

**THE ROLE OF TAXATION IN NIGERIA'S OIL AND GAS SECTOR REFORMS –  
LEARNING FROM THE CANADIAN EXPERIENCE**

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By

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## **ABSTRACT**

Several stakeholders in Nigeria's oil and gas industry have emphasized the need for petroleum sector reforms in Nigeria. Canada is reputed to have one of the best oil and gas tax regimes in the world. This thesis argues that certain tax measures in Canada's oil and gas industry have considerable potential for addressing certain industry inefficiencies in Nigeria's petroleum sector. In developing this argument, this thesis gives an overview of oil and gas taxation in both jurisdictions and examines the possibility of transferring laws between Nigeria and Canada by exploring legal and tax comparative law theories. The thesis also examines the major challenges in Nigeria's oil and gas industry and identifies viable areas in Canada's oil and gas tax system which have the potential to address these challenges. Given the peculiarities of oil and gas taxation in each jurisdiction, this thesis suggests that the selected Canadian fiscal and administrative measures may require certain modifications in order to make these measures more suitable for Nigeria's legal and tax system.

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## **DEDICATION**

To those who work tirelessly to ensure that “the labor of our heroes past shall never be in vain”.

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## CHAPTER ONE

### INTRODUCTION AND BACKGROUND

#### 1.1 Introduction

Nigeria has a rich variety of both renewable and non-renewable resources such as cocoa, groundnut, palm produce, rubber, iron ore, petroleum, lead and limestone to mention a few.<sup>1</sup> However, most of these resources remain underexplored since Nigeria's first commercial oil discovery in Oloibiri, the present day Bayelsa State of Nigeria in the late 1950s.<sup>2</sup> Since that discovery, crude oil (commonly known as petroleum) has been the most dominant of Nigeria's natural resources in terms of revenue generation.<sup>3</sup> Current statistics indicate that Nigeria is Sub-Saharan Africa's largest oil producer and is among the top five exporters of Liquefied Natural Gas (LNG) in the world.<sup>4</sup> The income generated from crude oil accounts for about seventy-five percent (75%) of government revenue,<sup>5</sup> thirty-five percent (35%) of the country's gross domestic product and over ninety percent (90%) of total export revenue for the country.<sup>6</sup>

However, the current state of Nigeria's oil and gas industry suggests that the oil revenue generated from petroleum has not been deployed in a manner conducive to the sustainable development of the oil and gas industry. Over the years, it has been consistently emphasized that the legal and

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<sup>1</sup> Ludwig Schätzl, *Petroleum in Nigeria* (Ibadan: Oxford University Press, 1969) at 152 [Schätzl]; Nigerian Federal Ministry of Information, "Investment Opportunities in Nigeria", online: Federal Ministry of Information <<http://fmi.gov.ng>> [NFMI]. Note that the usage of the term "petroleum" in Nigeria includes both oil and gas. See *Petroleum Act, LFN 2004*, c P10, s15 (1) [Petroleum Act]. This legislation is the primary statute that regulates the exploration and production of oil and gas in Nigeria.

<sup>2</sup> There appears to be a disagreement among prominent commentators on the exact date of the discovery. For instance Schätzl, *ibid* at 4 cites 1956; Godfrey Etikerentse, *Nigerian Petroleum Law* (London: Macmillan, 1985) at 2 cites 1956; Emmanuel I Kachikwu, "Legal Issues in the Oil and Gas Industry" (1989) 2:9 GRBPL 33 cites 1957 and Yinka Omorogbe, "The Legal Framework for the Production of Petroleum in Nigeria" (1987) 5 J Energy Nat Resources L 273 at 274 [Omorogbe, Legal Framework] cites 1958. However, there is a consensus among these commentators that the first oil discovery was made at Oloibiri village.

<sup>3</sup> NFMI, *supra* note 1; Chris Ehinomen, Babatunde Afolabi & Samuel Ogundare, "The Restructuring of the Nigerian Economy and the Nigerian Oil Sector Earnings Nexus", (2014) SSRN 1 at 3 [Ehinomen, Afolabi & Ogundare].

<sup>4</sup> AfDB/OECD/UNDP, *African Economic Outlook 2015: Regional Development and Spatial Inclusion*, OECD Development Centre, (Paris: OECD Publishing, 2015) at 27; Independent Statistics & Analysis, "Nigeria: Country Analysis Brief Overview", (last updated 27 February, 2015), online: U.S. Energy Information Administration <<http://www.eia.gov>>. [U.S Energy Info].

<sup>5</sup> International Monetary Fund, *Nigeria: 2013 Article IV Consultation-Staff Report; Press Release and Statement by the Executive Director for Nigeria*, IMF Country Report No. 14/103, (April 2014), online: < <http://www.imf.org>>.

<sup>6</sup> Organization of Petroleum Exporting Countries (OPEC), "Nigeria: Facts and Figures", OPEC Annual Statistical Bulletin 2014 at 58, online: <<http://www.opec.org>> [OPEC Facts].

regulatory framework governing the petroleum industry in Nigeria has not evolved at the same pace as developments in the petroleum industry and does not take into account the significant advancements and challenges that have occurred in the industry over the years.<sup>7</sup>

Looking at the industry from an international stand point, the Independent Statistics and Analysis (ISA) conducted by the United States Energy Information Administration notes that there are certain issues limiting the growth of the Nigerian petroleum industry.<sup>8</sup> Specifically, the ISA conducted on Nigeria's petroleum industry revealed that "instability in the Niger Delta", "violence from militant groups" and "[p]oorly maintained, aging pipelines and pipeline sabotage from oil theft" are factors limiting the growth of the Nigerian petroleum industry.<sup>9</sup> The ISA also stated that "[r]ising security problems coupled with regulatory uncertainty" in the petroleum industry have resulted in decreased oil exploration in the Nigerian petroleum industry.<sup>10</sup>

From a national perspective, the Nigerian government has attributed the dwindling growth in petroleum sector to crude oil theft and pipeline vandalism.<sup>11</sup> Stakeholders, on the other hand, have identified inadequate financing, poor policy implementation, professional knowledge gaps and low capacity building as the major factors limiting the growth of Nigeria's oil and gas industry.<sup>12</sup> Considering that crude oil is "Nigeria's single biggest source of income,"<sup>13</sup> there is an urgent and compelling case for petroleum sector reforms so that Nigeria can fully realize the benefits of its abundant oil resources.

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<sup>7</sup> Tominiyi Owolabi, Wolemi Esan & Damilola Salawu, "Oil and Gas Regulation in Nigeria: Overview", (1 May 2014) online: Practical Law <[uk.practicallaw.com](http://uk.practicallaw.com)>.

<sup>8</sup> U.S Energy Info, *supra* note 4.

<sup>9</sup> *Ibid.*

<sup>10</sup> *Ibid.*

<sup>11</sup> Goddey Wilson, "The Nigerian State and Oil theft in the Niger Delta Region of Nigeria" (2014) 16:1 J Sustainable Development Afr 69 at 70 [Wilson]; Femi Asu, "Nigeria's oil industry attraction undermined by risks", *Business Day* (11 June 2014) online: <<http://businessdayonline.com>>. Asu's article also notes that crude oil theft, vandalism, pirate attacks and the uncertainty of the passage of the Petroleum Industry Bill deter foreign direct investment in Nigeria.

<sup>12</sup> Wilson, *ibid* at 78; Isaac Aregbesola, "Nigeria's oil and gas industry: The challenges and prospects", *People's Daily* (10 April 2014) online: <[www.peoplesdailyng.com](http://www.peoplesdailyng.com)>.

<sup>13</sup> Wilson, *supra* note 11 at 70; OPEC Facts, *supra* note 6; Emeka Chiakwelu, "Nigeria: Naira's Dithering - Nollywood and Agriculture Can Aid Ebbing Nigerian Currency", *Daily Independent* (13 November 2014), online: <<http://dailyindependentnig.com>> [Chiakwelu].

Like Nigeria, oil revenue also plays a dominant role in Canada's economy.<sup>14</sup> However, Canada's petroleum industry is considered a "strong global player on the oil and gas stage".<sup>15</sup> Some commentators have noted that Canada's good institutional management for petroleum resources,<sup>16</sup> its minimal government interference at the operational level of petroleum operations as well as its fair and robust regulatory controls make Canada's oil and gas industry a preferred jurisdiction for oil and gas investment.<sup>17</sup> Specifically, a study conducted on petroleum resources and economic growth between Nigeria, Brazil and Canada suggests that there are certain institutional measures that Nigeria can learn from Canada in terms of management of oil revenue.<sup>18</sup> Given Canada's preferred status in the global oil and gas industry, this thesis compares certain aspects of Nigeria and Canada's oil and gas corporate tax systems with a view to proffer administrative and tax-related measures for Nigeria's petroleum sector reforms.

## 1.2 Structure of the Thesis

This thesis is divided into six chapters. This first chapter discusses the need for petroleum reforms in Nigeria by identifying the major challenges in Nigeria's petroleum industry. The challenges discussed relate to the ripple effect of recurrent fuel shortages on the Nigerian economy, the lack of transparency and accountability in petroleum sector operations, the environmental degradation resulting from petroleum exploration, the problem of tax evasion and the inadequacy of technology and qualified personnel in the general tax administration of the oil and gas industry. Since this thesis aims to draw on measures adopted in Canada's oil and gas industry for Nigeria's petroleum reforms, this first chapter also provides the basis for the preference for Canada as a comparator and considers the current challenges in the Canadian petroleum industry. The next section of this chapter examines the revenue generating function of the tax system and introduces

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<sup>14</sup> Independent Statistics and Analysis, "Canada: Overview", (30 September 2014) U.S Energy Information Administration, online: <<http://www.eia.gov>> [EIA, Canada Info]; Ivey Energy Policy and Management Centre, "Developing Global Market Access for Canada's Oil and Gas Industry", (November 2014) Policy Brief at 1, online: <<http://www.ivey.uwo.ca>>.

<sup>15</sup> PricewaterhouseCoopers, "Unlocking Canada's Oil and Gas Industry – Is Canada Becoming an Energy Superpower?", (7 May 2013) PWC Energy Vision Report at 2, online:<<http://www.pwc.com>> [PWC, Energy Vision].

<sup>16</sup> Emmanuel Nathan & Bassey E Okon, "Institutional Quality, Petroleum Resources and Economic Growth: A Difference-In-Differences Approach Using Nigeria, Brazil and Canada", (2013) 3:20 IJHSS 198 at 205 [Nathan & Okon]; Shawn McCarthy, "Mandatory-reporting plan for energy and mining companies welcomed by provinces", *The Globe and Mail* (26 August 2014) online: <<http://www.theglobeandmail.com>>.

<sup>17</sup> PWC, Energy Vision, *supra* note 15 at 9.

<sup>18</sup> Nathan & Okon, *supra* note 16.

the underlying and reformative roles of the tax system. The final section of this introductory chapter illustrates how the thesis proposes to use tax reforms in addressing the challenges in Nigeria's petroleum sector.

Chapter two of this thesis is divided into three major sections. The first section gives an overview of corporate taxation in the Canadian oil and gas industry with a specific focus on federal and provincial corporation taxes, royalties, indirect taxes as well as oil and gas tax administration in Canada's petroleum industry. Similarly, the second section of chapter two provides an overview of corporate taxation in Nigeria's oil and gas industry by describing the taxation of petroleum profits, the companies' income tax, royalty structure and other applicable taxes as well as Nigeria's oil and gas tax administration and the imminent reforms in Nigeria's petroleum industry. In the third section, this chapter identifies relevant legal considerations for the proposed recommendations by comparing the ownership of mineral rights, the extent of government participation as well as legislative and taxing powers in both jurisdictions.

Based on the contextual background provided in chapter two, chapter three of this thesis focuses on legal transplants as an approach to oil and gas reforms in Nigeria. This section of the thesis explores three competing views on legal transplant theories – those of Alan Watson, Pierre Legrand and Otto Kahn-Freund. The chapter examines and tests these three competing schools of thought to determine the transferability of laws between Nigeria and Canada. The second section of the chapter looks at the viability of legal transplants for Nigeria's petroleum sector reforms by exploring the existence of legal transplants in Nigeria's legal system. The final section of chapter three discusses tax transplants as a type of legal transplant and examines Carlo Garbarino's view on corporate tax transplants. Specifically, the tax transplant section focuses on the two major types of corporate tax transplant – the simple corporate tax transplant and the hybrid corporate tax transplant.

In chapter four, this thesis examines the propriety of using the tax system as a tool for public policy implementation. This chapter explains how governments use the tax system as a tool for non-tax policy implementation through tax expenditure programs (TEs). In exploring TEs, the positive and unfavourable aspects of TEs as tools for reforms and the methods that can be used to evaluate TEs are also discussed. Specifically, this thesis discusses the ex-post method which is used for

evaluating existing TEs and the ex-ante method which is used when introducing new TEs into a tax system.

