum of petroleum operations.³¹ Some of its subsidiaries, which are key actors within the upstream sector, would include –Nigerian Petroleum Development Corporation (NPDC), National Petroleum Investment Management Services (NAPIMS) and Integrated Data Services Ltd (IDSL)³²

Oil and gas are produced through a series of institutional arrangements for production which include: Joint Ventures (JVs), Production Sharing Contracts (PSCs), Sole Risk Operators (SROs), Service Contracts (SCs), Marginal Field Operators (MFOs)³³ DPR, 2018 report gives the distribution of Nigerian concession by lease contract type, as:³⁴

–see S I Nwatu & E O Wingate (2020) Determining the limits of the ministerial discretion to renew petroleum leases in Nigeria – *Shell v Minister of Petroleum*, Journal of Energy & Natural Resources Law, 38:3, 329-338

²⁹ The NEITI reports are a good source of material for the overall framework of oil and gas in Nigeria. The details of NEITI as a transparency initiative and links to CSR are fully discussed in the next section but this section attempts to highlight some of the legislative context to the gas cases and gas flaring. See NEITI Financial report final 2006-2008 issued July 2011 <https://neiti.gov.ng/index.php/neiti-audits/oil-and-gas/category/164-oga-2006-2008-report> p.5-6

³⁰ <https://www.nnpcgroup.com/About-NNPC/Pages/Corporate-Information.aspx> The creation of a state oil company is in line with the Oil Producing and Exporting Countries (OPEC) ideology and the permanent sovereignty over natural resources see S M Ghanem OPEC Routledge 2016 (originally published in 1986)

³¹ “exploration and production, gas development, refining, distribution, petrochemicals, engineering, and commercial investments” <https://www.nnpcgroup.com/About-NNPC/Pages/Corporate-Information.aspx> In the upstream, it acts through National Petroleum Investment Management Services (NAPIMS) In the downstream, the Nigerian gas company was established to “efficiently gather, treat, transmit and market Nigeria’s natural gas and its by-products to major industrial and utility gas distribution companies in Nigeria and neighbouring countries” NNPC in 1988 had 11 subsidiaries of its own but was restructured in 2016 to reduce to 5 commercial entities <https://www.napims.com/aboutus.html>
<https://ngc.nnpcgroup.com/pages/about-us.aspx>

³² DPR, 2018 Nigeria Oil and Gas Industry Annual Report p.54 <https://www.dpr.gov.ng/index.php> , Figure 1 – The Nigerian oil and gas industry

³³ NEITI report 2016 issued January 2019 p.29 https://eiti.org/sites/default/files/documents/neiti-oil-gas-report-2016-full-report-211218_1.pdf

³⁴ DPR, 2018 Nigeria Oil and Gas Industry Annual Report p.23 Figure 5- Distribution of Nigeria concession by lease contract type <https://www.dpr.gov.ng/index.php>

42% - PSC

34%- JV

23% - SR

1%- SC

There are also about 30 Marginal field operators.³⁵

Joint ventures involve a joint operating agreement with one partner designated as operator and the cost of operations agreed annually with funding through cash calls.³⁶ In Nigeria, the operator is often the international oil company. Omorogbe notes that: ‘... in Nigeria, the operator has always been the oil company, even before the signing of the various operating agreements’.³⁷ Each partner takes care of its interests subject to petroleum profits tax and royalty. PSCs involve the contractor bearing all risk and costs and then recovering production costs from cost oil, after which the remaining oil (profit oil) is shared.³⁸ However there have been issues about the low take of government from PSCs³⁹ and the Deep Offshore and Inland Basin (Amendment) Act 2019 is aimed at rectifying this anomaly.⁴⁰ NEITI Report 2018 estimates that 74.5% of total gas produced was provided by the joint ventures while PSCs provided 20.61%.⁴¹

³⁵ DPR, 2018 Nigeria Oil and Gas Industry Annual Report p.26 Table 5 – List of Marginal Fields
<https://www.dpr.gov.ng/index.php>

³⁶ Although NNPC had been usually the 60% partner, Omorogbe notes that the IOC partner are always designated operators. Y Omorogbe, 'The Legal Framework for the Production of Petroleum in Nigeria' (1987) 5 J Energy & Nat Resources L 273 -291. There have also been perennial issues with government cash call arrears U Inifome, 'IBA - The Burden and Benefit of the Joint Operating Agreement Framework to the Nigerian Government' (28 November 2019) Oil and Gas Law Committee Publications
https://www.ibanet.org/LPD/SEERIL/Oil_Gas_Law/Publications.aspx

³⁷ Omorogbe *ibid* at 279

³⁸ NEITI report 2016 (n33) p.70 'Under the PSC, the license is held by the Nigerian State. The state contracts a company to explore and produce oil and gas resources using the company's expertise, technology, human and capital resources with a guarantee from the state on the recovery of investment and a share of the associated profit when crude is produced.'

³⁹ Ogunleye TA, 'A Legal Analysis of Production Sharing Contract Arrangements in the Nigerian Petroleum Industry' (2015) 5(8) Journal of Energy Technologies and Policy 1-10

⁴⁰ Cap D3, LFN 2004 (Amendment Law)

⁴¹ NEITI 2018 Oil and Gas report <https://neiti.gov.ng/index.php/neiti-audits/oil-and-gas/category/203-oga-2018-report> P.29 For an analysis of ownership of gas under old JV contracts see: A I Chukwuemerie, 'Ownership of associated and discovered gas in Nigeria under the old joint venture contracts', (2003) 27(1) *OPEC Review: Energy Economics & Related Issues*, 9–23

2.2 Government regulation and gas flaring cessation attempts:

The Petroleum (Drilling and Production) Regulations⁴² made under the Petroleum Act 1969⁴³ regulated for the production of natural gas in the following manner: -

1. Section 25 outlined prevention of pollution but with emphasis on waters and seas⁴⁴
2. Section 39 outlined the use of approved methods and practices for the production of natural gas acceptable to the Director of Petroleum Resources.⁴⁵
3. Section 43 – provided for the submission of a feasibility study to the Minister for utilisation of gas within five years of production⁴⁶

The next major legislative measures was the outlawing of gas flaring, except with written ministerial in the Associated Gas Re-injection Act (AGRA) 1979.⁴⁷ The key section which provides for this is:

Flaring of gas to cease 3. (1) Subject to subsection (2) of this section, no company engaged in the production of oil or gas shall after 1 January, 1984 flare gas produced in association with oil without the permission in writing of the Minister. (2) Where the Minister is satisfied after 1 January, 1984 that utilization or re-injection of the produced gas is not appropriate or feasible in a particular field or fields, he may issue a certificate in that respect to a company engaged in the production of oil or gas- (a) specifying such terms and conditions, as he may at his discretion choose to impose, for the continued flaring of gas in the particular field or fields; or (b) permitting the company to continue

⁴² [L.N. 69 of 1969.]

