STREN & BLAN
PARTNERS

AN ANALYSIS OF THE IMPLEMENTATION GUIDELINES ISSUED IN RESPECT OF THE OIL AND GAS COMPANIES (TAX INCENTIVES, EXEMPTION, REMISSION, ETC) ORDER, 2024

www.strenandblan.com

INTRODUCTION

In February 2024, a significant development emerged in Nigeria's oil and gas sector. President Bola Ahmed Tinubu signed the Oil and Gas Companies (Tax Incentives, Exemption, Remission, etc.) Order, 2024 ("the **Order"**). This Order, empowered by the Companies Income Tax Act (**"CITA"**), aims to incentivize investment through tax breaks (***Our review of the executive order can be found here***). Pursuant to the power granted by the Order, the Minister of Finance (**'MOF**''), in collaboration with the Federal Inland Revenue Service (**"FIRS**''), Nigerian Upstream Petroleum Regulation Commission (**"NUPRC"**) alongside other relevant stakeholders , subsequently issued implementation guidelines to clarify the application process and eligibility criteria.

APPLICATION OF THE IMPLEMENTATION GUIDELINES

This order and implementation guidelines apply to the following:

i. Non-Associated Gas (NAG) greenfield developments in onshore and shallow water locations; and

ii. Midstream gas companies carrying out gas utilization projects.

The Implementation guidelines are addressed in three subdivisions:

a. The Federal Inland Revenue Service Guideline on the applicability of Tax Credits and Allowances for Non-Associated Gas Greenfield Development.

b. The Federal Inland Revenue Service Guideline on the applicability of the Midstream Capital and Gas Utilization Allowance.

c. The Nigerian Upstream Petroleum Regulatory Commission Guideline on Hydrocarbon Liquid Content in a Non-Associated Gas Field.

GUIDELINE ON THE APPLICABILITY OF TAX CREDITS AND ALLOWANCE FOR NON-ASSOCIATED GAS GREENFIELD DEVELOPMENT

This guideline aims to provide clarity on the fiscal incentives available for Non-Associated Gas (NAG)[2] greenfield developments in Nigeria. It outlines the conditions under which companies are eligible for Gas Tax Credits[3] (GTC) or Gas Tax Allowances (GTA)[4] based on the volume and composition of hydrocarbon liquids (HCL)[5] produced alongside natural gas.

Eligibility Criteria for GTC:

NAG greenfield developments in onshore and shallow water locations with a first commercial production date of January 1, 2029, or earlier, are eligible for a GTC equal to US$1.00 per thousand cubic feet or 30% of the fiscal gas price, whichever is lower, provided:

a. the HCL content does not exceed 30 barrels per million standard cubic feet[6] ("MMSCF");

b. the HCL is higher than 30 barrels per million standard cubic feet but less than 100 barrels per MMSCF, the tax credit is worth US$0.50 per thousand cubic feet, or 30% of the fiscal gas price, whichever is less.

[2] Non-associated gas, also known as "unassociated gas" or "free gas," refers to natural gas found without significant quantities of crude oil in the same reservoir. Unlike associated gas, which is found alongside oil deposits, non-associated gas exists independently in reservoirs. It is typically found in geological formations that lack significant oil content but contain natural gas in economic quantities.

[3] Gas Tax Credit refers to the amount of tax credit granted to an eligible company.

[4] Gas Tax Allowance refers to the amount of allowance granted to an eligible company.

[5] Hydrocarbon Liquids Content refers to the hydrocarbon liquids from the split or drop-outs of raw wet non-associated natural gas.

[6] MMSCF is equal to a million standard cubic feet; MSCF is equal to a thousand cubic feet.

Eligibility Criteria for GTA:

Companies commencing gas production after January 1, 2029, are eligible for GTA at a rate of US$0.50 per MCF or 30% of the fiscal gas price, whichever is lower, if the HCL content is not more than 100 barrels per MMSCF.

Nonetheless, if HCL exceeds 100 barrels per MMSCF, the company is required to revert to preexisting legislations. The measurement of the HCL in all circumstances is to be determined by the NUPRC.