Based on the background provided in the preceding chapters, chapter five identifies fiscal and administrative measures in Canada's oil and gas tax system that have the potential to address problems in Nigeria's oil and gas industry. In addition to identifying certain recommendations for reforms, chapter five also explores the viability of these prospective measures by drawing on the ex-post and ex-ante methods for evaluating tax expenditures discussed in chapter four. Where applicable, the thesis suggests certain modifications to the recommendations to boost the chances of successful transfer into the Nigerian tax and legal system.

In chapter six, the prospects and challenges of the recommendations proposed in chapter five are discussed. Given the peculiarities of oil and gas taxation in Nigeria and Canada, the thesis concludes that proper adaptation and implementation of the proposed Canadian measures can positively influence petroleum sector reforms in Nigeria.

### **1.3 Background**

According to the Central Bank of Nigeria (CBN), the oil and gas industry was responsible for ₦34.2 trillion in oil revenue from 2000 to 2009, which amounts to over 80% of revenue generated into Nigeria's Federation Account during that period.<sup>19</sup> In recent times, this amount has significantly increased as the 2014 CBN Statistical Bulletin indicates that Nigeria derived approximately ₦36 trillion from oil revenue between 2010 and 2014 alone.<sup>20</sup> These figures are reflective of the substantial revenue generated from the oil and gas industry over the years. Unfortunately, this oil wealth has done very little to improve the standard of living of Nigerians<sup>21</sup> and several commentators have noted that the activities of the oil industry are responsible for widespread corruption, oil spillage and certain environmental and health challenges in oil

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<sup>19</sup> Central Bank of Nigeria, "Statistical Bulletin 2010", (2010) CBN Annual Statistical Bulletin at Table B.1.1. This table contains a summary of federal government finances. The Central Bank of Nigeria is the apex bank in Nigeria.

<sup>20</sup> Central Bank of Nigeria, "2014 Statistical Bulletin", (2014) CBN Annual Statistical Bulletin at Table B.1.1.

<sup>21</sup> Michael L Ross, "Nigeria's Oil Sector and the Poor" (2003) *Position Paper for DFID-Nigeria*, UCLA, Los Angeles, online: <<http://www.sscnet.ucla.edu>> [Ross]; Dorcas Onigbinde, "Natural Resource Management and its Implications on National and Sub-regional Security: The Case of the Niger Delta" (2008) KAIPTC Occasional Paper 22 at 2 [Onigbinde].

producing communities in Nigeria.<sup>22</sup> The problems identified by these commentators portray some of the current industry inefficiencies in the Nigeria's oil and gas industry and justify the proposal for the reforms contemplated in this thesis.

### **1.3.1 The Need for Petroleum Sector Reforms in Nigeria**

While a detailed analysis of all the inefficiencies of Nigeria's oil and gas industry is beyond the scope of this thesis, the problems and challenges discussed in this section provide a concise overview of the major challenges in Nigeria's oil and gas sector. The major challenges include recurrent fuel shortages, lack of transparency and accountability, environmental degradation, tax evasion, inadequate technology and lack of skilled personnel in petroleum operations. As will be seen below, these challenges present a compelling case for oil and gas sector reforms in Nigeria.

#### **1.3.1.1 The Ripple Effect of Recurrent Fuel Shortages**

Despite being Africa's largest producer of crude oil, Nigerians still suffer from frequent fuel shortages.<sup>23</sup> The rate of recurrence of fuel scarcity in Nigeria has been a major cause of friction between Nigerians and the government for several decades.<sup>24</sup> The irony has been attributed to several factors like regulatory uncertainty in the petroleum sector, the poor state of the country's oil refineries, failure to pay oil marketers, militant activity and oil theft in the Niger Delta region of the country and corruption in the administration of the petroleum industry.<sup>25</sup>

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<sup>22</sup> Onigbinde, *ibid* at 15; Nwezeaku NC, "The Impact of Public Sector Financial Management on the Economies of Sub-Saharan Africa", (2010) 40 Int. J. Finance Econ 87; Collins NC Ugochukwu & Jurger Ertel, "Negative Impacts of Oil Exploration on Biodiversity Management in the Niger Delta Area of Nigeria", (2008) 26:2 Impact Assessment & Project Appraisal at 139; Konye Obaji Ori, "Nigeria: Oil Companies Blamed, Amid Pollution Reports", *The Africa Report*, (7 November 2013), online: <<http://www.theafricareport.com>>; Oil Watch, "Nigeria: Oil Pollution, Politics and Policy", (2012) Environmental Rights Action/Friends of the Earth and Oil Watch Africa, online: <<http://eraction.org/publications>> at 4.

<sup>23</sup> U.S Energy Info, *supra* note 4; Punch, "Fuel Scarcity Hits Lagos, Worsens in Abuja, Others", *Punch Newspaper* (2 March 2015), online: <<http://www.punchng.com>>; Associated Press, "Nigeria, Africa's biggest oil producer, dogged by fuel shortages blamed on corruption", *Fox News* (5 April 2014), online: <<http://www.foxnews.com>>.

<sup>24</sup> See generally, Bolanle Omisore, "Nigerians Face Fuel Shortages in the Shadow of Plenty", *National Geographic*, (11 April 2014), online: <<http://news.nationalgeographic.com>>; Tunde Dodondawa & Muhammad Sabiu, "Nigerians May Suffer Acute Fuel Shortages for Weeks", *Nigerian Tribune*, (4 March 2014), online: <<http://www.tribune.com>>

<sup>25</sup> See generally U.S Energy Info, *supra* note 4; James Butty, "Nigeria Oil Workers Strike Over Inefficiencies, Corruption", *Voice of America* (16 December 2014), online: <<http://www.voanews.com>>; Sarah Kent, "Nigeria Loses Billions to Inefficiencies in Oil Sector- Watchdog", *The Wall Street Journal* (30 July 2013), online: <<http://www.wsj.com/articles>>; The Economist, "Nigeria's Oil: A Desperate Need for Reform", *The Economist*, (20 October 2012), online: <<http://www.economist.com>>; Emma Ujah & Michael Eboh, "Real Causes of Fuel Scarcity, by Okonjo Iweala", *Vanguard Newspaper*, (4 March 2015), online: <<http://www.vanguardngr.com>>.

In different parts of the world, petroleum products are used in various activities (ranging from cooking, electricity supply, manufacturing, production of goods, transportation) and are also a source of foreign exchange for the governments. This indicates that the availability of petroleum products play a tremendous role in the daily life of citizens and countries as a whole. Consequently, an unexpected decrease in the supply of petroleum is likely to have adverse effects on any economy that relies on petroleum for the aforementioned activities.

Nigeria is no exception to the adverse effects that result from a decrease in supply of petroleum products as the irregular supply of petroleum products in Nigeria usually results in artificial inflation in the Nigerian economy.<sup>26</sup> In practical terms, a typical incidence of scarcity of petroleum products in Nigeria results in long queues of vehicles at several filling stations across the country accompanied by “sky-rocketing, deviating pump price and racketeering”.<sup>27</sup> For instance, the recent incidence of fuel scarcity that occurred in May 2015 brought about a sharp increase in pump price of premium motor spirit (PMS, also called petrol) from the official price of ₦87 per liter (approximately \$0.53 CAD) to ₦250 per litre (approximately \$1.52 CAD) across major cities in the country.<sup>28</sup> On some rare occasions, the scarcity of petroleum products extends to the aviation industry where the scarcity of aviation fuel results in domestic and international airlines rescheduling their flights and leaving passengers stranded.<sup>29</sup>

In 2006, The African Economic Research Consortium conducted a study on the economic effects of the fuel crisis on Nigeria’s economy.<sup>30</sup> This study highlighted the multifarious nature of the fiscal impact of fuel scarcity in Nigeria. In discussing the economic effects of fuel scarcity on business owners, the study noted higher costs of operation (due to an increase in price of raw materials), reduced productivity of workers caused by the tardiness resulting from limited means

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<sup>26</sup> EF Ogunbodede, AO Ilesanmi & F Olurankinse “Petroleum Motor Spirit (PMS) Pricing Crisis and the Nigerian Public Passenger Transportation System”, (2010) 5:2 TSS 113 [Ogunbodede, Ilesanmi & Olurankinse].

<sup>27</sup> Sunday S Akpan & Michael Nnamseh, “Managing Risks of Petrol Scarcity in Nigeria: A Test of the Efficacy of Strategic Management Approaches” (2014) 14:2 Global J of Human Soc Sc 25 at 27.

<sup>28</sup> News Agency of Nigeria, “Scarcity: Fuel sells at ₦250 per litre in Oyo” *The Guardian* (2 May 2015), online: < <http://www.nguardiannews.com>>.

<sup>29</sup> See generally, Lawani Mikairu, “Nigeria: Fuel Scarcity – Arik to Suspend Operations Today”, *Vanguard*, (2 May 2015), online: <[www.vanguardngr.com](http://www.vanguardngr.com)>; Ozioma Ubabukoh, “Passengers stranded as scarcity of fuel grounds international flights” *Punch Newspaper*, (2 May 2015), online: < <http://www.punchng.com>>.

<sup>30</sup> Adeola Adenikinju, & Niyi Falobi. “Macroeconomic and Distributional Consequences of Energy Supply Shocks in Nigeria” (2006) online: < <http://aercafrica.org>> [Adenikinju & Falobi].

of transportation and ultimately a decline in sales profits given the aforementioned low productivity and increase in operating expenses.<sup>31</sup>

A more recent study conducted in 2010, focused on the impact which fuel scarcity has on manufactured and agricultural products.<sup>32</sup> It was noted that the extra costs resulting from the drastic increase in price of petroleum products during any incidence of fuel scarcity are usually passed on to the final consumer of any goods or services.<sup>33</sup> For instance, transport businesses that buy fuel at the increased pump price (due to the demand exceeding supply) would transfer such costs to their passengers including farmers and manufacturers who in turn pass the costs to wholesalers, who ultimately pass them to retailers or the final consumers.<sup>34</sup> Given the ripple effect of these extra costs, incessant scarcity of petroleum products usually results in a huge rise in the cost of living among citizens as some stakeholders are reluctant to revert to the pre-scarcity price of their goods and services. In addition to the above, the incidence of scarcity also makes it almost impossible for millions of Nigerians to move around, offer their goods or services for exchange or go about their daily businesses and means of livelihood. Perhaps the ripple effect of incessant fuel scarcity on other sectors of Nigeria's economy is sufficient in affirming the desperate need for oil and gas reforms in Nigeria.<sup>35</sup>

### **1.3.1.2 Lack of Transparency and Accountability**

Another major problem in Nigeria's oil and gas industry is the lack of transparency and accountability, especially in the regulation and general administration of petroleum activities. The lack of transparency and accountability in Nigeria's petroleum industry creates a high vulnerability for corrupt practices.<sup>36</sup> While corruption is a global phenomenon and is not synonymous with Nigeria alone, it is a pandemic that "has defied all the necessary medicines".<sup>37</sup> The problem of corruption in Nigeria is one that cuts across the different sectors of the economy.<sup>38</sup>

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<sup>31</sup> *Ibid.*

<sup>32</sup> Ogunbodede, Ilesanmi & Olurankinse *supra* note 26.

<sup>33</sup> *Ibid.*

<sup>34</sup> *Ibid* at 120.

<sup>35</sup> Adenikinju & Falobi, *supra* note 30.

<sup>36</sup> Salisu Ogbo Usman, "The Opacity and Conduit of Corruption in the Nigerian Oil Sector: Beyond the Rhetoric of the Anti-Corruption Crusade." (2011) 13:2 J Sustainable Development Afr 294 at 294.

<sup>37</sup> Victor E Dike, "Corruption in Nigeria: A Paradigm for Effective Control", *Africa Economic Analysis* (23 January 2008), online: < <http://www.africaeconomicanalysis.org>>.