⁴³ Cap P10 LFN2004

⁴⁴ S. 25. "Prevention of pollution The licensee or lessee shall adopt all practicable precautions, including the provision of up-to-date equipment approved by the Director of Petroleum Resources, to prevent the pollution of inland waters, rivers, watercourses, the territorial waters of Nigeria or the high seas by oil, mud or other fluids or substances which might contaminate the water, banks or shoreline or which might cause harm or destruction to fresh water or marine life, and where any such pollution occurs or has occurred, shall take prompt steps to control and, if possible, end it."

⁴⁵ "39. Production of crude oil and natural gas The licensee or lessee shall use approved methods and practices acceptable to the Director of Petroleum Resources for the production of crude oil or natural gas from any pool or reservoir, and shall in particular take all necessary steps-"

⁴⁶ "43. Utilisation of natural gas: feasibility study Not later than five years after the commencement of production from the relevant area, the licensee or lessee shall submit to the Minister any feasibility study, programme or proposals that he may have for the utilisation of any natural gas, whether associated with oil or not, which has been discovered in the relevant area."

⁴⁷ A copy of the act is available on the government agency website: <http://www.ngfcp.gov.ng/media/1065/associated-gas-reinjection-act.pdf>

to flare gas in the particular field or fields if the company pays such sum as the Minister may from time to time prescribe for every 28.317 Standard cubic metre (SCM) of gas flared: Provided that, any payment due under this paragraph shall be made in the same manner and be subject to the same procedure as for the payment of royalties to the Federal Government by companies engaged in the production of oil.

Adewunmi indicates the low rate of fees which have been prescribed by subsequent amendments:⁴⁸ ‘

1. 2Kobo per million thousand standard cubic feet (Mscf) prescribed by the Associated Gas Re-Injection Amendment Decree 7 of 1985 on companies that flared gas without obtaining Ministerial approval. This fee was later increased to 50kobo in 1990.
2. N10 per Mscf in 1998 prescribed by the 1998 Budget.
3. \$3.50 per Mscf in 2011 prescribed by the Ministerial Directive of 2011.’

Further initiatives to eliminate gas flaring by developing midstream and downstream capabilities for gas include: ⁴⁹

- a. the creation of the Nigerian Gas company established in 1988,⁵⁰ which was tasked with developing the national domestic market and also involved in selling gas to other west African countries through the West African gas pipeline⁵¹

⁴⁸ O Adewunmi ‘ Gas Flaring Charges in Nigeria’ 20 November 2018 <https://www.mondaq.com/nigeria/oil-gas-electricity/756460/gas-flaring-charges-in-nigeria>

⁴⁹ Emam n2

⁵⁰ The national gas company is a subsidiary of NNPC. See the company website: <https://ngc.nnpcgroup.com/Pages/Home.aspx>

⁵¹The West African Gas Pipeline is a limited success as it supplies natural gas to Benin, Togo and Ghana. See the website <http://www.wagpa.org/>

- b. The establishment of the Nigerian Liquefied Natural Gas (NLNG) Plant to produce liquefied natural gas. The company was established in 1989⁵² and this was backed by an act, originally passed in 1990⁵³
- c. The Nigerian gas master plan in 2008.⁵⁴

In 2018 Minister of Petroleum resources⁵⁵ introduced new regulations guiding the flaring of gas with a view to implementing the Nigerian Gas Flare Commercialisation programme (NGFCP).⁵⁶ The Flare gas (prevention of waste and pollution regulations)⁵⁷ is in line with section 5 AGRA which allows the minister to make further regulations and it supports the new national gas flare commercialisation programme.

Although more evidence points to the push for a commercial approach to utilise gas for domestic markets and develop infrastructure, this may also be linked to the interest generated by cases examined in the later section.⁵⁸ The new regulations gives objectives which include⁵⁹:

1. The reduction of the environmental and social impact caused by gas flaring
2. The protection of the environment
3. Prevention of waste of natural resources
4. Creation of social and environmental benefits

⁵² See the company website: <http://nlng.com/Our-Company/Pages/Profile.aspx> It states that the “Nigeria LNG Limited was incorporated as a limited liability company on May 17, 1989 to harness Nigeria’s vast natural gas resources and produce Liquefied Natural Gas (LNG) and Natural Gas Liquids (NGLs) for export. The establishment of NLNG is backed by the NLNG Act. The company is owned by four shareholders, namely, the Federal Government of Nigeria, represented by Nigerian National Petroleum Corporation (49%); Shell (25.6%); Total Gaz Electricite Holdings France (15%) and Eni (10.4%). “

⁵³ Nigerian (LNG) (Fiscal Incentives & Assurances) Act Cap N87 LFN 2004

⁵⁴ For information on the 2008 Gas Master Plan see the NNPC website: <https://www.nnpcgroup.com/NNPC-Business/Midstream-Ventures/Pages/Nigerian-Gas-Master-Plan.aspx>

⁵⁵ Currently in Nigeria, this is vested in the President.

⁵⁶ The website of the national gas flare commercialisation programme see: <http://www.ngfcp.gov.ng/resources/regulations/ngfcp-regulations/>

⁵⁷ Flare Gas (Prevention of Waste and Pollution) Regulations 2018 Available from the website of the NGFCP <https://ngfcp.dpr.gov.ng/media/1120/flare-gas-prevention-of-waste-and-pollution-regulations-2018-gazette-cleaner-copy-1.pdf>

⁵⁸ T. Ojuawo ‘The Flare Gas (Prevention of Waste & Pollution) Regulations 2018- a summary’ 27 August 2019 IBA Oil and Gas Law Committee Publications

<https://www.ibanet.org/Article/NewDetail.aspx?ArticleUid=8F173D4A-10AB-43CF-B6E4-D141A246D9BB>

⁵⁹ See section 1 of the regulations (n57)

The approach in the regulations is a commercial but the government takes effective ownership of all flared gas⁶⁰ and then opening up access to flared gas through competitive bids.⁶¹ There is an increase in fees charged for gas flaring under section 13 of the regulations to USD \$2.00 for each 28.317 cubic metres of gas flared, for operators who produce more than 10,000 barrels per day in an Oil Mining Lease area or Marginal Field.⁶²

In spite of newer attempts, the past records of initiatives to reduce gas flaring has yielded only limited success. The NLNG (which is a joint venture between the Nigerian government and three multinational companies: Shell, Total and Eni) has benefitted from significant tax breaks totalling 12 years as the result of the NLNG Act, at an estimated cost to Nigeria of US\$3.3 billion dollars.⁶³ Furthermore, the measure of gas produced and flared depends largely on information provided by oil operators.⁶⁴ This issue is also the subject of the Flare Gas (Prevention of waste and Pollution) Regulations 2018⁶⁵ which will require daily logs and monthly submission of reports to the Department of Petroleum Resources (DPR).⁶⁶

⁶⁰ “...the federal government takes natural gas produced with oil free of cost at flare and without payment of royalty” –Section 2 section 44(3) of the Constitution of the Federal Republic of Nigeria “Notwithstanding the foregoing provisions of this section, the entire property in and control of all minerals, mineral oils and natural gas in under or upon any land in Nigeria or in, under or upon the territorial waters and the Exclusive Economic Zone of Nigeria shall vest in the Government of the Federation and shall be managed in such manner as may be prescribed by the National Assembly”. & section 1(1) of the Petroleum Act 1969 (Chap 350 LFN 1990) “The entire ownership and control of all petroleum in, under or upon any lands to which this section applies shall be vested in the State.”

