IMPACT OF THE PETROLEUM INDUSTRY ACT 2021 ON THE UPSTREAM OIL AND GAS SECTOR OF THE NIGERIAN ECONOMY

INTRODUCTION

After years of attempting to usher in a new regulation for the Petroleum Industry, the enactment of the Petroleum Industry Act 2021 is a welcome development. The upstream sector, which has been plagued by inadequate investment over the years will benefit immensely from the changes.

We have reviewed the Petroleum Industry Act, 2021 as it relates to the Upstream sectors and draw the attention to the implication of the enactment of the act to the Companies operating within this sector.

Major Changes

Regulator

Section 4(1) of the PIA provides a new regulator for the upstream sector known as the Nigerian Upstream Regulatory Commission (the "Commission"). The Commission will be responsible for the commercial and technical regulation of the upstream petroleum operations. This implies that the Department of Petroleum Resources (DPR) will cease to exist as all its functions will now be carried out by the new Commission.

Licenses

Section 70 (1) of the PIA provides the following changes with respect to acquisition of licenses in the upstream sector:

Petroleum Act 1969		Petroleum Industry Act 2021	
License	**Duration**	**License**	**Duration**
Oil Exploration license (OEL)	3years	Petroleum Exploration Licence (PEL)	3years but subject to renewal on fulfilment of certain conditions
Oil Prospective License (OPL)	5years	Petroleum Prospecting License (PPL)	6 years for onshore, 10 years deep offshore and frontier acreage
Oil Mining Lease (OML)	Not more than 20 years	Petroleum Mining Lease (PML)	

1) **Petroleum Exploration License (PEL):**
   a) Granted by the commission
   b) Three-year tenure which is renewable for additional three years.

2) **Petroleum Prospecting License (PPL):**
   a) This is granted by the Minister of Petroleum on recommendation by the Commission
   b) The tenure for the above license is three years for companies operating in the shallow waters which is renewable for extra three years

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c) The PPL has Five-year tenure for companies operating in the Deepwater and Frontier and renewable for additional Five years.
d) The company holding this license must notify the commission of discovery of crude oil that warrants appraisal within 180 days of discovery.
e) The company must also submit an appraisal program within One year for approval.
Commercial discovery not declared after retention period leads to abdication.

3) Petroleum Mining Lease (PML)

a) The Lease term is twenty years.
b) Its granted upon compliance with local content Act, environmental management plan and host communities.

Royalty

The new royalty rates will be based on price and production. This will be determined monthly and paid to the commission.
Prior to the PIA Act, royalty rates applicable to oil and gas companies operating in different areas is stated below:

Area	Royalties
Onshore	5% - 20% (barrel based)
Shallow waters (area up to 100 meters	2.5% - 18.5% (barrel based)
Offshore up to 200 meters	1.5% - 16.67% (barrel based
Deep offshore	0% - 12% (depth based)
Inland basin	10%
Marginal field	2.5% - 18.5%

The new rates are provided in paragraph 10 and 11 of the PIA 2021.

Production based royalty		
Topography/Landscape	Royalty rate (Crude oil)	Royalty rate (Gas)
Onshore	15%	5%
Shallow water up to 200m water depth	13%	
Deep offshore greater than 200m water depth	7.50%	
Frontier Basins	7.50%	
Marginal Fields	5% for the first 5000 bopd	
	7.5% for the next 5000 bopd for the share of production over 5000 bopd	

Price based royalty		
Details	Royalty rate (Crude oil)	Royalty rate (Gas)
Below $50 per barrel	0%	7.50%
$100 per barrel	5%	5%
Above $150 per barrel	10.00%	5%
Between $50 to $100 per barrel and $100 and $150 per barrel	Determined by interpolation	5%

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Hydrocarbon Tax (HCT)

Hydrocarbon Tax is defined by Section 261 of PIA 2021 as a tax charged and assessed on profit of companies engaged in upstream petroleum operations which is payable during each accounting period.

The HCT applies to companies engaged in the exploration and extraction of crude oil, condensates and Natural Gas liquids produced from non-associated gas in the field or gas processing plants, provided the related volumes are determined at the measurement points.
It excludes associated Natural Gas, including gaseous NGL's produced in the field and condensates and NGL's from non-associated gas fields or Gas processing plants.

Chargeable Tax

PPT Act (Section 22)	PIA (Section 267)
Oil Mining Licence	**Onshore and shallow waters**
65.75% (within 5 years of commencement of petroleum operations and	PML- 30% plus CIT 30%
85% onwards	OPL- 15% plus CIT 30%
CIT-30%	**Others:**
EDT-2%	Deepewater-0%
	Frontier basins 0%
	Frontier basins (after conversion to PPL-15%
	Marginal fields (prior to 1 Jan 2021^)-15%
	Existing OML (opted out of PIA and until renewable date- PPTA rates
	EDT- 2%

Filing of Returns

Section 277 and 280 of the Petroleum Industry Act 2021, requires upstream companies to file two returns namely:
Estimated Hydrocarbon Tax (EHT) and
Actual Hydrocarbon Tax.