<sup>38</sup> See generally, Emeka E Okafor, "Corruption and Implications for Industrial Development in Nigeria" (2013) 7:29 Afr J BM 2916. Okafor states that corruption is the major obstacle for socio-economic development in Nigeria;



Nigeria's position in the Corruption Perceptions Index (CPI) for the past three years is reflective of the high rate of corruption in the country.<sup>39</sup> The CPI is an assessment carried out by an international anti-corruption organisation based in Germany called Transparency International.<sup>40</sup> This organisation ranks several countries based on how corrupt each public sector is perceived to be.<sup>41</sup> The results of the CPI report by Transparency International in 2012 and 2013 places Nigeria in 139<sup>th</sup> and 144<sup>th</sup> positions respectively out of about 176 countries that were surveyed.<sup>42</sup> In the most recent survey conducted in 2014, Nigeria was ranked as the most corrupt country in Sub-Saharan Africa and had a position of 136<sup>th</sup> (worst) out of 174 countries.<sup>43</sup>

Despite the fact that corruption is also evident in other sectors of Nigeria's economy, the incidence of corruption in Nigeria's petroleum industry is particularly high.<sup>44</sup> For instance, the 2009 to 2011 assessment of the petroleum industry conducted by the Nigeria Extractive Industries Transparency Initiative (NEITI) disclosed several areas lacking in accountability of oil revenue.<sup>45</sup> The NEITI is a Nigerian agency which is responsible for (among other things) the development of a framework for accountability and transparency in the reporting and disclosure of revenues due to or paid to the federal government of Nigeria by all companies in Nigeria's extractive industry.<sup>46</sup> Some specific activities identified in the NEITI assessment report that reflect the lack of transparency and accountability include underpaid royalty and taxes by stakeholders, non-remittance of revenue derived from the domestic sale of crude oil by Nigeria's national oil company and poor data management by the Niger Delta Development Commission.<sup>47</sup> Based on this report and similar

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Bolarinwa Bayode, *Analysis of Organizational Leadership: A Phenomenological Study of Organizational Leaders in the Private Sector in Nigeria* (PhD Diss, Walden University, 2008) (Michigan, United States: UMI Dissertations Publishing, 2008). Bayode states that while corruption exists in both the private and public sector, the public sector is much more corrupt than the private sector.

<sup>39</sup>Transparency International, "Corruption Perception Index 2014", Transparency International website, online: <<http://www.transparency.org>>.

<sup>40</sup>Transparency International, "Who We Are", Transparency International website, online: <<http://www.transparency.org>>.

<sup>41</sup> *Ibid.* A country's score shows the perceived level of public sector corruption on a scale of 0 to 100 (0 indicates highly corrupt and 100 indicates very clean). Nigeria currently has a score of 27.

<sup>42</sup> Transparency International, "Corruption Perception Index 2013", Transparency International website, online: <<http://www.transparency.org>>.

<sup>43</sup> *Supra* note 39.

<sup>44</sup>Ross, *supra* note 21 at 18; Ogbonnaya Orji, "NEITI and the Petroleum Industry Bill", *The Punch* (24 May 2012) online: <<http://www.punchng.com>>.

<sup>45</sup> Patrick Ugeh, "Nigeria: NEITI - How the Country Loses Oil Revenue", *All Africa* (18 August 2009), online: <<http://allafrica.com>>.

<sup>46</sup> See generally, *Nigeria Extractive Industries Transparency Initiative Act*, LFN 2007 s2 [NEITI Act].

<sup>47</sup> *Ibid.*

reports evaluating the Nigerian oil and gas industry, there appears to be a general consensus that the missing revenues are depriving Nigerian citizens of a fair share of the country's oil wealth that could go to improving education, health and creating employment for the youth.<sup>48</sup>

The overlapping role performed by the federal government in the petroleum industry has been considered a major contributing factor to the lack of transparency and accountability in the petroleum sector.<sup>49</sup> This is because the federal government performs a dual role as a *commercial entity* and a *regulator* in the petroleum industry.<sup>50</sup> The federal government *conducts* commercial operations through its national oil company called the Nigerian National Petroleum Corporation (NNPC) and also *regulates* and *supervises* activities in the petroleum industry through its petroleum regulatory authority called the Department of Petroleum Resources (DPR).<sup>51</sup> Thus, the government negotiates and performs commercial activities in the petroleum industry through the NNPC and *also* plays a supervisory role through the DPR. Specifically, the NNPC is vested with the exclusive responsibility for the development of the upstream and downstream sectors of the Nigerian oil and gas industry, which entails exploiting, refining, and marketing Nigeria's crude oil.<sup>52</sup> The DPR, on the other hand, is the governmental agency that is charged with the

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<sup>48</sup> Transparency International Secretariat, "Transparency International Calls on the Nigerian Government to Step Up its Fight Against Corruption and Welcomes an Investigation into the Oil Sector", Transparency International Press Release, (27 February 2014) online: <<http://www.transparency.org>>. Huguette Labelle, the Chair of Transparency International also added that the Nigerian government owes it to Nigerians to investigate the oil and gas industry and hold those responsible for corrupt practices to account.

<sup>49</sup> Muideen Olaniyi, "Nigeria: Under APC, NNPC Must Publish Its Balance Sheet – Lai Mohammed", *Daily Trust* (11 January 2015) online: <<http://allafrica.com>>; Chukwudi Nweje, "Nigeria: How Lack of Transparency in Oil Sector Under-Develops Nigeria", *Daily Independent* (24 August 2014), online: <<http://allafrica.com>>.

<sup>50</sup> *Ibid*; NNPC, "Operators in the Industry", NNPC Business, online: < <http://www.nnpcgroup.com>>.

<sup>51</sup> *Constitution of the Federal Republic of Nigeria 1999*, LFN 2004, c C23, s 44(3) [1999 Constitution]; *Nigerian National Petroleum Corporation Act*, LFN 2004, c N123, s 1 [NNPC Act]; Department of Petroleum Resources, "Functions", Department of Petroleum Resources, online: < <https://dpr.gov.ng/>> [DPR Functions] (accessed on 21 April 2015).

<sup>52</sup> NNPC Act, *supra* note 51 at Preamble. In Nigeria, agreements setting out the terms of operations are entered into between the federal government and oil producing companies (usually international oil companies). Since ownership of petroleum resources is vested in the government, the federal government grants licences and leases to oil companies. The NNPC, acts as a representative of the federal government and holds the interests of the government and also negotiates privately with the companies who act as operators. The role of "operator" in the technical sense is dependent on the nature of contractual arrangement a party has with the federal government. Under the most common arrangement called the joint venture arrangement, one of the partners to the joint operating agreement (JOA) is designated the operator. Usually, the NNPC is an equity shareholder and the foreign oil company is the operator. However, the NNPC reserves the right to become an operator under the JOA. The operator's role is to conduct, manage and control the activities of the joint venture in accordance with the JOA in order to achieve the objectives of the parties. See generally Omorogbe, Legal Framework *supra* note 2 at 286. For a detailed account of the different contractual arrangements under Nigerian petroleum law, see Yinka Omorogbe, *Oil and Gas Law in Nigeria* (Lagos: Malthouse, 2003) at ch 4 [Omorogbe, Oil and Gas]; Kamoru T Lawal, "Taxation of Petroleum Profit under the Nigeria's Petroleum Profit Tax Act", (2013) 4:2 Int'l JALSG 1 online: <<http://www.icidr.org>>.

responsibility of regulation and supervision of *all* the operations being carried out under different licenses and leases in Nigeria's petroleum industry.<sup>53</sup> Consequently, there is very limited room for objective scrutiny of petroleum activities since the federal government's participation is evident in every sector of the industry including the upstream, midstream and downstream sectors.<sup>54</sup>

In emphasizing the poor transparency of Nigeria's petroleum industry, some writers have described the NNPC as "being accountable to no one" because it controls all aspects of the industry from the exploration of petroleum to the production, refining and sale of the finished petroleum products.<sup>55</sup> Perhaps this excessive control by the national oil company in Nigeria's petroleum industry is responsible for the corporation being referred to as one of the world's most "closed" oil companies.<sup>56</sup> Based on a study conducted by the Revenue Watch Institute and Transparency International, Nigeria's NNPC is reported to have the *worst* transparency record out of the "44 national and foreign oil companies" that were examined.<sup>57</sup> Thus, it is apparent that the limited channels for checks and balances of petroleum operations is a contributory factor to the limited growth and development of Nigeria's petroleum industry.

### **1.3.1.3 Environmental Degradation and its Consequent Effects**

While proceeds from crude oil has been of great financial benefit to Nigeria, its exploration has resulted in massive environmental degradation for oil producing communities in Nigeria.<sup>58</sup> The negative impact of oil exploration activities has been attributed to oil spillages and gas flaring, which are prevalent in the Niger Delta area where most of Nigeria's petroleum exploration activities are carried out.<sup>59</sup> Some of the adverse effects of petroleum activities in these areas range from environmental hazards, health risks, high unemployment rates and economic loss.

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<sup>53</sup> DPR Functions, *supra* note 51.

<sup>54</sup> The Economist, "The Scope of Corruption in Nigerian Oil is Truly Horrifying", *Business Insider*, (19 October, 2012), online: <<http://www.businessinsider.com>>.

<sup>55</sup> *Ibid.*

<sup>56</sup> *Ibid.*

<sup>57</sup> *Ibid.*

<sup>58</sup> Wilson, *supra* note 11 at 76; Ephraim Ikechukwu Elenwo & Justine Ayaegbunem Akankali, "Environmental Policies and Strategies in Nigeria Oil and Gas Industry: Gains, Challenges and Prospects" (2014) 5:4 Nat Resources J 884 at 885 [Elenwo & Akankali]; Jethro Ibileke, "Nigeria Overdue for Environmental Audit", *The News*, (11 November 2014), online: <<http://thenewsnigeria.com.ng>> [Ibileke].

<sup>59</sup> Kadafa Adati Ayuba, "Environmental Impacts of Oil Exploration and Exploitation in the Niger Delta of Nigeria" (2012) 12:3 Global J Sc Frontier Res Env't & Earth Sci 18.

The chemical composition of Nigeria's crude oil has been identified as a major contributory factor to the adverse environmental effects caused by oil exploration activities. The nature of Nigeria's gas reserves is predominantly "associated gas" - a natural gas found in deposits of petroleum which comes to the surface during oil production.<sup>60</sup> Since Nigeria's crude oil is usually found in reservoirs of this nature, oil production is often accompanied by the production of natural gas. Nigeria has a large-scale proven natural gas reserves and is often described as a "gas province with a little bit of oil in it".<sup>61</sup> However, the expensive cost and poor availability of infrastructure for refining its associated gas by oil producing companies has been identified as the major cause of excessive gas flaring in Nigeria.<sup>62</sup> Oladipo and Eyesan noted that, "[i]t is simply not commercially viable for oil producers to put in place requisite infrastructural facilities to develop and trap associated gas".<sup>63</sup> Therefore, oil exploration companies "flare" the associated gas generated during exploration of crude oil by releasing the gas into the atmosphere rather than capturing the natural gas for utilization. This release of associated gas contributes to greenhouse gas emissions, acid rain and similar adverse environmental effects.<sup>64</sup>

A recent assessment of gas flaring in Nigeria indicates that Nigeria flares about 17.2 billion cubic meters (m<sup>3</sup>) of natural gas annually during the exploration of crude oil in the Niger Delta region.<sup>65</sup> This amount of gas that is flared is estimated as being equal to a quarter of power consumption of the African continent in 2013.<sup>66</sup> In 2013, the Director of Nigeria's DPR noted that Nigeria incurs a loss of \$4.9 million USD *daily* due to gas flared during oil exploration activities.<sup>67</sup> Specifically, the rate of gas flaring at that time (2013) was 1.4 billion cubic feet of gas and this was measured

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<sup>60</sup> This incidental discovery of natural gas is sometimes regarded as a nuisance and treated as a waste. See Yinka Omorogbe, "Law and Investor Protection in the Nigerian Natural gas Industry" (1996) 14 J. Energy Nat Resources L. 179 at 181; Ibironke Tinuola Odumosu, *Reforming Gas Flaring Laws in Nigeria: The Transferability of the Alberta Framework* (LL.M Thesis, University of Calgary, 2005) [Unpublished] at 1. However, Nigeria also has non-associated gas reserves which are reservoirs that contain only natural gas and no oil.

<sup>61</sup> Mark Hollingsworth & Von Kemedi, *Against the Odds* (Leicestershire, UK: Susquehanna Press, 2015) at 124; Kayode Oladipo & Yuli Eyesan, "Unlocking Nigeria's Gas Potential" (16 March 2015) King & Wood Mallesons Publication at 29, online: <<http://www.savca.co.za>> [Oladipo & Eyesan]; Tade Oyewumi, "The Nigerian Gas Industry: Policy, Law and Regulatory Developments" (2013) ACASP 1 at 3 online: <<http://www.acas-law.com>>;

<sup>62</sup> Anslem O Ajugwo, "Negative Effects of Gas Flaring: The Nigerian Experience", (2013) 1.1 J Env'tl Pollution & Hum Health 6 [Ajugwo].

<sup>63</sup> Oladipo & Eyesan, *supra* note 61 at 31.

<sup>64</sup> Ajugwo, *supra* note 62 at 7.

<sup>65</sup> *Ibid* at 6.

<sup>66</sup> *Ibid* at 7.