Carry-Forward and Expiry of GTC Surplus:

Companies that accumulate more GTC than needed to offset their tax liabilities can carry forward these excess credits for up to three years. However, if these excess credits are not utilized within this timeframe, they expire and can no longer be used to reduce taxes. Additionally, companies eligible for GTC for their greenfield gas projects are ineligible to receive any other incentives or benefits under the Associated Gas Framework Agreement for the same project. This measure aims to ensure fairness and prevent companies from receiving double benefits for the same project, thereby promoting a balanced fiscal regime within the Nigerian oil and gas industry.

Time Limit and Claim Conditions:

A company is eligible to claim the GTC if its HCL content remains below 100 barrels MMSCF and it achieved first gas production on or before January 1, 2029. This claim can be made for a maximum of 10 years from the first gas production date. Conversely, the GTA can only be declared by a business that commenced producing commercial gas after January 1, 2029, as long as the HCL content in each MMSCF remains below 100 barrels.

Transition from Gas Tax Credit to Gas Tax Allowance

Companies granted GTC in Greenfield development may be eligible to GTA after the expiration of 10 years in so far it achieved its first gas production on or before 1st January 2029.

THE FEDERAL INLAND REVENUE SERVICE GUIDELINE ON THE APPLICABILITY OF THE MIDSTREAM CAPITAL AND GAS UTILIZATION ALLOWANCE (GUIA)

Under this guideline, the gas utilization investment allowance is granted on qualifying capital expenditure incurred on plant and equipment by midstream gas companies in respect of any new[7] and ongoing project[8] in the midstream oil and gas industry engaged in processing and transportation of natural gas as regulated by the Nigerian Midstream and Downstream Petroleum Regulatory Authority (NMDPRA). This allowance serves to reduce the company's taxable profits in the qualifying year. The gas utilization investment allowance is set at 25% of the actual cost of the purchased plant and equipment.

Eligibility for GUIA

To qualify for the GUIA, a company must have incurred eligible capital expenditure[9] on plants and equipment in one or more of the following midstream gas operations[10]:

- Transportation of natural gas to gas conditioning and processing plants.
- Transportation of natural gas from gas conditioning and processing plants to gas-based industries and other end-use customers, specifically not exceeding exit points connecting gas distribution pipelines and networks.
- Gas processing and conditioning plants.
- Gas bulk storage infrastructures installed which are not for sale, but holds stock of plant condensates, liquefied petroleum gas (LPG), or liquefied natural gas (LNG).

[7] New project means gas project that was initiated and executed after the commencement date of the executive order.

[8] On-going project means gas project currently under construction or in progress, prior to the commencement date of the executive order.

[9] Capital expenditure refers to the funds that a company spends on acquiring, maintaining, or improving fixed assets. These are assets that are expected to provide benefits to the company for more than one accounting period.

[10] Midstream gas operations refer to the processing, transportation, and storage of natural gas after it has been extracted from the ground (upstream) but before it reaches the end consumer (downstream). Midstream operations play a crucial role in the natural gas value chain by ensuring that the gas is processed, transported, and stored efficiently and safely.

Companies engaged in these operations must possess the relevant licenses as issued by the NMDPRA. Furthermore, under Section 39 of CITA, a company will only be granted the gas utilization investment allowance after the expiration of the tax-free period granted under section 39(1) of CITA. It's important to note that a company that has already enjoyed the 25% GUIA will not be entitled to any other investment allowance under Section 39 of CITA.

Qualifying Plant and Equipment for GUIA

Qualifying plant and equipment are tangible assets and other components comprising a plant or equipment used for gas processing and transportation in midstream gas operations, with a useful life exceeding one year.

To be eligible for GUIA, the following conditions must be met:

- The cost of the qualifying plant and equipment must have been incurred by the company.
- The cost must have been incurred from the commencement date of this incentive order.
- Proof of ownership of qualifying plant and equipment must be provided.
- Evidence of direct use of the plant and equipment for gas processing and transportation in midstream gas operations is required.