⁶¹ See section 2 & 3 of the regulations (n57)

⁶² S.13(1) of the regulations (n57)

⁶³ “The tax break was granted in 1990, when Nigeria was under military rule, though did not kick in until 1999. After the standard five-year holiday, there was an unusual five-year extension and a rollover of certain allowances, which ActionAid says resulted in the consortium not paying corporate income tax until 2012. “ see: M Leftly, 20 January 2016 “Shell attacked for its extraordinary part in the £2.3 billion Nigerian tax break” The independent see also <https://www.independent.co.uk/news/business/news/shell-attacked-for-its-part-in-extraordinary-23bn-nigerian-tax-break-a6822061.html> see also the report by NGOs SOMO/ActionAid “How Shell, Total and Eni benefit from Tax breaks in Nigeria’s gas industry- The case of NLNG- “ January 2016 <https://www.somo.nl/how-shell-total-and-eni-benefit-from-tax-breaks-in-nigerias-gas-industry/>

⁶⁴ See SOMO/ActionAid report ibid p.28

⁶⁵ Section 15-18

⁶⁶ See Regulations (n24). See also I Aye E O Wingate “Nigeria’s Flare Gas (Prevention of Waste & Pollution) Regulation 2018” (2019) 21(2) Environmental Law Review 119-127

Aspects of AGRA itself could also be clarified. It has been noted that increased fees under AGRA are unlikely to have any effect if they remain tax deductible.⁶⁷

Overall, the petroleum industry could benefit from clarified and streamlined governance instruments in the petroleum industry. In this regard, efforts have been made since 2008 to overhaul the governance of the oil industry in a Petroleum Industry Bill but this has been unsuccessful. Notably in 2018, the Petroleum Industry Governance Bill which was refused assent by the President.⁶⁸ Though there is renewed hope in 2020 that the bill could become law.⁶⁹

Finally, there is also a lack of compliance and effective enforcement. This often results in disputes which are adjudicated retrospectively. Nigeria has a poor record of enforcement of regulatory standards and accordingly, oil companies in Nigeria also have an equally poor record of compliance with regulatory and reporting requirements.⁷⁰

2.3 Taxation

An overview of the fiscal regime for the Nigerian petroleum industry would include⁷¹: 1. Petroleum Profits Tax (PPT) 2. Royalty (oil) 3. Royalty (gas) 4. Company Income Tax (CIT)

⁶⁷ Ojuawo (n58) points out that 'The Ministry of Finance condemned the practice pointing out that the FGN loses billions of dollars in potential revenue and stating that the government was approaching lawmakers to amend the AGRA to use the word 'penalty' in describing gas flare fees. However, the 2018 Regulations do not change the nature of the charge. As such, the characterisation of the gas flare fees may not necessarily be affected by the steep increase.'

⁶⁸ C Katsouris "Buhari's second chance at oil and gas reform in Nigeria 4 April 2019 Chatham House <https://www.chathamhouse.org/expert/comment/buhari-s-second-chance-oil-and-gas-reform-nigeria>

⁶⁹ Deloitte reports on the re-submission of the bill by the President to the Senate in September 2020. It highlights that one of the latest provisions would make the gas flare penalties explicitly non-tax deductible see: 'Petroleum Industry Bill 2020 Submitted to the National Assembly' (*Deloitte Nigeria Blog*, 1 October 2020) <http://blog.deloitte.com.ng/petroleum-industry-bill-2020-submitted-national-assembly>

⁷⁰ For details see: E O Ekhaton "Public Regulation of the Oil and Gas Industry in Nigeria: An Evaluation," (2016) 12(1) *Annual Survey of International & Comparative Law* Article 6. See also B R Konne "Inadequate monitoring and enforcement in the Nigerian Oil Industry –The case of Shell and Ogoniland" (2014) 47 *Cornell International Law Journal* 181-204

⁷¹ This list is contained in the NEITI 2016 report (n33) at p.77

5. Education Tax 6. Concession Rentals 7. NDDC (The Niger Delta Development Commission) Levy 8. NCDMB (Nigerian Content and Development Monitoring Board) Payments 9. Gas Flared Fees/ Penalty 10. Dividend, interest and loan repayment by NLNG 11. Capital Gains Tax 12. Pipeline Transportation fees

The Petroleum Profits Tax Act (PPTA) and the AGRA were the key legislative acts in contention within the cases examined in the later section so PPTA merits some focus. The PPTA is the principal legislation governing taxation on petroleum operations and payments from joint ventures are made at the company level.⁷² A crucial and relevant section governs tax deductions:

“10. Deductions (1) In computing the adjusted profit of any company of any accounting period from its petroleum operations, *there shall be deducted all outgoings and expenses wholly, exclusively and necessarily incurred*, whether within or without Nigeria, during that period by such company for the purpose of those operations, including but without otherwise expanding or limiting the generality of the foregoing- ...

(c) all royalties, the liability for which was incurred by the company during that period in respect of natural gas sold and actually delivered to the Nigerian National Petroleum Corporation, or sold to any other buyer or customer or disposed of in any other commercial manner; (d) all royalties the liability for which was incurred by the company during that period in respect of crude oil or of casing head petroleum spirit won in Nigeria...”

This implies that companies can deduct outgoings and expenses from royalties’ payments and payments like royalties. The act also contains an incentives for utilization of associated gas in section 11. The companies were allowed by FIRS to self-assess liabilities and the verification was usually a desk based exercise.⁷³ Federal Inland Revenue Service is the apex tax agency of Nigeria and has the responsibility for tax revenue collection and compliance.

To gain a full picture relevant to the cases, the wider context of transparency regulation and environmental regulation must also be examined.

⁷² NEITI report 2016 (n46) at p.78

⁷³ NEITI Executive summary report 2006-2008 issued July 2011 p.28

<https://neiti.gov.ng/phocadownload/executive-summary-report-final-300112.pdf>

3. **The wider context: transparency regulation and environmental regulation**

Similarly relevant to our context is the focus on the petroleum industry as the centre of activity for corporate social responsibility.⁷⁴ Such corporate responsibility agenda includes responsible taxation, responsible climate action, transparency and respect for human rights amongst other social demands. Gas flaring could be placed at the intersection of these corporate social responsibility issues mentioned. To buttress this argument, it is noteworthy that a Nigerian Federal High Court decision of *Gbemre v Shell & Ors* in 2005, on a fundamental human rights application,⁷⁵ had declared gas flaring unconstitutional asserting that it had breached the claimants fundamental right to life (including a healthy environment) and dignity of the human person guaranteed in section 33 and 34 of the Constitution of the Federal republic of Nigeria 1999. It also asserted that both AGRA s. 3(2) a, b, and c & s.1 of the Associated Gas Re-injection (Continued Flaring of Gas) Regulations 1984 made under the act, as unconstitutional. The Judge suggested reform of the relevant sections to bring it in line with the constitution especially as the aim is to cease the flaring of gas.⁷⁶

The section examines two relevant areas of CSR which are entangled in the focus of gas flaring and could provide a relevant wider context. They are transparency regulation and environmental regulation.