<sup>67</sup> Mohammed Shosanya, "Nigeria Loses U.S. \$4.9 Million to Gas Flare Daily", *Daily Trust* (10 July 2013), online: <<http://allafrica.com>>.

against \$3.5 per 1000 standard cubic feet of gas to arrive at monetary value of the adverse effect of gas flaring.<sup>68</sup>

Apart from gas being flared, oil spillages also contribute to the environmental degradation of oil producing communities. The oil that is spilled as a result of oil exploration activities results in water pollution, land degradation and deforestation.<sup>69</sup> Given that a large majority of residents in the Niger Delta area of Nigeria are involved in farming and fishing activities, oil spillages have destroyed the means of livelihood of most residents in the oil producing areas.<sup>70</sup> Thus, there is a high unemployment rate in such communities.<sup>71</sup> It has been reported that this high rate of unemployment is a major contributory factor to the youths of these communities engaging in oil theft and vandalism for the purpose of economic survival.<sup>72</sup> According to the 2013 NEITI report, Nigeria lost approximately \$11bn to oil theft and vandalism between 2009 and 2011.<sup>73</sup>

In addition to the economic loss resulting from the above, scientific research has identified several health implications of gas flaring and oil spillages on human health. Research carried out on the health impact of the pollution on residents of the Niger Delta has revealed that exposure to the aforementioned environmental hazards could result in “respiratory problems, skin ailments such as rash and dermatitis, eye problems, gastro-intestinal disorders, water borne diseases and nutritional problems associated with poor diet” as a result of the contamination of food and water in these regions.<sup>74</sup>

Even though there have been attempts to impose fines and implement laws to address these environmental problems in Nigeria (some of these measures are discussed in the latter part of the

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<sup>68</sup> *Ibid.*

<sup>69</sup> Elenwo & Akankali, *supra* note at 58; Ibileke, *supra* note 58.

<sup>70</sup> *Ibid.*; Wilson, *supra* note 11 at 72.

<sup>71</sup> *Ibid.*

<sup>72</sup> Wilson, *supra* note 11 at 72; Simon Utebor, “I Vandalised Oil Wellheads to Protest Unemployment”, *The Punch* (8 April 2014), online: <<http://www.punchng.com>>.

<sup>73</sup> Nigeria Extractive Industries Transparency Initiative, “EITI Annual Activity Report 2013”, (June 2014), online: <<http://www.neiti.org.ng>> at 24; Noel Onoja, “Nigeria loses \$11bn to oil theft, vandalism – NEITI”, *Vanguard* (30 July 2013), online: <<http://www.vanguardngr.com>>.

<sup>74</sup> Pyagbara Legborsi Saro, “The Adverse Impacts of Oil Pollution on the Environment and Wellbeing of a Local Indigenous Community: The Experience of the Ogoni People of Nigeria”, (Paper delivered at the Workshop Organized by United Nations Department of Economic and Social Affairs, Secretariat of the Permanent Forum on Indigenous Issues, Government of Khabarovsk Krai and Russian Association of Indigenous People of the North on August 27-29, 2007) [unpublished].

thesis) these measures have not had the desired effects as the problems continue to persist.<sup>75</sup> Therefore, this thesis also argues that there is a compelling need to explore alternative or supplementary means to address the problems of oil spillage and gas flaring in Nigeria.

#### **1.3.1.4 Tax Evasion**

Generally, the incidence of tax evasion in any country reduces the revenue needed by the government for the provision of public goods for citizens.<sup>76</sup> In May 2014, a diagnostic study of Nigeria's tax system revealed that sixty-five percent (65%) of eligible corporate taxpayers in Nigeria do not pay taxes to the federal government as required by tax laws.<sup>77</sup> This conduct was reported to have contributed to an eight percent (8%) decline in tax revenue contribution to Nigeria's Gross Domestic Product (GDP) for the period under consideration.

Multinational oil companies have been identified as being responsible for a high percentage of the tax evasion incidents in the petroleum industry.<sup>78</sup> Despite the fact that these multinational oil companies earn huge profits from their commercial activities in Nigeria, Adegbe and Adeniran noted that "[t]ax evasion and tax avoidance are unnecessary evils being practiced by the oil exploring and extraction companies".<sup>79</sup> In some cases, corporate taxpayers prefer to give bribes amounting to a (substantial) fraction of their tax liability to tax officials rather than paying their applicable tax liability.<sup>80</sup> Similarly, the failure of tax officials to remit taxes collected from compliant corporate taxpayers to the federal government also contributes to the high incidence of tax leakage in the oil and gas sector of Nigeria's economy.<sup>81</sup> In August 2013, Nigeria's Minister

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<sup>75</sup> Oladipo & Eyesan, *supra* note 61 at 31; Aderonke Adejugbe & Bayo Onamade, "Nigeria: Gas Flaring in Nigeria: Challenges & Investment Opportunities", (31 July 2014), online: <<http://www.strachanpartners.com>>.

<sup>76</sup> OJ Otusanya, "The Role of Multinational Companies in Tax Evasion and Tax Avoidance: The Case of Nigeria" (2011) 22:3 *Critical Perspectives on Accounting* 316 at 316. [Otusanya]

<sup>77</sup> Friday Atufe, "65% of Corporate Citizens Don't Pay Tax – Okonjo-Iweala", *Leadership Newspaper*, (16 May 2013), online: <<http://leadership.ng>>.

<sup>78</sup> Otusanya, *supra* note 76.

<sup>79</sup> Folajimi Festus Adegbe & Samuel Adeniran Fakile, "Petroleum Profit Tax and Nigeria Economic Development" (2011) 1:1 *IJRCM* 11 at 17.

<sup>80</sup> Sesan Olufowobi, Chukwudi Akasike & Temitayo Famutimi "Four Britons Arraigned for Bribing Lagos [and] Rivers Officials" (22 December 2012), Bribe Nigeria (blog), online: <<http://www.bribenigeria.com>>. In this case, the officers of the company bribed tax officials "to avoid, reduce or delay paying taxes on behalf of [their] oil- and gas-industry workers". This shows that not only is tax evasion a problem in Nigeria, the poor reputation of the tax administration in Nigeria is being exploited by foreign companies. This does not augur well for the country's image.

<sup>81</sup> Jude Okwe, "FIRS: Corruption, Enemy of Tax Administration", *ThisDay Live* (13 May 2013), online: <<http://www.thisdaylive.com>>.

of Finance confirmed that Nigeria loses “over ₦ 80 billion monthly from tax dodgers”.<sup>82</sup> In order to fully realize the financial benefits of being an oil producing country, there is a desperate need for Nigeria to address the issue of tax evasion, especially in its petroleum sector.

### **1.3.1.5 Inadequate Technology and Qualified Personnel in Tax Administration**

Lack of qualified personnel and the slow pace of technology are additional factors limiting the growth of Nigeria’s oil and gas industry. According to Okonjo Iweala - Nigeria’s former finance minister - the automation of Nigeria’s tax administrative system is very fundamental to efficient revenue collection and prevention of tax leakages for the government.<sup>83</sup> A 2010 study conducted on tax administration in Nigeria reveals that the slow pace of technology in tax administration is a contributing factor to the high rate of tax evasion in Nigeria.<sup>84</sup>

Currently, the majority of tax filings and tax remittances in Nigeria are done manually through the submission of hard copies of relevant documents. Such manual tax filing system has the tendency to increase human errors and processing times as tax officials may be required to sort through unrelated paperwork in order to find relevant data needed for any verification exercise. Notably, there have been recent attempts by the Federal Inland Revenue Service (FIRS) to automate and improve the use of technology in Nigeria’s tax administration.<sup>85</sup> Specifically, the FIRS has embarked on an Integrated Tax Administration System (ITAS) project.<sup>86</sup> This project is directed at enhancing tax administration and ultimately simplifying the tax compliance process in Nigeria through the use of technology.<sup>87</sup> This initiative is currently in its pilot phase and is only available for taxpayers in selected tax offices.<sup>88</sup> However, when the ITAS system is fully operational in the whole of Nigeria, taxpayers will be able to file their tax returns electronically and pay their taxes

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<sup>82</sup> “Nigerians don’t like to pay tax – Finance Minister”, Editorial, *The Leader News* (18 August 2013), online: <<http://theleaderassumpta.com>>.

<sup>83</sup> Agency Report, “FG Urges FIRS To Deploy Technology to Boost Its Operation”, *Leadership Newspaper* (24 June 2014), online: <<http://leadership.ng>>.

<sup>84</sup> See generally, James Abiola & Moses Asiweh, “Impact of Tax Administration on Government Revenue in a Developing Economy – A Case Study of Nigeria” (2012) 3:8 Int’l J Bus & Soc Sci 99; PricewaterhouseCoopers, “Nigeria @ 50: Top 50 Tax Issues”, (October 2010) online: PricewaterhouseCoopers < <http://www.pwc.com>>.

<sup>85</sup> Federal Inland Revenue Service, “FIRS Launches Tax E-Filing Platform”, FIRS Press Release (14 Dec 2014), online: <<http://www.firs.gov.ng>>; Isaac Anumhie, “FIRS launches online tax payment”, *Sun Newspaper* (3 March 2015), online: <<http://sunnewsonline.com>>.

<sup>86</sup> *Ibid.*

<sup>87</sup> PricewaterhouseCoopers, “FIRS introduces electronic filing of tax returns and online payment of taxes”, (February 2015), online: <<http://pwc-nigeria.typepad.com>> [PWC, ITAS].

<sup>88</sup> *Ibid.*

online.<sup>89</sup> This improvement is particularly relevant to oil and gas taxation in Nigeria because the eligible taxes included in the pilot phase include (but are not limited to) the major oil and gas taxes in the petroleum industry (companies' income tax and petroleum profit tax).<sup>90</sup> With this development, it is expected that filing of tax returns can be done by taxpayers at *anytime* and *anywhere* within the required filing period.

While this thesis is not oblivious to the teething problems that the ITAS may have to overcome, the thesis argues that leveraging the enormous capabilities of technology in automating processes through the proper implementation of the ITAS will significantly improve the administrative efficiency of tax compliance in Nigeria.<sup>91</sup> Even though the efficacy of the ITAS is not verifiable as the program is still in its pilot phase, this thesis contemplates that the effective implementation and full adoption of the program would increase compliance, reduce the cost of tax administration and ultimately increase government's revenue.

In addition to the need for advanced technology in tax administration, Nigeria's National Tax Policy report indicates that a major factor limiting the development of tax administration in Nigeria is shortage of qualified personnel.<sup>92</sup> This shortage of skilled workers has been attributed to poor funding of tax administrative agencies as the agencies do not have the financial capacity to attract the required personnel.<sup>93</sup> In 2013, Micah, Ebere and Umobong, noted that the FIRS had only 645 tax professionals out of a total of 7,643 employees, which amounts to 12.6% of its total workforce during the period under review.<sup>94</sup> Consequently, the few tax professionals that are available often delegate certain roles to subordinates or third parties that lack the required competency to meet the ever increasing challenges and difficulties in Nigeria's tax administrative system.<sup>95</sup> In addition, the competent staff members (tax professionals) are not provided with regular training to keep them abreast of global trends in tax administration.<sup>96</sup>

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<sup>89</sup>*Ibid.*

<sup>90</sup>*Ibid.*

<sup>91</sup>*Ibid* at 22.

<sup>92</sup> Nigeria Leadership Initiative (NLI), *The NLI White Papers Volume 2* at 47, online: <[www.nli-global.org](http://www.nli-global.org)> at 47. The NLI White Papers were generated to identify critical issues in the Nigerian tax system in relation to policy, legislation and tax administration.

<sup>93</sup>*Ibid.*

<sup>94</sup> Micah Leyira, Chukwuma Ebere & Asian Umobong, "Tax System in Nigeria – Challenges and the Way Forward", online: (2012) 3:5 Research J of Fin & Acc at 1 [Leyira, Ebere & Umobong].

<sup>95</sup> NLI, *supra* note 92.

<sup>96</sup> Leyira, Ebere & Umobong, *supra* note 94.



While the inefficiencies discussed above may paint a bleak picture of Nigeria's petroleum industry and its oil and gas tax administration, the industry has enormous potential for exponential growth. However, such growth can only be achieved if the structural defects and turbulence hindering the growth of this industry are removed.<sup>97</sup> In providing context for the great potential inherent in Nigeria's oil and gas sector, current projections indicate that reforms in Nigeria's oil and gas industry will result in a major increase in its oil revenue. Specifically, it has been noted that "[w]ith the right reforms ... liquids production could increase from an estimated 2.35 million barrels a day, on average, in 2013 to a new high of 3.13 million by 2030".<sup>98</sup> In monetary terms, this means that the "[o]il and gas [industry] would then contribute \$108 billion annually to the [Nigerian] economy, compared with \$73 billion in 2013."<sup>99</sup> Given this potential for exponential growth, the need for oil and gas reforms to harness this growth is great.

### **1.3.2 Justifying the Preference for Canada as a Comparator**

In suggesting the tax system as a tool for Nigeria's oil and gas reforms, this thesis will explore the policies and practices in Canada's oil and gas tax system with a view to propose recommendations that can address the current industry inefficiencies in Nigeria. To propose such recommendations, it is important for a prospective law reformer to explore a tax system that has a reputable petroleum industry and also shares certain similarities with Nigeria's petroleum industry for the purpose of effective comparison. As will be seen in subsequent paragraphs, Canada's petroleum industry satisfies these requirements and provides a suitable model for petroleum sector reforms in Nigeria.