Submission of Information by Eligible Companies to FIRS

Upon filing their returns, eligible companies must provide a certified copy of the relevant information submitted to the NMDPRA concerning all new and ongoing projects. Following this, the FIRS will process claims for allowances on qualifying plants and equipment, granting GUIA to eligible applicants.

Exemptions

The gas utilisation investment allowance will not apply under certain circumstances:

- If the company sells or transfers the plant and equipment to another company not engaged i the same or related business within five years of incurring the expenditure.

- If there is an appropriation of the plant and equipment for purposes other than gas utilisation within five years of incurring the expenditure.

- If the cost incurred on the plant and equipment is not a bona fide business transaction or is an artificial or fictitious transaction.

- If the company is an end-product user of gas as feedstock, energy source, and related purposes.

Non-Interference with Capital Allowance

The GUIA does not reduce the value of any asset on which capital allowance is claimable under the Companies Income Tax Act. In other words, if a company claims capital allowance for an asset, such as a piece of machinery or equipment, the value of that asset for capital allowance purposes remains the same even if the company also claims GUIA.

Also, the capital allowance available under the CITA will continue to apply to eligible companies. This means that the company can still claim the regular capital allowance on its assets in addition to any GUIA claimed. The company is also entitled to other deductions, allowances, and incentives available under the CITA and any other relevant legislation. This ensures that companies can benefit from both the regular tax incentives and the specific GUIA without any reduction in the value of their assets for capital allowance purposes.

THE NIGERIAN UPSTREAM PETROLEUM REGULATORY COMMISSION GUIDELINE ON HYDROCARBON LIQUID CONTENT IN A NON-ASSOCIATED GAS FIELD

To ensure accurate determination of Hydrocarbon Liquid Content (HCL) in NAG fields, the NUPRC released accompanying Measurement Guidelines.

These guidelines mandate a dynamic method for all natural gas measurements unless specifically approved by the NUPRC for static methods.

Order Implementation and Sunset Clause:

Paragraph 5.0 of the Implementation Guidelines clarifies the Order's lifespan. The Order will no longer be in effect after the fiscal incentives it provides are included in official legislation. In a similar vein, if first gas production is not reached by January 1, 2029, the Gas Tax Credit provided by the Order will no longer be valid. In cases where an inevitable accident occurs which prevents a company from achieving first gas production by January 1, 2029, the operator may be eligible for an extension of the Sunset Date granted by the NUPRC.

POTENTIAL IMPACT OF THE IMPLEMENTATION GUIDELINES

The Order and its implementation guidelines are expected to have a significant impact on the Nigerian oil and gas industry. The tax breaks aim to:

- Attract Investment: By lowering tax burdens, the incentives aim to make Nigeria a more attractive destination for investment in gas exploration and development.
- Boost Gas Production: Increased investment in NAG projects can lead to a rise in gas production, which is crucial for domestic gas supply and power generation.
- Stimulate Gas Utilization: Incentives for gas processing and utilization infrastructure can encourage companies to invest in this area, reducing gas flaring and promoting efficient gas utilization.

POTENTIAL HURDLES IN THE IMPLEMENTATION OF THE GUIDELINES

1. Inadequate Clarity on Hydrocarbon Liquid Content (HCL) Measurement:

The Guidelines stipulate specific eligibility criteria for Gas Tax Credits (GTC) and Gas Tax Allowances (GTA) based on the Hydrocarbon Liquid Content (HCL) in the produced gas. However, the method for determining HCL is only broadly outlined, relying on a dynamic measurement method unless otherwise approved by the NUPRC. This leaves room for interpretation and potential inconsistencies in measurement. Without detailed procedural standards, companies might dispute the results, leading to compliance and enforcement challenges.

2. Overlapping Incentives and Legislative Gaps:

The Guidelines restrict companies eligible for GTC from receiving other incentives under the Associated Gas Framework Agreement. However, there is ambiguity around how these restrictions interact with existing and future fiscal regimes. This can lead to uncertainties, particularly if legislative changes occur post-2024, potentially leaving some projects ineligible for expected benefits.