⁷⁴ P Utting K Ives 'the Politics of Corporate Responsibility and the Oil Industry' (2006) 2 (1) *St Anthony's International Review* 11-34, 12

⁷⁵ *Gbemre v Shell Petroleum Devt Co. of Nigeria Ltd & Others* (2005) Unrep FHC/B/ CS/53/05 See also B Faturoti, G Agbaitoro and O Onya, 'Environmental Protection in the Nigerian Oil and Gas Industry and Jonah Gbemre v. Shell PDC Nigeria Limited: Let the Plunder Continue?' (2019) 27 *African Journal of International and Comparative Law* 225 - 245

⁷⁶ This case was not utilised, in the tax cases under consideration as the law remains unchanged in this regard.

3.1 Transparency regulation

One of the major weaknesses of the petroleum industry, has been that in spite of huge revenues the potential of such wealth of natural resources has not been realised in many resource-rich developing countries. Rather, there is an increasing association between resource wealth and corruption and poverty⁷⁷. This has been described as the ‘resource-curse’. The failure of a country to benefit from its natural wealth’.⁷⁸ Furthermore the resulting economic impacts include: 1. currency appreciation and the diminishing competition of non-oil products (Dutch disease), 2. The fluctuation of commodity prices and 3. The effect on political conditions.⁷⁹Crucially, the effect on political conditions can be such that ‘resource –rich countries tend to be less democratic and often fall into the hands of repressive rulers’.⁸⁰

This is because petroleum often engenders a rentier state, where the government of country can engage in large public expenditure, without resorting to extensive personal income taxation, thereby diminishing the link between elected and electorate.⁸¹It could also lead to lack of pressure for effective utilisation of resources as seen with the incidence of gas flaring. It is against this background and in the face of deepening ‘resource curse’ issues, the extractives industry transparency initiative (EITI) was launched, in a bid to reconnect potential state and companies revenues with human development, through the use of transparency as a tool. ⁸².

⁷⁷ J. D. Sachs & A. M. Warner “The curse of natural resources” (2001) 45(4-6) *European Economic Review* 827-838 R. Auty *Resource Abundance and Economic Development* (OUP, Oxford, 2001)

⁷⁸ Soros, G (2007) ‘Foreword’ in Stiglitz, J. E, Humphreys, M and Sachs, J. D *Escaping the resource curse* (Columbia University Press) xi- xv, xi

⁷⁹ Ibid

⁸⁰ Soros (n78) xii

⁸¹H MahDavy ‘The patterns and problems of economic development in rentier states : the case of Iran’ in Cook, M. A *Studies in the economic history of the middle east: from the rise of Islam to the present day* (SOAS, University of London, 1970) 428 -467

Also cited in D A Yates *The rentier state in Africa, oil rent dependency and neo-colonialism in the republic of Gabon* (Africa World Press, Inc., 1996)

⁸² The EITI was launched in 2003 in London following the publication of an undelivered speech by Tony Blair. The speech was intended for the 2002 World Summit on Sustainable Development in Johannesburg EITI website (2014) ‘History of EITI’ <http://eiti.org/eiti/history>

The idea was to build on the civil society ‘publish what you pay’ initiatives and self-made disclosures by companies and create an international initiative where transparency would be key. The EITI argument is that ‘a country’s resources belong to its citizens’ and therefore citizens should have a right to see what is received’.⁸³ EITI twelve principles are the cornerstone of the initiative and it involves a commitment to transparency and accountability by stakeholders in the extractive industry under a shared belief that resource wealth should contribute to sustainable development and economic growth.⁸⁴

The listed stakeholder include ‘governments and their agencies, extractive industry companies, service companies, multilateral organisations, financial organisations, investors and non-governmental organisations’.⁸⁵ The initiative works on the basic principle that companies disclose payments, governments disclose receipt of payments and then there is independent audited verification of tax and royalty payments overseen by a multi-stakeholder group.⁸⁶

Nigeria adopted EITI and created the Nigerian Extractives Industry Transparency Initiative (NEITI) in 2004, the NEITI Act was passed in 2007 empowering NEITI to do the following:

“2 (a) to ensure due process and transparency in payments made by all extractive industry companies to the federal government and statutory recipients...(c) to eliminate all forms of corrupt practices in the determination, payments, receipts and posting of revenues accruing to the federal government from the extractive industry companies; (d) to ensure transparency and accountability by government in the application of resources from payments received from the extractive industry companies.”⁸⁷

⁸³ EITI website (2014) ‘History of EITI’ <http://eiti.org/eiti/history>

⁸⁴ The EITI standard was updated in 2013 to include a clear 7 step requirement which includes the effective oversight by the multi-stakeholder group, timely publication of reports, production of comprehensive EITI reports, verification of such reports through a credible assurance process, The reports are now required to include contextual information about the extractive industry and to be comprehensible and publicly accessible. Finally the multi-stakeholder group (MSG) is tasked with acting on lessons and reviewing outcomes EITI (2013) The EITI Standard EITI International Secretariat 11 July 2013

⁸⁵ EITI principle 12

⁸⁶ M Abutudu D Garuba ‘Natural Resource Governance and EITI implementation in Nigeria’ Current Africa Issues 47 Nordiska Afrika Institutet (Nordic Africa Institute, Uppsala, 2011) <http://www.diva-portal.org/smash/get/diva2:471319/FULLTEXT01.pdf> <last accessed 31st July 2014>

⁸⁷ NEITI Act 2007 The adoption of EITI in Nigeria can be fully credited to the reform programme of the past President Olusegun Obasanjo see Shaxson, N (2009) ‘NEITI: Just a glorious audit’ November 2009 Chatham House, London

NEITI conducted a financial, physical and process audit (1999-2004). The first of its kind in the Nigerian oil industry and that audit has been cited as the being ‘in scope and detail the gold standard of the global EITI’.⁸⁸ The other audits since then have included the 2005 audit report, the 2006-2008 audit report, 2009-2011 audit reports and yearly audits from 2012-2016 & 2018.⁸⁹ These reports have uncovered significant and unprecedented financial discrepancies, unpaid taxes and system inefficiencies in the oil and gas industry.⁹⁰

There has been significant advantage to this process as the transparency reports which cover petroleum industry tax revenues drew the attention of the FIRS to the anomaly of discounting gas flaring penalty fees from tax payments made in the years 2006-2008.⁹¹ The cases examined in the later section, highlight, how these reports were the source of information for the FIRS re-assessment of PPTA liabilities for gas flaring which had occurred. They identified that fact that these companies were treating this charge as tax deductible. The legal status of such reports is still doubtful as the courts rejected its conclusions, as a legal basis for its decision. However the reports are often extremely detailed (which somewhat defeats the purpose of accessibility to all stakeholders) and occasionally there have also been significant delays in the production of the reports. For example the NEITI 2006-2008 report was delivered in 2011⁹² and the current 2016 report was delivered in December 2018.⁹³

<http://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Africa/1109neiti.pdf>

⁸⁸ EITI (2012) ‘Nigeria EITI: Making transparency count, uncovering billions’ case study 20.01.12 <http://eiti.org/document/case-study-nigeria> NEITI began with an influential chair prominent in anti-corruption issues (, Dr Oby Ezekwesili), who conducted audits which at that time went beyond the requirement of the global EITI.