From a global perspective, Canada ranks as the fifth largest oil producer and controls the third largest proved oil reserves in the world.<sup>100</sup> Despite Canada's relatively small share of the world's proven natural gas reserves, it is the fifth largest dry natural gas producer and the fourth largest exporter of natural gas in the world.<sup>101</sup> Based on the 2014 Environmental Performance Index (EPI), which highlights how each country manages environmental issues, Canada had an

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<sup>97</sup> Marcel Mbamalu, "Nigeria: Local Firms Are Gradually Reclaiming Nigeria's Oil Sector, Says Abazie", *The Guardian*, (20 October 2015), online: < <http://allafrica.com> >.

<sup>98</sup> Acha Leke et al, "Nigeria's renewal: Delivering inclusive growth in Africa's largest economy", (July 2014), McKinsey Global Institute Report, online: <[www.mckinsey.com](http://www.mckinsey.com)> at 53.

<sup>99</sup> *Ibid.*

<sup>100</sup> Government of Canada, "About Crude Oil and Petroleum Products", Natural Resources Canada website, (5 September 2014) online: < <http://www.nrcan.gc.ca> >; EIA Canada Info, *supra* note 14 at 1.

<sup>101</sup> EIA Canada Info, *ibid.*

admirable score of 73% with respect to safeguarding human health from environmental harm while Nigeria had a significantly lower score of 39.2%.<sup>102</sup>

In addition to Canada's enviable reputation,<sup>103</sup> certain similarities between Nigeria and Canada's oil and gas industry is another factor that informed the preference for Canada's tax system as a model for reforms. Geographically, Nigeria and Canada both have vast endowment of crude oil and natural gas reserves concentrated in select areas of the country - the majority of Nigeria's crude oil and gas reserves is located in the Niger Delta region<sup>104</sup> while in Canada's crude oil and gas reserves are concentrated in the western provinces.<sup>105</sup> In addition to this geographical similarity, both countries have been oil producing countries for several decades and oil revenue plays a dominant role in the economy of both countries.<sup>106</sup>

Perhaps, the most important justification for the choice of Canada as a model for Nigeria's petroleum sector reforms is the fiscal structure of Canada's oil and gas industry. It has been noted that the tax and royalty elements of the Canadian fiscal structure acknowledges the high-risk and high-cost nature of oil and gas exploration and development activities.<sup>107</sup> A most recent example relating to this claim is the structure of the new British Columbia Liquefied Natural Gas (LNG) Income Tax Act.<sup>108</sup> This legislation imposes tax at a gradual rate so as to facilitate a corporation's recovery of capital investment on liquefaction activities and ensure flexibility of the transition process following the introduction of the LNG tax.<sup>109</sup> In addition to well-structured legislation,

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<sup>102</sup>Environmental Performance Index, "Country Rankings", online: < <http://epi.yale.edu/> >. The EPI assessment is a joint project between the Yale Center for Environmental Law & Policy and the Center for International Earth Science Information Network at Columbia University, in collaboration with the World Economic Forum.

<sup>103</sup> Harrission Jacobs, "The 17 Countries Sitting on the Most Valuable Energy Reserves", *Business Insider* (13 February 2014), online: <<http://www.businessinsider.com>>

<sup>104</sup> Kadafa Adati Ayuba, "Oil exploration and spillage in the Niger Delta of Nigeria" (2012) 2:3 Civil & Env'l Res 38. The article calls it the Niger Delta basin and continental shelf.

<sup>105</sup> Some commentators refer to it as the Western Canada Sedimentary Basin; Robert Bott, David M Carson & Jan W Henderson "Evolution of Canada's Oil and Gas Industry" Canadian Center for Energy Information, online: (2004) <<http://www.energybc.ca>> at 1; Canada Association of Petroleum Producers, "Crude Oil: Forecast, Markets, and Transportation" (June 2014), online: <<http://www.capp.ca>>.

<sup>106</sup>See generally, EIA Canada Info, *supra* note 14; Todd Whitcombe, "Canadian economy dependent on oil" *The Prince George Citizen Newspaper* (19 January 2015), online: <<http://www.princegeorgecitizen.com>>; For Nigeria, see *Chiakwelu*, *supra* note 13.

<sup>107</sup>Bob Bleaney, "Canadians Realize Significant Value from Oil and Gas Sector", online: (2014) Canadian Association of Petroleum Producers <<http://www.capp.ca>> [Bleaney].

<sup>108</sup> Bill 6, *An Act to introduce the Liquefied Natural Gas Income Tax Act*, 3rd Sess, 40th Parl, British Columbia, 2014.

<sup>109</sup> Canadian Energy Law, "BC Unveils the Liquefied Natural Gas Income Tax Act-significant issues and uncertainty", (6 November 2014), Canadian Energy Law website, online: < <http://www.canadianenergylaw.com>>.

Canada's oil and gas tax system has also been noted as very instrumental in attracting oil and gas investments and maximizing the economic benefit derived from Canada's oil wealth for both Canadians and the Canadian government.<sup>110</sup> In addition to its fiscal framework, Canada is also recognized for oil and gas technology and innovation which is an additional factor that makes the Canadian petroleum industry even more attractive.<sup>111</sup>

In order to attract oil and gas investment as well as safeguard the Nigerian petroleum industry's competitiveness and relevance in the international oil and gas industry, certain international fiscal policy standards are beneficial and worthy of emulation.<sup>112</sup> For instance, recent reforms in the Mexican petroleum industry is said to be responsible for the increase in Mexico's economic and investment prospects for the supply of oil.<sup>113</sup> Considering the recent decline in the United States' import of crude oil from Nigeria, there is an urgent need to implement fiscal measures that will attract additional foreign investment for Nigeria.<sup>114</sup> Since Canada is recognized as "one of the most stable jurisdictions to do business in" among the world's major oil-producing nations,<sup>115</sup> the Canadian oil and gas industry provides a good reference point if Nigeria intends to adopt policy measures that meet international standards.

### **1.3.3 Some Criticisms and Challenges of the Canadian Petroleum Industry**

Although there are laudable tax initiatives in the Canadian oil and gas industry, Canada's oil and gas industry – like other oil and gas industries - is by no means a perfect one. This is because the Canadian oil and gas industry also has some challenges which are worth mentioning. Some of these challenges relate to fluctuating oil prices and expensive cost of extraction in the oil sands while other challenges relate to human resources and technological challenges.<sup>116</sup> In terms of

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<sup>110</sup> Bleaney, *supra* note 107.

<sup>111</sup> Mario Toneguzzi, "Global Petroleum Show to be biggest ever", *Calgary Herald* (20 May 2014), online: <<http://www.calgaryherald.com>>.

<sup>112</sup> Frank Uzuegbunam, "Nigeria oil and gas reforms: endless revolving door", *Business Day* (22 January 2014) online: <<http://businessdayonline.com>>.

<sup>113</sup> *Ibid.* Particularly, there are concerns that that Mexico's reforms may adversely affect the quantity of Nigeria's crude oil export to the United States because the proximity of Mexico to the United States (Nigeria's largest customer for crude oil) provides a cheaper alternative for the US. See Roseline Okere & Sulaimon Salau, "Nigeria: U.S. Crude Oil Import from Nigeria Declines by 93 percent", *The Guardian* (24 November 2014) online: <<http://allafrica.com>> [Okere & Salau].

<sup>114</sup> Okere & Salau, *ibid.*

<sup>115</sup> PWC, Energy Vision, *supra* note 15 at 9.

<sup>116</sup> For fluctuating oil prices see Michael Mckerracher, "Western Canada Will Feel the Decline in Oil Prices, But It's Not Catastrophic" *The Globe and Mail*, (14 December 2014), online: <<http://www.theglobeandmail.com>>; for

human resources, the Canadian oil and gas industry has been described as having an aging workforce. Despite having a competitive salary rate, corporations in the oil and gas industry have difficulties in recruiting younger generation of workers.<sup>117</sup> Specifically, it has been noted that “[o]nly 18% of the current Canadian oil and gas labor force is under 35”.<sup>118</sup> In 2012, the Canadian Chamber of Commerce predicted a shortfall of 130,000 skilled workers in Canada’s oil and gas industry over the next decade.<sup>119</sup> The importance of skilled workers is particularly important to this industry given the increase in oil production predictions for the industry. For instance, it has been predicted that “Alberta oil sands production alone is set to double to 3.8 million over the next decade, while the liquefied natural gas projects will also require significant labour force”.<sup>120</sup> Thus a decline in labour force may have long term adverse effects on the continued relevance of the Canadian oil and gas industry.

In addition to the declining and aging labour force, there are also concerns regarding acquisition and advancement of technology in the oil and gas industry.<sup>121</sup> Given that technology advancement is crucial in maintaining the Canadian oil and gas industry competitiveness with its international counterparts, it is very important for the industry to acquire workers with the requisite “sophisticated and *up-to-date* training and skills”.<sup>122</sup> Acquisition of such skills could be challenging if there are no workers that match the required competency. Apart from the need to attract competent employees, these challenges could also adversely affect the delivery and quality of petroleum products or major capital projects and ultimately, the international reputation of the Canadian petroleum industry and the revenue generated from the industry.<sup>123</sup> Thus, in proposing

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expensive cost of extraction see Jeff Lewis, “Is Oil Sands Development Still Worth It?” *The Globe and Mail*, (28 October 2014), online: <<http://www.theglobeandmail.com>>.

<sup>117</sup> Hussain Yadullah, “Canada energy labour shortage: Young workers shun oil and gas sector”, *Financial Post Energy* (14 May 2013), online: <<http://business.financialpost.com>>. Canadian oil and gas professionals typically receive the fifth most generous pay packages in the world behind their counterparts in Norway, Australia, Netherlands and New Zealand.

<sup>118</sup> *Ibid.*

<sup>119</sup> CBC News, “Labour shortage ‘desperate,’ Chamber says”, *CBC News* (8 February 2012), online: <<http://www.cbc.ca>>.

<sup>120</sup> *Supra* note 117.

<sup>121</sup> Ernst & Young, “Human Resources in Canada’s Oil and Gas Sector: A snapshot of challenges and directions”, (2011), online: Ernst & Young <<http://www.ey.com>> at 4.

<sup>122</sup> *Ibid* at 1 [*emphasis added*]. On page 2, this report anticipates shortage of 77,000 workers in Alberta alone in the “coming decade”.

<sup>123</sup> *Ibid.*

recommendations for reforms, this thesis acknowledges these shortcomings and the impact they may have on the proposed recommendations.

#### 1.3.4 The Role of Taxation

Even though the primary (and most popular) objective of taxation is to raise revenue, the tax system plays other roles in the economy.<sup>124</sup> These underlying roles of the tax system have been recognised and discussed at length in legal, economic and tax scholarship.<sup>125</sup> The report of the Royal Commission on Taxation (“Carter Commission”), which is the seminal work on tax policy in Canada, is particularly instructive in this regard.<sup>126</sup> Specifically, Volume Two of this report discusses the “*Use of the Tax System to Achieve Economic and Social Objectives*”.<sup>127</sup> In emphasizing the multiple roles of taxation, the Carter Commission noted that taxation is not solely for raising of revenue for public goods as there are other alternative means through which the government can raise its revenue (such as borrowing, creating money and commandeering resources).<sup>128</sup> The Carter Commission report also noted that, “[t]he *first* and most essential purpose of taxation is to share the burden of the state fairly among all individuals and families”.<sup>129</sup> This claim suggests that the purpose of a tax system is beyond the *primary* purpose of raising revenue for government expenditures but extends to *secondary* purposes such as ensuring “fairness” and equality among taxpayers.

In addition to the revenue generating function of taxation, it is important to acknowledge that the tax system also has *redistributive* and *regulatory* functions.<sup>130</sup> The redistributive function of the tax system is closely related to its primary function of raising revenue. Through the imposition of

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<sup>124</sup> Peter W Hogg, Joanne E Magee & Jinyan Li, *Principles of Canadian Income Tax Law*, 8<sup>th</sup> ed (Toronto: Carswell, 2010) at 2. The authors state that the main objective of taxation is to raise revenue and also acknowledge the other roles of the tax system.

<sup>125</sup> Neil Brooks, “The Changing Structure of the Canadian Tax System: Accommodating the Rich” (1993) 31:1 Osgoode Hall Rev 138 at 140-4; Robin W Boadway & Harry M. Kitchen, *Canadian Tax Policy*, 2d ed., Canadian Tax Paper No 76 (Toronto: Canadian Tax Foundation, 1984) at 1.