3. Transition Challenges from Gas Tax Credit (GTC) to Gas Tax Allowance (GTA):

The transition mechanism from GTC to GTA is outlined for companies that achieve first gas production on or before January 1, 2029. However, the guidelines lack detailed procedures on how companies should manage this transition, especially regarding the documentation and approvals required for the switch.

4. Bureaucratic Complexities and Inter-Agency Coordination:

The implementation of the guidelines requires coordination among multiple agencies, including FIRS and NUPRC. This multi-agency involvement can lead to bureaucratic hurdles, delayed approvals, and inconsistent application of the guidelines.

5. Insufficient Monitoring and Compliance Framework:

The current Guidelines does not provide detailed mechanisms for regular audits and compliance checks. This oversight can lead to companies exploiting the incentives without adhering to the stipulated conditions, thus undermining the guidelines' objectives.

6. Limited Scope for Capital and Gas Utilization Allowance (GUIA):

The GUIA applies to specific midstream gas operations but does not cover all potential capital expenditures that could drive gas utilization. Additionally, the exemption clauses might inadvertently exclude projects that could significantly benefit from these allowances.

PROPOSED SOLUTIONS

1. Establishing Comprehensive HCL Measurement Procedures: Development and implementation of standardized procedures for HCL measurement, including specific equipment, calibration methods, and verification protocols to ensure accuracy and consistency across all measurements.

2. Harmonizing Incentive Guidelines with Existing and Future Legislation: This can be done by conducting a thorough legislative review to align the Guidelines with existing laws and future policy directions. Clear communication of these harmonized rules will help prevent legal disputes and ensure a consistent regulatory environment for companies.

3. Developing a Detailed Transition Framework: Create a comprehensive transition framework with clear timelines, documentation requirements, and approval processes to guide companies through the switch from GTC to GTA, thus, preventing disruptions and ensuring smooth transitions.

4. Implement a Centralized Application and Approval System: Introducing a single-window clearance mechanism that integrates FIRS and NUPRC processes, streamlining operations, reducing delays, and ensuring consistent application of the guidelines.

5. Establishing a Robust Monitoring and Compliance Framework: Set up a dedicated compliance unit within FIRS and NUPRC to oversee adherence to the Guidelines. Regular audits, compliance reporting requirements, and clear penalties for non-compliance will ensure companies adhere to the stipulated conditions.

6. Expanding the Scope of Eligible Capital Expenditures under GUIA: Re-evaluate the exemption clauses to ensure they do not unduly restrict deserving projects from accessing the allowance. Also, the scope of eligible capital expenditures could be broadened to include a wider range of gas utilization projects, promoting more extensive investment in this area.

By addressing these potential hurdles and implementing the proposed solutions, it's our belief that the effectiveness of the 2024 Order and its implementation Guidelines can be significantly enhanced, fostering a transparent and efficient regulatory environment for oil and gas companies in Nigeria.

CONCLUSION

In conclusion, the implementation guidelines represent a proactive step towards incentivizing investment in Nigeria's oil and gas sector. By providing clarity on eligibility criteria and conditions for tax credits and allowances, the guidelines aim to attract investment, boost gas production, and stimulate gas utilization. While these incentives hold great potential for economic growth and technological advancement, careful monitoring and management will be essential to mitigate potential challenges such as revenue loss and environmental risks. Overall, striking a balance between incentives and oversight is crucial for maximizing the benefits of these measures for the petroleum sector and the Nigerian economy as a whole.

ABOUT STREN & BLAN PARTNERS

Stren & Blan Partners is a full-service commercial Law Firm that provides legal services to diverse local and multinational corporations. We have developed a clear vision for anticipating our clients' business needs and surpassing their expectations, and we do this with an uncompromising commitment to client service and legal excellence.

THE AUTHORS

OZIOMA AGU
Team Lead

Oziomaagu
@strenndblan.com

KOLAJO ONASOGA
Associate

Kolajoonasoga
@strenndblan.com

Stren & Blan Partners

+234 (0)702 558 0053
3 Theophilus Orji Street, Off Fola Osibo
Road, Lekki Phase 1, Lagos, Nigeria

www.strenandblan.com
contact@strenandblan.com
@strenandblan