⁸⁹ See reports until 2015 on the NEITI website <https://neiti.gov.ng/index.php/neiti-audits/oil-and-gas> The 2016 Oil and Gas audit report is on the EITI website: <https://eiti.org/nigeria>

⁹⁰ Ibid

⁹¹ This was specifically noted in the cases discussed in the later section.

⁹² NEITI report 2006-2008 Executive Summary of Recommendations and Proposed Actions issued July 2011 <https://neiti.gov.ng/phocadownload/executive-summary-report-final-300112.pdf>

⁹³ https://eiti.org/sites/default/files/documents/neiti-oil-gas-report-2016-full-report-211218_1.pdf

Yet they represent a vast improvement on the opacity of the industry that existed before such transparency reporting and they can create a wider persuasive context and value, which can be taken into account, if the court in its decisions seek to adopt a general purposive approach.

3.2 Environmental regulation

Gas flaring is also an environmental issue. It involves the direct release of pollutants into the air so it has implications for climate change, acid rain, agriculture and human health.⁹⁴ The national environmental standards and regulations enforcement agency (establishment) act (NESREA)2007⁹⁵ established the National Environmental Standards and Regulations Agency with powers to ‘have responsibility for the protection and development of the environment, biodiversity conservation and sustainable development of Nigeria's natural resources in general and environmental technology, including coordination and liaison with relevant stakeholders within and outside Nigeria on matters of enforcement of environmental standards, regulations, rules, laws, policies and guidelines.’⁹⁶

However key aspects of its scope regarding functions and powers exempt regulation of its oil and gas industry: for example: ⁹⁷

“(g) enforce compliance with regulations on the importation, exportation, production, distribution, storage, sale, use, handling and disposal of hazardous chemicals and waste other than in the oil and gas sector; (h) enforce through compliance monitoring, the environmental regulations and standards on noise, air, land, seas, oceans and other water bodies other than in the oil and gas sector; (j) enforce environmental control measures

⁹⁴ AO Ajugwo ‘Negative Effects of Gas Flaring: The Nigerian Experience’ (2013) 1 Journal of Environment Pollution and Human Health 6-8

⁹⁵ 2007 Act No.25

⁹⁶ Section 2 NESREA (Establishment) Act 2007

⁹⁷ Section 7 NESREA (Establishment) Act 2007

through registration, licensing and permitting systems other than in the oil and gas sector;
(k) conduct environmental audit and establish data bank on regulatory and enforcement mechanisms of environmental standards other than in the oil and gas sector”

Even the 2018 amendment act deletes the words, ‘oil and gas’ from s.7 (c): ‘(c) enforce compliance with the provisions of international agreements, protocols, conventions and treaties on the environment, including climate change, biodiversity, conservation, desertification, forestry, oil and gas, chemicals, hazardous wastes, ozone depletion, marine and wild life, pollution, sanitation and such other environmental agreements as may from time to time come into force ‘⁹⁸

Therefore these leaves the DPR with the responsibility to ensure that petroleum industry operations do not degrade the environment. Although certain overlaps remains in the area of oil spills⁹⁹ and environmental impact assessment.¹⁰⁰ The DPR issue environmental guideline and standards for the petroleum industry of Nigeria (EGASPIN).¹⁰¹

“Part III (Production), Sec. 3.8.8.1 prohibits gas flaring, then states if flaring must occur, operators must secure a waiver and permit to flare gas; they must pay the necessary fines for every standard cubic meter flared; they must pre-treat the gas; create a setback of 60 m radius for the flare; ensure complete combustion; close system valves when flare is in use (to prevent venting); and ensure "leakages minimized"”¹⁰²

Olawuyi & Tubodenyefa in a report which involved an extensive review of EGASPIN 2018 indicated major weaknesses in stringency, compliance, transparency with weak

⁹⁸ See NESREA (Establishment) Amendment Act 2018 Act No.26

⁹⁹ NOSDRA National Oil Spill Detection and Response Agency (Establishment) Act 2006 Act No.15 2006

¹⁰⁰ Environmental Impact Assessment Act

¹⁰¹ <https://www.dpr.gov.ng/egaspin/>

¹⁰² <https://www.iea.org/policies/8676-environmental-guidlines-and-standards-for-the-petroleum-industry-in-nigeria-egaspin>

enforcement, standards below international best practices and absence of clear framework for stakeholders to intervene on project applications. ¹⁰³This is especially important because DPR as the federal regulator has to be seen to represent stakeholder interests especially those of local and indigenous communities and it has a dual role to promote operations and yet ensure operations are done at a standard which is suitable and sustainable for the peoples and environment. Olawuyi & Tubodenyefa suggest that there is clear conflict of interest in having one regulator which permits oil operations on the one hand and also enforces environmental compliance on the other. ¹⁰⁴

¹⁰³ D S Olawuyi Z Tubodenyefa Review of EGASPIN November 2018 Institute for Oil and Gas Energy, Environmental and Sustainable Development (OGEES)
https://www.iucn.org/sites/dev/files/content/documents/2019/review_of_the_environmental_guidelines_and_standards_for_the_petroleum_industry_in_nigeria.pdf

¹⁰⁴ Ibid p.5

4. Gas flaring cases

The cases: *Mobil Producing Nigeria Unltd v FIRS no.4 (2015)*¹⁰⁵ ; *Shell Petroleum development Company Nig. Ltd v FIRS (2016)*¹⁰⁶ & *Chevron Nigeria Ltd v FIRS (2016)*¹⁰⁷ examined the issues of strategic tax planning around the costs of gas flaring by the major oil companies in Nigeria.¹⁰⁸ The starting point for resolution of tax disputes within the Nigerian legal systems is the Tax Appeal Tribunals which are administrative tribunals vested by legislation with the power to resolve tax disputes.¹⁰⁹ Therefore disputes over the tax assessments of the Federal Inland Revenue Service (FIRS) can be taken before the Tax Appeal Tribunal (TAT) and from there further appeals may lie to the Federal High Court, then the Court of Appeal and the Supreme Court.¹¹⁰

In 2013, the initial appeal was lodged before the Tax Appeals Tribunal regarding a tax assessment decision of the FIRS for additional Petroleum Profit tax for 2006-2008 years of