<sup>126</sup> Canada, *Report of the Royal Commission on Taxation* (Ottawa: Queen's Printer, 1966) [Carter Commission]. This report has been described as the “starting point for any responsible program of income tax reform in an industrialized country”. The Report is issued in six volumes and subsequent reference to the report in this thesis will be done by volume number; see also Boris I Bittker, “Income Tax Reform in Canada: The Report of the Royal Commission on Taxation” (1968) 35 U Chicago L Rev 637 at 637-38.

<sup>127</sup> Carter Commission, Vol 2, *ibid* at 17.

<sup>128</sup> Carter Commission, Vol 2, *ibid* at 2-5.

<sup>129</sup> Carter Commission, Vol 1, *ibid* at 4 [emphasis added].

<sup>130</sup> Reuven S Avi-Yonah, “Three Goals of Taxation” (2006) 60:1 Tax L Rev 1 at 3.

various types and rates of taxes, the government can target certain groups of taxpayers and reduce the uneven distribution of income and wealth resulting from normal operation of a market-based economy.<sup>131</sup> In addition to this redistributive purpose, taxation also has a regulatory function. For instance, Avi-Yonah noted that through the tax system, the government can conduct the “regulation of private sector activity by rewarding activities that are considered desirable (via deductions or credits) and deterring activities that are considered undesirable (via increased taxation).”<sup>132</sup> Such regulatory provisions in the tax system are called “tax expenditures”.<sup>133</sup>

Given the multiple roles of the tax system discussed above, one may reasonably question how the tax system can address the aforementioned challenges in Nigeria’s oil and gas industry. Without relegating the other functions of the tax system, this thesis suggests the regulatory function of the tax system for this purpose. In terms of the regulatory function of taxation, it has been advised that governments should only regulate through the tax system (as opposed to other means of regulation) when (i) such regulation is applied to a small group of taxpayers; (ii) the taxpayers in question are sophisticated enough to deal with complex tax incentives; and (iii) the regulatory goal for the particular provision is clear and related to the level of tax.<sup>134</sup> This thesis argues that the regulatory function of taxation is relevant for addressing the inefficiencies in Nigeria’s petroleum industry because these three conditions are present. Specifically, the thesis contemplates that the regulatory function is applicable in the context of oil and gas reforms because (i) the proposed reforms are intended for corporate taxpayers in the petroleum industry (a small group of taxpayers); (ii) the taxpayers are corporations and are reasonably equipped to “deal with complex tax incentives”; and (iii) the “reform of the petroleum industry” provides a clear “regulatory goal” for the application of the regulatory function of taxation. Consequently, this thesis contends that the regulatory role of taxation is a viable means for promoting oil and gas reforms in Nigeria.

### **1.3.5 Using the Tax System as a Tool for Nigeria’s Oil and Gas Reforms**

As discussed in the preceding section, this thesis looks at the regulatory function of the tax system in proffering Canadian measures that have the potential to address the aforementioned challenges

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<sup>131</sup> *Ibid* at 3.

<sup>132</sup> *Ibid* at 24.

<sup>133</sup> *Ibid* at 23.

<sup>134</sup> Reuven S Avi-Yonah, “Taxation as Regulation: Carbon Tax, Health Care Tax, Bank Tax and Other Regulatory Taxes” (2010) Law & Economics Working Papers, Paper 21 at 8.

in Nigeria's petroleum industry. While this thesis does not contemplate that the tax system is the only tool with which the previously identified problems can be addressed, this thesis argues that the tax system provides a promising avenue for improving administrative efficiency and growth of Nigeria's oil and gas industry while raising tax revenue for the federal government. For instance, tax incentives administered through the tax system can help to attract investment in the oil and gas industry while the imposition of tax on undesirable activities can influence corporate decisions and mitigate the incidence of such activities.<sup>135</sup>

Given the reputation of the Canadian petroleum industry, this thesis argues that there are certain regulatory provisions in Canada's tax system that are potentially beneficial to Nigeria's petroleum industry. Therefore, this thesis proposes five recommendations derived from Canada's oil and gas tax regime to address the previously identified problems in Nigeria's oil and gas industry. While some of the selected Canadian measures are novel to the Nigerian petroleum industry, the other measures simply provide supplementary insights to existing measures in Nigeria's oil and gas tax system.

Specifically, the thesis proposes that the incentivizing of research and experimental development (R&D) in Nigeria's oil and gas industry through tax credits can address the problem of recurrent fuel shortages and inadequate technology. In practical terms, the thesis contemplates that such R&D incentives are likely to promote local investment in oil exploration activities and increase local production of petroleum products thereby reducing Nigeria's heavy reliance on imported petroleum products. Similarly, such R&D credits may also incentivize existing international oil companies to invest in more advanced technology for oil exploration activities especially for the utilization of associated gas. Secondly, the thesis suggests that the use of clean energy generation equipment by oil exploration companies can mitigate the adverse environmental effects of oil exploration activities in oil producing communities. The use of clean energy equipment can be promoted by granting an accelerated capital cost allowance for purchase of specified clean energy generation equipment to eligible oil and gas companies. In addition to the use of clean energy, the thesis also recommends the imposition of a pollution tax to address the problem of environmental degradation and its consequent effects in the oil producing communities in Nigeria. In addition to

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<sup>135</sup> The preference for the tax system as a tool for public policy is discussed in more detail in Chapter 4 of this thesis.

these three fiscal measures, the thesis also proposes two tax administrative measures. First, the thesis recommends Canada's tax informant reporting program to address the problem of tax evasion and aggressive tax avoidance. Finally, the thesis recommends the recent mandatory reporting requirement for Canadian extractive companies to address the problem of lack of transparency and accountability in Nigeria's oil and gas sector.

To fully appreciate the anticipated benefits of the measures proposed in this thesis, an overview of the oil and gas tax regimes in Canada and Nigeria is beneficial. In addition to providing a contextual basis for the recommendations proposed in this thesis, an overview of taxation of oil and gas corporations in both countries is also essential for identifying certain features in both tax systems that may promote or hinder favourable adoption of these measures in Nigeria's oil and gas industry.



## CHAPTER TWO

### TAXATION OF OIL AND GAS CORPORATIONS IN CANADA AND NIGERIA

The Canadian *Income Tax Act*<sup>1</sup> is the legal basis for imposition of federal income taxes on corporations resident in Canada for income tax purposes. A corporation is deemed resident in Canada if the corporation was incorporated in Canada, the corporation's reorganization was done under Canadian laws or the corporation was a Canadian corporation prior to its reorganization.<sup>2</sup> Generally, the federal government has legislative powers to impose taxes on corporations.<sup>3</sup> In addition to federal income taxes, provincial and territorial income taxes are also levied on corporations. While the provinces have constitutional powers to impose taxes under respective provincial statutes,<sup>4</sup> the territories do not have separate constitutional taxing powers but derive their taxing powers from the federal government.<sup>5</sup> It is as a result of this imposition of taxes at the various levels of government that Canada is considered to have a multi-tier system of taxation.

#### 2.1. Overview of Corporate Taxation in the Canadian Oil and Gas Industry

In Canada, business in the oil and gas industry can be conducted by corporations, individuals acting in personal interest, trusts, joint ventures and partnerships. For income tax purposes, the nature of an oil and gas business entity is very significant. Even though the focus of this thesis is the taxation of oil and gas corporations, it is instructive to note that the tax treatment applicable to other business entities in the oil and gas industry is quite different from the applicable tax treatment for corporations. For instance, oil and gas businesses that are conducted as partnerships are *not* treated

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<sup>1</sup> *Income Tax Act*, RSC 1985, c1 (5<sup>th</sup> Supp) [ITA].

<sup>2</sup> ITA, *ibid*, s 89. The ITA defines a Canadian corporation as one that is resident in Canada and was i) incorporated in Canada ii) resident in Canada from June 18, 1971, to the present or a corporation formed by a corporate reorganization is a Canadian corporation due to incorporation in Canada only if i) the reorganization happened under the laws of Canada or a Canadian province or territory; and ii) each of the involved corporations was, just before reorganization, a Canadian corporation. However, a corporation that was incorporated outside Canada can also be resident in Canada if its central management and control is located in Canada. See also *De Beers Consolidated Mines, Limited v. Howe*, [1906] AC 455; *Unit Construction Co v Bullock*, [1960] AC 351; and *M.N.R. v. Crossley Carpets (Canada) Ltd.*, 69 DTC 5015 (Ex. Ct.). These are leading cases that have affirmed the judicial position in terms of residence of a corporation in Canada.

<sup>3</sup> *Constitution Act*, 1867, 30 & 31 Vict, c 3, reprinted in RSC 1985, Appendix II, No 5, s 91 [Constitution Act, 1867] vests taxing powers in the federal government.

<sup>4</sup> *Constitution Act* 1982, being Schedule B to the *Canada Act 1982* (UK), 1982, c 11 [Constitution Act, 1982] ss 92(2), 92A (4) grants provinces the exclusive jurisdiction to make laws relating to exploration and management of non-renewable natural resources within their provinces.

<sup>5</sup> *Constitution Act*, 1982, *ibid*, s 32 (1).

as separate entities from their partners for tax purposes and are not liable to tax.<sup>6</sup> However, the tax liability on the income derived from the partnership business is imposed on the partners.<sup>7</sup> Similarly, income derived from oil and gas joint ventures are proportionately allocated to the joint venture participants and reported in the participants' income tax returns for the relevant tax year.<sup>8</sup>

With respect to corporate entities, which is the focus of this thesis, income tax liability for a corporation in any given year is determined by applying the relevant tax rates to the applicable tax base of the corporation. Although oil and gas corporations are taxed at the same rate as other Canadian corporations, a slight variation is that oil and gas corporations are also subject to the payment of royalties.<sup>9</sup> In addition to income taxes and royalties, oil and gas corporations are also subject to goods and services tax (GST), provincial sales tax (PST) and harmonized sales tax (HST).<sup>10</sup>

### **2.1.1 Corporation Taxes**

In Canada, a corporation's taxable income is based on the company's profits which include its business income, capital gains as well as property income.<sup>11</sup> Under this classification, business income is revenue that was derived from a certain degree of commercial activity<sup>12</sup> while property income relates to proceeds from passive investment like collection of rent, interest, royalties and dividends.<sup>13</sup> Notably, the "income" of a corporation for accounting purposes is quite different from its "income" for tax purposes. This is because certain elements must be added to or deducted from a corporation's accounting income in order to determine its taxable income. According to the ITA, a corporation's taxable income in a tax year is "the taxpayer's income for the year plus the

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<sup>6</sup> Deloitte, "Oil and Gas Taxation in Canada: Deloitte Taxation and Investment Guides", (2013) online: Deloitte <[www2.deloitte.com](http://www2.deloitte.com)> at 5 [Deloitte].

<sup>7</sup> *Ibid.*

<sup>8</sup> *Ibid.*

<sup>9</sup> Ernst & Young, "Global Oil and Gas Tax Guide", (2014), online: Ernst & Young <<http://www.ey.com>> at 100 [EY, Tax Guide]. The authors state that "[c]rown royalties are applicable to crown lands, at a rate of 10% to 45%; [there are] special regime[s] for oil sands and offshore production; [and] freehold royalties vary from lease to lease."

<sup>10</sup> Basically, non-resident corporations that are not subject to the ITA Part I income tax are required to pay a withholding tax (ITA Part XIII tax) based on the gross amounts of their passive investment they receive or derive from Canadian taxpayers. Although the withholding tax rate is 25%, the applicable withholding tax rate depends on the country of origin of the non-resident corporation. This is because such rate may be subject to a reduction if the non-resident corporation originates from a country with which Canada has signed a tax treaty.

<sup>11</sup> *Ibid.*

<sup>12</sup> ITA, *supra* note 1, s 125 (7) defines the "income of the corporation for the year from an active business".

<sup>13</sup> *Ibid.*

additions and minus the deductions permitted”.<sup>14</sup> Due to this reclassification of income items, the prior determination of a corporation’s taxable income is essential for arriving at an accurate corporate income tax liability amount.<sup>15</sup>

Once a corporation’s applicable tax rate and taxable income has been determined, certain deductions may be available to reduce the corporation’s tax liability. For instance, royalties paid to provincial governments and certain non-capital expenditures are deductible for the purpose of computing a corporation’s taxable income.<sup>16</sup> Also, capital expenses of the corporation can often be depreciated, with special regimes applicable to oil and gas expenditures.<sup>17</sup>

### **2.1.1.1 Federal Tax**

At the federal level, corporation tax is imposed on both local and foreign corporations deriving income or *doing business* within Canada.<sup>18</sup> Thus, a company which is not resident in Canada for the taxation year but “carried on business in Canada” at any time in that tax year would be liable to pay taxes on the income derived from such business.<sup>19</sup> Further to section 253 of the ITA, a non-resident corporation will be deemed to be carrying on business in Canada regardless of which stage of the commercial activities was conducted in Canada.<sup>20</sup> Upon confirmation that a company has carried on business in Canada, such a resident/non-resident company will be liable to pay federal and provincial taxes on its taxable income.<sup>21</sup>

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<sup>14</sup> ITA, *supra* note 1, s 2(2).