The period for filing returns

Details	Petroleum Profits Tax Act	Petroleum Industry Act
1. Period of Returns (Actual)	(a) Section 30(2) Within 5 months after the Company's year end	(a)Section 277(2) Within 5 months after the Company's year end (31 December).
		(b)For Company which is yet to commence bulk sales or disposal of chargeable oil shall file the returns within 18 months from the date of its incorporation
2. Basis of Assessment	Actual Year Basis for OML (S.30(2) of PPTA)	Actual Year Basis for PML,
	Preceding Year Basis for OPL (S 55 of CITA)	Preceding Year Basis for PPL (S.277 of PIA)
3. Delivery of Account and Particular	The Audited Accounts for the period,	The Audited Accounts for the period,
	Chargeable Tax Computation	Chargeable Tax Computation
	Computation of Capital Allowance (in line with fifth Schedule of the Act)	Computation of Capital Allowance (in line with fifth Schedule of the Act)
		Computation of Production Allowance (Sixth Schedule of the Act)
		Computation of chargeable profits for the two classes of chargeable profits identified in S 267

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Penalty

Section 273 of the PIA prescribed penalty for non-compliance with the provisions of any regulations made under the Act. The section provides the penalties below:

- 10 million naira on the first day; and
- 2 million for every and subsequent day in which a company fails to file return.

Allowable and Non-Allowable Deductions

Under the Petroleum Profit Tax Act (PPTA) all costs needed only to be wholly, exclusively, and necessarily incurred to be allowable for tax purposes, all costs incurred within the sector are taken to be reasonable.
However, the PIA has introduced the reasonability test for any cost to be allowable. Below are highlights of the allowable deductions as provided in section 263 of the PIA.

Allowable deductions

Items	PPTA (Section 10)	PIA (Section 263)
Basis	Wholly, exclusively, necessarily (WEN)	WREN
Cost item	Intangible drilling cost	Royalty (this must be incurred and paid)
	Administrative expenses	rent
	Finance cost	Contribution to approved fund (host communities, environmental remediation fund, NDDC etc)
	Royalty incurred	Costs of Geological, Geophysical and Geochemical data
	EDT	Contribution to decommissioning or abandonment funds approved by the commission. (end of field surplus returned to lessee are taxable income).
	Rent	

Disallowable deductions

Items	PPTA (Section 13)	PIA (Section 264)
Cost item	Decommissioning	EDT
	Gas flaring penalty	Gas flare penalty
	Depreciation	Interest on borrowing
	Royalty incurred	Head office cost
	EDT	Office rent
	Rent	Bad debt written off

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Schedules to the Act

Capital Allowance-Fifth Schedule

The PIA only provides for Annual allowance for capital allowance purposes under the Hydrocarbon Tax (HCT).

Annual Allowance:
These are claimable in full on any qualifying capital expenditure (QCE), however the QCE must have been incurred wholly, exclusively, necessarily, and reasonably for the purpose of petroleum operations. The types of QCE includes:

a) Qualifying Plant expenditure: Plants, machinery, and fixtures.
b) Qualifying Pipelines and Storage tanks
c) Qualifying Building expenditure: building, structures, or works of a permanent nature.
d) Qualifying Drilling expenditure.

All expenditures incurred prior to the first accounting date (pre-production costs) which has not resulted into any asset will be treated as part of qualifying expenditure.
The qualifying capital expenditures under PIA has a maximum tax life of five years, this aligns with the PPTA, the rates of annual allowances are as follows;

Year 1	20%
Year 2	20%
Year 3	20%
Year 4	20%
Year 5	19%

The 1% retention rate can only be written off with the approval of the Minister of Petroleum resources who will issue certificate of disposal.

Production Allowance- Fifth Schedule

The PIA, grants production allowance to existing operators in crude oil production holding Oil Mining Lease (OML) that choose to convert their lease to PML. This will be determined based on conversion contract at the lower of USD2.5 per barrel and 20% of the fiscal price.
Other production allowances granted to companies operating in different fields are highlighted below:

Field-Leases	Description
New lease (shallow water)	(a) Lower of USD 8.00 per barrel and 20% of the fiscal oil price up to cumulative maximum of production of 100 million barrels from commencement of production and
	(b) Lower of USD 4.00 per barrel and 20% of the fiscal oil price thereafter
New lease (Onshore)	(a) Lower of USD 8.00 per barrel and 20% of the fiscal oil price up to cumulative maximum of production of 50 million barrels from commencement of production and
	(b) Lower of USD 4.00 per barrel and 20% of the fiscal oil price thereafter

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New Lease (Deep offshore and frontiers)	(a) Lower of USD 8.00 per barrel and 20% of the fiscal oil price up to cumulative maximum of production of 500 million barrels from commencement of production and
	(b) Lower of USD 4.00 per barrel and 20% of the fiscal oil price thereafter

Cost Price Limit Ratio-Sixth Schedule

The PIA 2021 provides that total cost incurred under section 263 and the fifth schedule excluding those related to section 263 (1) a, b, and h i.e., rent, royalty and contribution to government approved fund eligible for deduction under hydrocarbon tax will subjected to a cost price ratio limit of 65% of gross revenues determined at the measurement points.

However, the act did not provide for utilization of unrelieved capital allowance carried forward, also production allowance is not considered as part of the total cost to be compared with cost limit ratio.

Ascertainment of profits, adjusted profits, assessable profits, and chargeable profits

The PIA provides in section 266 that chargeable profits of any company of any accounting period shall be the amount of the assessable profits of that period after the deduction of any amount to be allowed in accordance with the provisions of this section.

The amount to be allowed as a deduction under the above section shall be:

The aggregate amount computed as capital allowance due to the company under the provisions of the fifth schedule of this Act.

The aggregate amount computed as capital allowances due to the Company under the provisions of the Sixth schedule of this act.

Conclusion

The introduction of the PIA by the government is to provide clarity on the legislation and adequate regulation of the upstream oil and gas industry. However, the Act needs to provide clarity on the removal of TET as an allowable deduction and its double taxation under both the HCT and CIT. This is to allow for proper accountability of companies in the industry.

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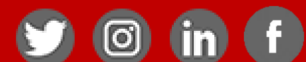

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