¹⁰⁵ (Tax Appeal Tribunal initial hearing) *Mobil Producing Nigeria Unltd v FIRS no.4 (2015)* 18 TLRN 115 17th March 2015 (Appeal no: TAT/LZ/033/2013)

¹⁰⁶ *Shell Petroleum development Company Nig Ltd v FIRS (2016)* 21 TLRN 86 27th October 2015 (Appeal no: TAT/LZ/040/2013)

¹⁰⁷ *Chevron Nigeria Ltd v FIRS (2016)* 22 TLRN 1 30th October 2015 (Appeal no: TAT/LZ/045/2013)

¹⁰⁸ Ernst & Young (EY) Global Tax Alerts 29 June 2018 "Nigeria's Federal high Court rules that Minister's approval is required for tax deductibility of payment's made on gas flares" see <https://www.ey.com/gl/en/services/tax/international-tax/alert--nigeria-s-federal-high-court-rules-that-minister-s-approval-is-required-for-tax-deductibility-of-payments-made-on-gas-flare> see also EY, Tax Insights "Nigeria's FIRS provides updates on Tax administration in Nigeria" (the updates were provided on 6 September 2018 by the FIRS chairman at a stakeholder meeting.) see: <https://taxinsights.ey.com/archive/archive-news/nigeria%E2%80%99s-firs-provides-updates-on-tax-administration-in-nigeria.aspx>

¹⁰⁹ <http://tat.gov.ng/> Established by virtue of section 59 (1) Federal Inland Revenue Service (Establishment) Act 2007

¹¹⁰ The Court of Appeal (Nigeria) clarified the jurisdiction of the tribunal and the appeal process over tax disputes in the case of *CNOOC Exploration and Production Nig. Ltd & Anor v NNPC & Anor (2017)* 32 TLRN 34 at 56 which states that: "The procedure for resolving claims and objections such as in the instant matter, are spelt out. When an assessment is made and the party is not satisfied, it can serve a Notice of refusal to amend the assessment as desired where it disagrees with FIRS. The party may also then appeal against the assessment to the Tax Appeal Tribunal, then it can approach the Federal High Court, the Court of Appeal and the Supreme court." (2017) 32 TLRN 34 at 56 citing a previous judgement *Shell Nigerian Exploration and Production & Ors. Vs FIRS & Anor* (unreported judgement Appeal No. CA/A/208/2012 delivered on 31st August 2016) at pg 38

assessment in the total sum of US\$7,633,850 against Mobil Producing Nigeria Unlimited.¹¹¹

This reassessment was based on the issue of the validity of the gas flaring ‘fees’ or penalties deduction.

The issues centred on two arguments:

1. Whether the sums fall within a statutory obligation which is “wholly, exclusively and necessarily” for the purpose of the operations of the company as required for deductions under the governing petroleum tax legislation.
2. In the case of gas flaring, in order to establish this statutory obligation, the “legality” of the gas flared is material to its tax deductibility.

There were also appeals from *Shell Petroleum development Company Nig. Ltd and Chevron Nigeria Ltd* on a substantially similar issues which dealt with the tax treatment of the gas flaring penalty included in the Associated Gas Reinjection Act (AGRA) 1979.¹¹²

The AGRA is as discussed above, provides for cessation of gas flaring and the exceptions.

The latter paragraph in section 3(2) (b): states: ‘*Provided that, any payment due under this paragraph shall be made in the same manner and be subject to the same procedure as for the payment of royalties to the Federal Government by companies engaged in the production of oil.*’ This appeared to bring gas flaring penalties within the purview of the Petroleum Profits Tax Act¹¹³ which provides for tax regulation for oil companies, when determining adjusted profits for tax accounting purposes. Section 10 (1) of the PPTA permitted deductions of “all outgoings and expenses *wholly, exclusively and necessarily*

¹¹¹ (Tax Appeal Tribunal initial hearing) *Mobil Producing Nigeria Unltd v FIRS no.4* (2015) 18 TLRN 115 17th March 2015 (Appeal no: TAT LZ/033/2013)

¹¹² Other recent cases filed at the Tax Appeal Tribunals level on this issue include *Shell Petroleum development Company Nig Ltd v FIRS* (2016) 21 TLRN 86 27th October 2015 (no: TAT/LZ/040/2013) & *Chevron Nigeria Ltd v FIRS* (2016) 22 TLRN 1 30th October 2015 (no: TAT/LZ/045/2013)

¹¹³ Originally 1959 Cap P13 LFN 2004

incurred, whether in Nigeria or without” during the period of petroleum operations in a given tax accounting period.

The Supreme Court (Nigeria) had in an earlier petroleum tax case had given a wide interpretation of the phrase. It had stated that: “once there is a statutory or contractual obligation...for a company engaged in petroleum operations to perform, such obligation is wholly, exclusively and necessarily for the purpose of the operations of the company”¹¹⁴

As a result of this, the tribunal therefore gave the following decision:

“The Appellant applied for gas flaring certificates and made requisite payments for the period from 2006, 2007 and 2008, to continue to flare gas. The Minister did not issue certificate nor sanction the Appellant for illegal gas flaring. The Respondent has not provided proof of sanction on the Appellant for illegal flaring of gas from 2006 to 2008. In the circumstances, we believe that the Minister did not consider the gas flared by the Appellant illegal. If the Minister had sanctioned the Appellant, then, the gas flare fee paid by the Appellant would be considered an illegal payment which would disqualify the Appellant from benefiting under section 10(1) of the PPTA.”

This decision permitted deductions because, firstly the fee was determined to be a legal payment qualifying under section 10(1) of the PPTA and secondly, although certificates applied for were not issued over the intervening years, the appellant was not sanctioned either. In doing so, it took a limited interpretative approach, which did not investigate the ethical issues or the absence of the certificate but rather focused on the inaction of the Minister as a benchmark for measuring the illegality of the gas flaring.

However the tribunal acknowledged that the case, stemmed from the report of the transparency initiative which highlighted the deduction of gas penalty fees from the Petroleum Profits Tax for 2006-2008.¹¹⁵ And that the NEITI report had indicated that this deduction was wrong.

¹¹⁴ *Shell Petroleum Development Company v Federal Board of Inland Revenue (1996) 8 NWLR (Part 466) 256 per Uwais CJN*

¹¹⁵ *Mobil Producing Nigeria Unltd v FIRS no.4 (2015) 18 TLRN 115 17th March 2015 (Appeal no: TAT LZ/033/2013)* also see <https://pwcnigeria.typepad.com/files/tat-ruling-on-deductibility-of-gas-flaring-payment.pdf> p.8

However the tribunal disagreed on the relevance of the NEITI report in this regard, rather it pointed out that, “the NEITI report which states that gas flare fee paid by the Appellant for the said years of assessment is not deductible is not based on any provision of the law. NEITI report which the respondent relied on, cannot overrule either the PPTA or the AGRA.”¹¹⁶

While a purposive interpretation is mentioned in determining the answer to the question of whether legal gas flaring fees or penalty should be deducted from tax revenues, there was insufficient detail in the reported judgement about how this was applied in the tribunal’s reasoning. The purpose of the AGRA act was to reduce and stop gas flaring. The issue of fees for exceptionally permitted gas flaring then ascribed as tax deductible expenses incurred in the course of petroleum operations, could be seen as a defeat of the spirit of the legislation.