<sup>15</sup> ITA, *supra* note 1, Division C. For instance, the “deductions permitted” relate to expenses a corporation is allowed to claim on its income taxes. The allowable deductions are provided in Division C of the ITA. Charitable donations and certain dividends received from a corporation’s foreign affiliate are some examples.

<sup>16</sup> Deloitte, *supra* note 6 at 2.

<sup>17</sup> *Ibid.*

<sup>18</sup> ITA, *supra* note 1, s 2 (3).

<sup>19</sup> Although the ITA is silent on the meaning of “carrying on business *in Canada*”, the phrase has been interpreted by the provisions of s 253 of the ITA (also called a deeming rule). This section provides an “extended meaning of carrying on business” and provides details of activities that constitute “carrying on business in Canada”.

<sup>20</sup> A non-resident corporation will be deemed to be carrying on business in Canada if the corporation: i) produces, grows, mines, creates, manufactures, improves, packs, preserves or constructs, in whole or in part, anything in Canada, regardless of whether the non-resident sells it or exports it from Canada without selling it. ii) Directly or indirectly solicits orders or offers anything for sale in Canada regardless of whether the contract or transaction is to be completed inside or outside Canada or partly in and partly outside Canada. iii) Disposes of Canadian resource property, timber resource property, Canadian real property (excluding capital property). ITA s115 stipulates how to arrive at a non-resident corporation’s taxable income in Canada.

<sup>21</sup> Where the business is not carried on through a “permanent establishment”, some tax reliefs may be applicable depending on Canada’s tax treaty with the contracting country or state. See generally, Convention with Respect to Taxes on Income and on Capital, Canada and United States, September 26 1980, Article V (entered into force 16

Once the taxable income of a resident oil and gas corporation has been determined by applying the applicable additions and deductions, the corporation is subject to a federal income tax at the rate of thirty-eight percent (38%).<sup>22</sup> This rate is reduced by ten percent (10%) where the corporation has a permanent establishment in a Canadian province<sup>23</sup> and by another thirteen percent (13%) for corporations that are not eligible for other preferential tax treatment.<sup>24</sup> Such preferential tax treatment could be in the form of additional reductions or credits. For instance, the small business deduction which is an annual tax credit for certain businesses is aimed at reducing the tax liability of eligible small businesses in Canada.<sup>25</sup> Thus, the minimum federal income tax rate for corporations in Canada is fifteen percent (15%) or eleven percent (11%) for corporations that are able to claim small business deductions.<sup>26</sup> The computed corporate tax liability is payable in monthly or quarterly installments subject to some exceptions<sup>27</sup> and the CRA may charge interest and penalties when a corporation makes late or insufficient payment of its tax liability.<sup>28</sup>

### 2.1.1.2 Provincial Tax

Apart from the federal taxes, oil and gas corporations are also subject to provincial tax or territorial tax depending on the tax rate applicable to the province or territory<sup>29</sup> in which it has permanent

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August 1984). This provides that a U.S. entity that carries on business in Canada without a permanent establishment (e.g. broker, general commission agent acting in the ordinary course of business) would not be taxed on the income derived from such business. Furthermore, *Income Tax Regulations* CRC, c 945 s 402 [ITR] defines a permanent establishment as a fixed place of business of the corporation, including an office, a branch, a mine, an oil well, a farm, a timberland, a factory, a workshop or a warehouse. Where the corporation does not have any fixed place of business, its permanent establishment is the principal place in which the corporation's business is conducted.

<sup>22</sup> ITA, *supra* note 1, s 123(1).

<sup>23</sup> *Ibid*, s 124 (1).

<sup>24</sup> *Ibid*, s 124 (1) (f); Deloitte, *supra* note 6 at 1. The 10% reduction is called provincial abatement and is applied to provide allowance for provincial taxes. Therefore, income earned outside Canadian province is subject to the full 38% tax rate. In addition, the 13% is called general rate reduction and it is applicable to corporations that are not subject to any other exemptions.

<sup>25</sup> ITA, *supra* note 1, s 125 (1) & s 125 (2); Canada Revenue Agency, "The Small Business Deduction", Interpretation Bulletin IT-73R6 (25 March 2002) at para 1.

<sup>26</sup> ITA, *supra* note 1, s 125 provides for small business deductions; see also, Canada Revenue Agency, "Corporation Tax Rate" (3 March 2014), website, online: Canada Revenue Agency <<http://www.cra-arc.gc.ca>>

<sup>27</sup> For instance, instalment payments are not applicable where a corporation is in its first tax year, has a tax payable that is \$3000 or less or has a tax year that is shorter than one month. See generally, s 157 of ITA; Canada Revenue Agency, "When You Do Not Have to Pay Instalments" (1 January 2014), online: Canada Revenue Agency <<http://www.cra-arc.gc.ca>>.

<sup>28</sup> ITA, *supra* note 1, s 161 (11) provides for the Receiver General to collect interests and penalties; Canada Revenue Agency, "When We Charge Interest and Penalty", (1 January 2014), online: Canada Revenue Agency <<http://www.cra-arc.gc.ca>>.

<sup>29</sup> Canada has ten provinces (Ontario, Quebec, Nova Scotia, New Brunswick, Manitoba, British Columbia, Prince Edward Island, Alberta, Saskatchewan and Newfoundland and Labrador) and three territories (Yukon, the Northwest Territories and Nunavut).

establishment.<sup>30</sup> The provincial income tax rates are within a range of ten percent (10%) to sixteen percent (16%) of the corporation's taxable income depending on the province in which the corporation is situated.<sup>31</sup> Provincial income tax rates are applied to taxable income, which is essentially the same as for federal purposes, though provincial tax credits often differ from those offered federally. It is noteworthy that provincial tax liability is not a deductible item for the purpose of arriving at a corporation's federal taxable income.<sup>32</sup> In addition, a particular corporation that has permanent establishment in more than one province is expected to allocate taxable income to each of the provinces.<sup>33</sup> The basis for this allocation of taxable income to each province is by calculating the weighted average of revenue, salaries and wages 'reasonably attributable' to the respective provinces.<sup>34</sup>

### **2.1.2 Royalties and Other Applicable Taxes**

In Canada, ownership of the majority of mineral rights are held by the federal, provincial and territorial governments ("governments").<sup>35</sup> These mineral rights are leased to interested parties for the exploration of oil and gas.<sup>36</sup> Consequently, a corporation engaged in the production of oil and gas is required to pay royalties to the holder of such mineral rights. These payments vary from province to province because each province or territory operates its own royalty regime. Where the mineral rights are owned by private individuals or companies (also called freehold leases), the royalty payments are called "freehold royalties."<sup>37</sup> Given that the freehold royalties are paid to the private individuals and not to the governments, "freehold mineral taxes" are levied on such freehold leases.<sup>38</sup> However, for the purpose of this thesis, the term "royalties" is used in reference

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<sup>30</sup> *Supra* note 21. In *American Income Life Insurance Co. v. The Queen*, 2008 DTC 3631, 2008 TCC 306, the court held that a United States company did not have a permanent establishment in Canada because *inter alia* the office of its Canadian agents were not at its disposal.

<sup>31</sup> *Constitution Act 1982*, *supra* note 4, s 92 of gives provinces taxing powers.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid.* In addition, where a corporation has a permanent establishment in more than one province, the corporation is expected to complete Schedule 5 whether or not the corporation has taxable income in these provinces.

<sup>34</sup> ITR, *supra* note 21 provides general rules for the allocation of taxable income among the provinces

<sup>35</sup> ITA, *supra* note 1; Technology Tax Credits Limited, "10% Alberta SR&ED Tax Credit", online: Technology Tax Credits Limited <<http://www.sreds-services.ca>>.

<sup>36</sup> Canada Revenue Agency, "Mining Regulations" (16 November 2013), online: Canada Revenue Agency <<http://www.nrcan.gc.ca>>.

<sup>37</sup> Canada Revenue Agency, "Oil and Gas Extraction Reporting Guide", Schedule II para 15, online: Canada Revenue Agency <<http://www23.statcan.gc.ca>>

<sup>38</sup> *Freehold Mineral Rights Tax Act* of Alberta, RSA 2000, c F-26 s 2. See generally, Canada Revenue Agency, "Oil and Gas Extraction Reporting Guide", online: Canada Revenue Agency <<http://www23.statcan.gc.ca>> and Alberta Energy, "About Freehold Mineral Tax", online: Alberta Energy <<http://www.energy.alberta.ca>> Alberta has a

to crown royalties as governments own about ninety percent (90%) of mineral rights in Canada.<sup>39</sup> These royalty payments are usually based on production and the royalty percentage varies according to the freehold lease. Unlike provincial taxes, royalties are fully deductible in computation of federal income tax.<sup>40</sup> Therefore, the royalties paid by Canadian corporations to the owners of the mineral rights are fully deductible for federal income tax purposes.<sup>41</sup>

In addition to royalties, goods and services tax (GST) is also levied on the sale of all goods and services in the Canadian oil and gas industry.<sup>42</sup> The GST is a federal sales tax which is applicable at the point of supply of domestic and imported goods or services in Canada. In addition to the GST, some provinces also impose additional taxes on goods and services called the provincial sales tax (PST).<sup>43</sup> A province where GST and PST are applicable may choose to merge the two taxes into a unified tax called the harmonized sales tax (HST)<sup>44</sup> while some other provinces prefer to levy GST and PST as separate sales taxes on taxable supplies. Combined provincial and federal sales taxes ranges from 5% to 15%. However, some taxable supplies are zero-rated. For instance, basic groceries, livestock and most fishery and agricultural products are zero-rated for GST and HST purposes. That is, GST/HST will apply to these supplies but at a rate of 0%.<sup>45</sup> However, input tax credits can be claimed by the corporation on such zero-rated goods and services.<sup>46</sup>

In the same vein, some goods and services are exempt from GST/HST. For instance, health, child care, dental and residential rentals are exempt from GST/HST. In the oil and gas industry, some transactions are GST/HST exempt because such transactions are not deemed supplies of goods and/or services.<sup>47</sup> For instance, acquisitions of certain natural resources property rights are not

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specified royalty provision for freehold mineral tax and this is contained in the Freehold Mineral Taxation Act of Alberta.

<sup>39</sup> *Supra* note 36.

<sup>40</sup> Canada Revenue Agency, "Mining Specific Tax Provisions" (7 July 2014), online: Canada Revenue Agency <<http://www.nrcan.gc.ca>>.

<sup>41</sup> *Ibid*; PricewaterhouseCoopers, "Canadian Mining Taxation: Guidance on the Complexities", (2013) online: PricewaterhouseCoopers <<http://www.pwc.com>>.

<sup>42</sup> *Excise Tax Act*, RSC 1985, c E-15, Part IX, s 122-3 [*Excise Tax Act*] imposes GST on all taxable supplies in Canada.

<sup>43</sup> For instance, *Ontario Retail Sales Tax Act*, R.S.O. 1990, c.R.31 (as amended) s2 imposes PST in the province of Ontario.

<sup>44</sup> *Excise Tax Act*, *supra* note 42, s 123(1) describes these provinces as "participating provinces".

<sup>45</sup> *Ibid*.

<sup>46</sup> *Ibid*. The input tax credits can be used to recover GST/ HST paid or owed on purchases and expenses related to a corporation's commercial activities in the form of input tax credits.

<sup>47</sup> EY Tax Guide, *supra* note 9 at 107

deemed as a supply.<sup>48</sup> Thus, GST/HST would not apply to such transactions because the consideration paid or payable in respect of these rights, are not deemed to be consideration for purposes of levying GST/ HST.

### 2.1.3 Oil and Gas Tax Administration in Canada

In Canada, the Department of Finance Canada is responsible for development and evaluation of corporate tax policies,<sup>49</sup> however, the Canada Revenue Agency (CRA) administers such fiscal policies on behalf of the federal and provincial governments in Canada (except Alberta and Quebec).<sup>50</sup> The CRA collects and remits corporate taxes to relevant provinces based on tax collection agreements with such provinces.<sup>51</sup> Alberta and Quebec have separate provincial tax administrative agencies for administration of taxes.<sup>52</sup>

Oil and gas corporations, like other business entities in Canada play a major role in the CRA's corporate tax administration because the Canadian tax system adopts a self-assessment regime whereby taxpayers have the responsibility to complete and file income tax returns with the CRA.<sup>53</sup> Where the CRA disagrees with the information provided in a taxpayer's income tax return, such a taxpayer has the opportunity to make an appeal with respect to the reassessment made by the CRA.<sup>54</sup>

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<sup>48</sup> *Excise Tax Act*, *supra* note 42, s 162(2), lists some natural resources property rights which would not be deemed to be a supply and for which consideration paid would not be attributable to such rights.