Most importantly, this tribunal decision was followed by similar tribunal decisions for other oil multinationals involved in the Nigerian petroleum industry such as: Shell and Chevron before TAT.¹¹⁷

Then the case was appealed to the Federal High Court by FIRS.¹¹⁸ The main grounds were:

1. The lower tribunal erred in law when it held that PPTA and AGRA do not expressly required a company must obtain gas flare certificate before expense incurred would be tax deductible
2. The lower tribunal misinterpreted section 3(2) AGRA above
3. The lower tribunal erred in its decision which qualified for tax deductibility on the basis that the flaring was not sanctioned by the Minister of Petroleum Resources.

¹¹⁶ See Ibid

¹¹⁷ Shell Petroleum development Company Nig Ltd v FIRS (2016) 21 TLRN 86 27th October 2015 (no: TAT/LZ/040/2013) & Chevron Nigeria Ltd v FIRS (2016) 22 TLRN 1 30th October 2015 (no: TAT/LZ/045/2013)

¹¹⁸ The appeal to the Federal High Court- FIRS v Mobil Producing Nigeria Unltd (2018) 37 TLRN 1 26th March 2018 (Case suit no: FHC/3A/2017)

In 2018, the FHC held that upon its reading of both sections 3 AGRA and section 10 PPTA, the gas flaring payments are tax deductible, provided there is written evidence of permission from the minister in the form of the certificate. However, it also held that in the instant appeal, where the flaring had been done without a certificate, it was an invalid act.

The court said *“The whole transaction of neither the respondent for flaring gas in 2006, 2007 and 2008 without permit nor certificate was an invalid action and therefore payment made is also not valid going by the literal meaning of AGRA”*

The emphasis on the literal meaning for tax issues was paramount in the minds of the federal high court although it was manifestly noted that the primary purpose of AGRA was to discourage gas flaring and limit the practice.¹¹⁹ It was deemed relevant to the arguments that the phraseology used in the act, did not include the word: penalty. The use of the word, ‘penalty’ would have rendered it outside the scope of the section 10 PPTA.¹²⁰ The respondent also argued the word ‘penalty’ is used in section 4 of the AGRA only in relation to non-compliance with section 3 and therefore section 3 could be deemed to refer to the “payments of fees for gas flared”¹²¹ hence similar to a charge.

The decision of deducting gas flaring charges for tax purposes is viewed as ‘controversial’.¹²² The court’s insistence on the adoption of a literal approach to judicial interpretation of tax statutes by making the construction about the exact meaning in the legislative instrument, should be subject to some scrutiny. A brief comparative analysis in the approaches used in other common law jurisdictions may also provide some relevant indicators.

¹¹⁹ FIRS v Mobil Producing Nigeria Unltd (2018) 37 TLRN 1 26th March 2018 (Case suit no: FHC/3A/2017) at P.21

¹²⁰ See section 13 (1a) PPTA

¹²¹ See FIRS v Mobil Producing Nigeria Unltd (2018) 37 TLRN 1 26th March 2018 (Case suit no: FHC/3A/2017) at p.23 .see also section 4(1) AGRA which provides for penalty “4. (1) where any person commits an offence under section 3 of this Act, the person concerned shall forfeit the concessions granted to him in the particular field or fields in relation to which the offence was committed.”

¹²² Deloitte 25 September 2018 ‘Gas Flaring Charge in Nigeria- is FHC’s decision in Mobil v FIRS good law?’ see http://blog.deloitte.com.ng/gas-flaring-charge-in-nigeria-is-fhcs-decision-in-mobil-v-firs-good-law/?utm_source=Mondag&utm_medium=syndication&utm_campaign=View-Original

5. Potential purposive test – the role of judicial interpretation

The general role of the court interpret and give meaning to particular words in dispute can be fulfilled through a number of approaches. The classic interpretative approaches include: the literal rule, the golden rule and the mischief rule.¹²³ However because of the expansion of the crucial role, interpretation plays in modern law-creation, the teleological purposive approach is gaining momentum.¹²⁴ The role of the ‘purpose’ of the taxing act has not always been given predominance in judicial interpretation but this is not necessarily a result of judicial precedents.

In the Nigerian context, the Supreme Court held in the case of *Mobil Oil Nigeria Ltd vs Federal Board of Inland Revenue* (1977) that: “*In considering a statute, regard shall be given to the cause and necessity of the Act and then such construction shall be put upon it as would promote its purpose and arrest the mischief which it is intended to deter”¹²⁵. The courts also showed flexibility in the case of *Shell v Federal Board of Inland Revenue* (1996).¹²⁶ Nevertheless it appears some newer case law has chosen to utilise the literal interpretation in line with old cases of the English courts¹²⁷.*

¹²³ N Lee A purposive approach to the interpretation of tax statutes (1999) 20(2) Statute Law Review 124-143, 126

¹²⁴ G Davidov *A purposive Approach to Labour Law* (OUP, 2016) p.16-17

¹²⁵ 1 NCLR 1 see also T Esan “The shift in interpretation of tax statutes” The Cable April 07, 2017 <https://www.thecable.ng/shift-in-interpretation-of-tax-statute>

¹²⁶ (1996) 8 NWLR (Pt. 466) 256 (Supreme Court)

¹²⁷ See also Court of Appeal Nigeria *7-up Bottling Company plc v Lagos State Inland Revenue Board* (2003) 3 NWLR (Pt. 650) 565-591. “*Taxation provisions are strictly interpreted.....If a person sought to be taxed comes within the letter of the law, then such a person must be taxed. On the other hand, if the tax authority seeking to recover tax from a person is unable to bring him within the letter of the law, the person will be free, however apparently within the spirit of the law his case ought otherwise to be.*” See also Esan n121

For example in the case of *Haliburton West Africa Limited v Federal Board of Inland Revenue* (2013)¹²⁸ where Mustapha J states that:

“This is a taxing statute. The maxim of income Tax Law according to Lord Simonds in the case of *Russell v. Scott* (1948) 2 All E.R. 1 at page 30 is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax on him. And as stated by the House of Lords in *Pryce v. Monmouth Shire Canal and Railway Companies* (1879) 4 A.C. 197. Tax laws are strictly construed; a taxpayer has a right to stand upon literal construction of the words used in a taxing statute whatever might be the consequences.”¹²⁹

In contrast, the newer English case-law on issues of tax avoidance indicate a move towards a purposive approach. The Ramsay principles which emanate from the case before the House of Lords, *W T Ramsay v IRC* which clearly identifies the shift.¹³⁰ Lord Wilberforce in his judgement suggested that: “what are ‘clear words’, is to be ascertained upon normal principles: these do not confine the courts to literal interpretation. There may, indeed *should, be considered the context and scheme of the relevant Act as a whole*, and its purpose may, indeed should, be regarded.”¹³¹

The courts also noted in the 2004 case of *Barclays Mercantile Business Finance Limited v Mawson*¹³² that:

¹²⁸ 11 TLRN 84 at 112. The judge also cites *Okupe v FBIR* (1974) 4 SC 93 & *Peenok Investments v Hotel Presidential* (1999) 11 NWLR (Pt. 628) 543 for support. See also Esan (n125)

¹²⁹ Case Ibid

¹³⁰ 1982 AC 300

¹³¹ Case Ibid at p.323 it also stated further that “While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. ...It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded.” P. 323-324

¹³² This case concerned a gas pipeline in the Irish Sea and tax deductions see (2004) UKHL 51 (word in bracket mine).

‘the Ramsay case did not introduce a new doctrine operating within the special field of revenue statutes (but) on the contrary, as Lord Steyn observed in *McGuckian* [1997] 1 WLR 991, 999 it rescued tax law from being “some island of literal interpretation” and brought it within generally applicable principles. Lord Steyn concluded correctly that this “The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description.”¹³³

In 2016 Lord Reed in *UBS AG v HMRC* reviewed the jurisprudence following Ramsay and concluded that such purposive rules would need to be applied with sensitivity to fiscal context.¹³⁴

Purposive approach is not a unitary approach because it can also be construed in quite a limited way as to amount to the same result as a literal approach¹³⁵ or it can be stretched so widely as to open one to accusation of judicial law-making.¹³⁶

However the lack of flexibility which a literal approach creates with regard to tax statutes (especially those that impinge on issues of environmental responsibility and wider social responsibility) is quite unhelpful as it reinforces creative compliance while dis-incentivising

¹³³ Para 32 *Barclays Mercantile Business Finance Limited vs Mawson*

¹³⁴ (2016) UKSC para 95 ‘This point illustrates the need to apply the Ramsay approach with sensitivity to the particular fiscal context which is relevant: the conditions have to be disregarded for the purpose of deciding whether the shares were restricted securities, since that is necessary in order to apply Chapter 2 as Parliament intended; but they do not have to be disregarded for the purpose of assessing the value of the perquisite, since ordinary taxation principles require the tax to be based on its true value’

¹³⁵ For a narrow interpretation of intention see Lord Reid *IRC v Hinchy* (1960) A C 748 at 767 “But we can only take the intention of Parliament from the words which they have used in the Act, and therefore the question is whether these words are capable of a more limited construction. If not, then we must apply them as they stand, however unreasonable or unjust the consequences, and however strongly we may suspect that this was not the real intention of Parliament.”

¹³⁶ See arguments made in N Lee A purposive approach to the interpretation of tax statutes (1999) 20(2) *Statute Law Review* 124-143, 137 Suggests the use of parliamentary materials as a yardstick. However it is unhelpful in my opinion for the courts to limit itself in that manner.

affirmative action. Purposive approach can take into account specific purposes and/or general values.¹³⁷ Context is a key instrument in the purposive approach.¹³⁸ Therefore one can examine the specific context of gas flared and the general context of corporate responsibility and tax. McCormack while examining the cases of US court decisions on interpretation of tax shelters, observed that courts can focus on minutiae without paying attention to real problems behind such tax regimes especially where they fall outside the law's purpose.¹³⁹ To remedy this, she suggests that: "In determining the purposes of exploited laws, courts should first consider the specific purposes of the provisions. If specific purposes prove unhelpful, courts should consider whether general principles help fill the gap or ambiguity being exploited. Whether it makes sense to assume that general principles of tax law were meant to apply depends on the type of provision at issue."

In this context the purposive interpretation would mean that the purpose of AGRA is considered firstly in its specific section 4, Minister's permission sense but then also in the wider context of AGRA itself as an anti- gas flaring legislation. The cases demonstrate that interpretative approaches could play a role in giving meaning to the law and it is desirable that such meaning should serve the purpose of the legislative instrument.

These purpose may be difficult to ascertain but legislative history, regulatory environment and wider context can aid the work of the courts.

¹³⁷See more details on proposed purposive tests in S W McCormack "Tax Shelters and Statutory Interpretation: a much needed purposive approach" (2009) University of Illinois Law Review 697-772;

¹³⁸ "In the area of statutory construction, context is critical" R v Massey (2007) EWCA 2664 Toulson L J para. 15

¹³⁹ S W McCormack, 'Tax Shelters and Statutory Interpretation: A Much Needed Purposive Approach' (2009) 2009 U Ill L Rev 697 -772, 714

6. Conclusion

In the drive for tax revenues, through timely and adequate tax payments, that necessary link between the ethically desirable conduct such as the reduction and cessation of gas flaring and the legal requirement outlawing gas flaring is weakest at the point of enforcement. It is further weakened by the deployment of strict legal tools of interpretation by the judiciary which allows for the exploitation of gaps in drafting. These gas flaring cases exposed the adherence to literal or limited interpretative tool in tax cases, thereby creating more scope for strategic tax compliance in the future. A purposive approach to tax interpretation will create more scope for the constructive enforcement of links between ethical legislative intent and legal construction in given circumstances, where this is deemed applicable.

The analysis also indicates the relative weakness of the transparency tool in a regulatory dominated environment especially for enforcement before the courts. The cases nevertheless suggest that transparency is of some value because it recommends openness, visibility and accountability. In the cases examined, the visibility of payments made and deducted for gas flaring in Nigeria were only discovered via transparency reports. Open reports on oil and gas revenues can transfer of power and responsibility to those who encounter, understand and utilise the information to hold power-holders to account. It could provide a kind of egalitarian solution to a social problem. The idea that ‘sunlight is the best disinfectant’¹⁴⁰ or that the panopticon (publicity) can ensure the watchers have the power¹⁴¹ can be seen in philosophy long before its current popularisation in political thinking. Yet in today’s data driven world, questions remain about the accessibility and effectiveness of such information.¹⁴²

¹⁴⁰ L D Brandeis *Other People’s Money and How bankers Use it* (1914)

¹⁴¹ For more on Bentham see the UCL project: <https://www.ucl.ac.uk/bentham-project/who-was-jeremy-bentham/panopticon>

¹⁴² J Kemper D Kolkman “Transparent to whom? No algorithmic accountability without a critical audience” (2018) 22(14) *Information, Communication & Society* 2081-2096

In these cases, it allowed regulators such as FIRS to work more closely with NEITI reports and derive strong financial accountability mechanisms through its re-assessments but the legal effectiveness still relies on constructive and purposeful judicial interpretation. Finally the paramount role of courts, in giving effectiveness to tax provisions is highlighted, it is important that an effective purposive approach is adopted for future tax interpretative cases in order to fulfil the goals of legislation while reducing scope for creative compliance.