<sup>49</sup> *Financial Administration Act*, RSC 1985, c F-11 s 14-5. The Department is responsible for formulation of general tax policies including policies for corporation in Canada.

<sup>50</sup> *Canada Revenue Agency Act*, SC 1999, c 17 [CRA Act] s 2(a); ITA, *supra* note 1, s 22(1).

<sup>51</sup> CRA Act, *ibid*, s 63(1) on "Agreements to Administer a Tax". For implementation, see generally s 5(1) (b) CRA Act which states that: the CRA is responsible for "implementing agreements between the Government of Canada or the Agency and the government of a province or other public body performing a function of government in Canada to carry out an activity or administer a tax or program. Specifically, *Corporations Tax Act*, RSO 1990, c C-40 s 98.1 (1) [*Ontario Corporation Tax Act*] empowers Ontario's Minister of Finance and the Minister of Revenue to enter into an agreement with the CRA for administration and enforcement of the CRA Act.

<sup>52</sup> *Constitution Act 1982*, *supra* note 4 at s 17.

<sup>53</sup> Canadian Tax Dispute Help, "Overview of the Tax Dispute Process in Canada", online: Canadian Tax Dispute Help <<http://taxdisputehelp.ca>>. The result of the evaluation conducted by the CRA is called the "Notice of Assessment". This article provides an abridged process of Tax Appeals in Canada. Tax appeal in Canada may result in a confirmation or variation of the assessment by the CRA or further appeal to the Tax Court of Canada and ultimately the Federal Court of Appeal.

<sup>54</sup> ITA, *supra* note 1, s 165 and 169.

In addition to administration of taxes, the *CRA Act* also empowers the CRA to administer various social and economic benefit and incentive programs delivered through the tax system.<sup>55</sup> However, the CRA is expected to consult with provincial governments on matters that may substantially affect a tax or program of activity being administered by the CRA.<sup>56</sup> In addition to the above, the CRA is also responsible for resolution of tax related disputes<sup>57</sup> and other compliance matters<sup>58</sup> such as tax investigations and tax audits in order to ensure accurate and proper administration of taxes in Canada.<sup>59</sup>

## 2.2 Overview of Taxation in the Nigerian Oil and Gas Industry

In terms of ownership of resources, the ownership of mineral rights is vested in the Federal Government by virtue of the *Constitution of the Federal Republic of Nigeria*.<sup>60</sup> In sharp contrast to Canada, which allows for diversity in the type of business entities engaged in its oil and gas industry, only *companies* incorporated in Nigeria may engage in the exploration or production of petroleum in the Nigerian petroleum industry.<sup>61</sup> Section 2 of Nigeria's *Petroleum Act*<sup>62</sup> provides that, "[a] licence or lease ... may be granted only to a company incorporated in Nigeria under the Companies and Allied Matters Act or any corresponding law."<sup>63</sup> Under the *Petroleum Act*, there

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<sup>55</sup> See generally *CRA Act*, *supra* note 50 at s 5 (1) (b-c) states that the CRA is responsible for "implementing agreements between the Government of Canada or the Agency and the government of a province or other public body performing a function of government in Canada to carry out an activity or administer a tax or program; examples of such program is the Scientific Research and Experimental Development Tax Credit Program, Canada child tax benefit (CCTB) and Universal Child Care Benefit (UCCB).

<sup>56</sup> *CRA Act*, *supra* note 50 at s 40 (1-2).

<sup>57</sup> *ITA*, *supra* note 1, s 165(2) provides that the CRA may accept service of the notice of objection on behalf of the government.

<sup>58</sup> *ITA*, *supra* note 1, s 231 (1).

<sup>59</sup> *CRA Act*, *supra* note 50 at s 40(2). Of the ten provinces in Canada, Alberta and Quebec stand out in the area of tax administration as these are the only two provinces that do not have corporate tax collection agreement with the CRA. Alberta's corporation taxes are administered by the Tax and Revenue Administration (TRA). In addition to the administration of Alberta's corporate taxes, the TRA is also saddled with the responsibility of administering Alberta's scientific research and experimental development program. In the administration of these taxes, the TRA operates under the supervision of Alberta's Minister of Finance - *Alberta Corporate Tax Act*, RSA 2000, c A-15, s 55(1). Similarly, Revenu Quebec is responsible for the administration of corporate taxes in Quebec. This agency is also under the supervision of the Minister of Finance of the province. In addition to provincial taxes, the Revenu Quebec also administers GST within its territory.

<sup>60</sup> *Constitution of the Federal Republic of Nigeria 1999*, LFN 2004, c C23, s 44(3) [*1999 Constitution*]. Specifically, the Constitution provides that, "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."

<sup>61</sup> *Companies and Allied Matters Act*, LFN 2004, c C20, s 54 [CAMA].

<sup>62</sup> *Petroleum Act*, LFN 2004, c P10, s 2 [Petroleum Act].

<sup>63</sup> *Ibid.*



are three major types of interests that can be granted to oil companies namely exploration, prospecting and production. Specifically, oil exploration licences (OEL) are non-exclusive licences which are granted for the conduct of preliminary exploration surveys.<sup>64</sup> An oil prospecting licence (OPL), on the other hand, is an exclusive licence granted for more extensive exploration surveys and includes the right to take away and dispose of oil discovered while prospecting.<sup>65</sup> The third type of interest is the oil mining lease (OML) which is a lease that allows for full scale commercial production once oil is discovered in merchantable quantities in the specified acreage.<sup>66</sup> As mentioned earlier, these concessions can only be granted to companies incorporated under Nigerian law.<sup>67</sup>

The principal statutes with which the federal government manages the oil and gas resources include the *Petroleum Act*,<sup>68</sup> *Petroleum Profits Tax Act* (PPTA),<sup>69</sup> *Oil Pipelines Act*,<sup>70</sup> *Nigeria Liquefied Natural Gas (LNG) Act*<sup>71</sup> and the *Environmental Impact Assessment Act*.<sup>72</sup> Apart from the PPTA, other tax regulations which are also applicable to corporations in the Nigerian oil and gas industry include the *Companies Income Tax Act* (CITA),<sup>73</sup> *Capital Gains Tax Act*<sup>74</sup> and *Value Added Tax Act*.<sup>75</sup> However, the tax legislations which govern the major oil and gas corporation taxes are the PPTA and the CITA. The PPTA governs the taxation of petroleum operations while the CITA is Nigeria's general corporate income tax regulation. Taxation of the oil and gas industry under these two legislation are discussed in further details below.

### **2.2.1 Corporation Taxes**

Nigeria's oil and gas corporations are taxed under the PPTA or the CITA depending on the particular sector of the petroleum industry in which the corporation operates. The three major

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<sup>64</sup> *Ibid*, s 2(1) (a).

<sup>65</sup> *Ibid* s 2(1) (b).

<sup>66</sup> *Ibid* s 2(1) (c).

<sup>67</sup> *Ibid*. s 2(2).

<sup>68</sup> *Petroleum Act*, *supra* note 62.

<sup>69</sup> *Petroleum Profits Tax Act*, LFN 2004, c P13 [*PPTA*].

<sup>70</sup> *Oil Pipelines Act*, LFN 2004, c O7.

<sup>71</sup> *Nigeria Liquefied Natural Gas (LNG) Act*, LFN 2004, c N87.

<sup>72</sup> *Environmental Impact Assessment Act* LFN 2004, c. E12.

<sup>73</sup> *Companies Income Tax Act* LFN 2004, c. C21 [*CITA*].

<sup>74</sup> *Capital Gains Tax Act* LFN 2004, c. C1.

<sup>75</sup> *Value Added Tax Act* LFN 2004, c. V1 [*VAT Act*].

sectors of petroleum operations in Nigeria are upstream, downstream and service sectors.<sup>76</sup> The upstream sector relates to exploration and production of crude oil and gas and the companies in this sector are taxed under the PPTA.<sup>77</sup> However, profits derived by an upstream company which are not related to “petroleum operations”<sup>78</sup> are liable to tax separately under the CITA.<sup>79</sup> The downstream sector involves the processing of petroleum collected in the upstream stage into finished products.<sup>80</sup> This stage also includes the distribution and marketing of petroleum products to consumers. Companies operating in the downstream sector are taxed under the CITA.<sup>81</sup> Companies in the services sector provide support services to the upstream and downstream sectors.<sup>82</sup> Examples of these support services are seismic data acquisition, drilling services, production support services, refinery maintenance, banking, catering and related services.<sup>83</sup> Like the downstream sector, companies in the services sector are also subject to tax under the CITA.<sup>84</sup> The applicable tax rates under the PPTA and CITA regimes are discussed in subsequent paragraphs.

#### **2.2.1.1 Petroleum Profits Tax**

The PPTA<sup>85</sup> is the tax legislation governing the taxation of companies engaged in “petroleum operations” in Nigeria. Section 2 of the *PPTA* defines petroleum operations as:

*“the winning or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a company for its own account by any drilling, mining, extracting or other like operations or process, not including refining at a refinery, in the course of a business carried by the company engaged in*

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<sup>76</sup> Some literature also include a “midstream” sector in the classification of the oil and gas industry. However, the midstream sector operations are usually included in the downstream sector. See KPMG, “KPMG Nigeria Oil and Gas Industry Brief” (June 2014), online: KPMG Nigeria <<http://www.kpmg.com>> at 5 [KPMG Brief].

<sup>77</sup> PPTA, *supra* note 69, s 8. This section provides for the “charge of tax” for companies engaged in “petroleum operations” and s 2 of the Act describes these companies as upstream companies.

<sup>78</sup> PPTA, *supra* note 69 at s 2 defines petroleum operations. Note that upstream companies that also conduct some downstream sector operations will be liable to tax under the CITA for such downstream operations.

<sup>79</sup> CITA, *supra* note 73; KPMG Brief, *supra* note 76.

<sup>80</sup> KPMG Brief, *ibid* at 8.

<sup>81</sup> *Supra* note 79.

<sup>82</sup> KPMG Brief, *supra* note 76 at 9.

<sup>83</sup> *Ibid*.

<sup>84</sup> CITA, *supra* note 73.

<sup>85</sup> PPTA, *supra* note 69 at s 2.

*such operations, and all operations incidental thereto and sale of or any disposal of chargeable oil by or on behalf of the company”.*

Based on this provision, oil and gas industry activities that are not covered by the given definition are liable to tax under the Companies Income Tax Act (CITA).<sup>86</sup> Where a corporation’s activities are categorized as “petroleum operations”, the applicable tax rate for such oil and gas corporation under the PPTA is further dependent on the nature of the contractual arrangement the corporation has with the federal government.

The terms of participation for oil and gas corporations are contractual arrangements which stipulate the rights and duties of the parties. The national oil company (NNPC) is the entity that negotiates and enters into such contractual agreements on behalf of the federal government and thus, is charged with the responsibility of giving effect to these contractual agreements.<sup>87</sup> Examples of such contractual arrangements are Joint Ventures (JVs), Production Sharing Contracts, (PSCs) and Service Contracts (SCs).<sup>88</sup> However, the JVs and PSCs are the most common types of contractual arrangements used by *upstream* petroleum corporations and these two arrangements are liable to tax under the PPTA.

Under Nigerian petroleum law, JVs are described as any agreement or arrangements under which the NNPC “jointly owns and develops various oil and gas concessions in Nigeria”.<sup>89</sup> In practical terms, the NNPC collaborates with international oil companies (IOCs) to exploit petroleum resources through a joint operating agreement (JOA) which provides a framework for the joint venture relationship.<sup>90</sup> Under a JV arrangement, ownership, funding and production sharing are all based on each JV partner’s equity share - the parties jointly hold the OML and the costs for exploration, development and production of the petroleum (and the hydrocarbons produced) are shared among the parties in proportion to the participating interest held by each party under the JOA.<sup>91</sup>

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<sup>86</sup> CITA, *supra* note 73.

<sup>87</sup> *Nigerian National Petroleum Corporation Act*, LFN 2004, c N123, s 5 [NNPC Act]. See especially, s 5 (1) (g).

<sup>88</sup> CITA, *supra* note 73; Yinka Omorogbe, *Oil and Gas Law in Nigeria* (Lagos: Malthouse, 2003) at 38-54 [Omorogbe, Oil and Gas].

<sup>89</sup> *Deep Offshore and Inland Basin Production Sharing Contracts Act* Decree No 9 of 1999, LFN 2004 c D3 s 18 [DOIBPSCA].

<sup>90</sup> Omorogbe, Oil and Gas, *supra* note 88 at 47.

<sup>91</sup> *Ibid.*

The OML essentially constitutes the concession for the production of petroleum and authorizes the lessee (oil companies) to “search for, win, work and carry away” discovered petroleum.<sup>92</sup> The OML only confers a non-possessory interest of the petroleum produced in the lessee while the ownership of land and all the resources on and under such land remains under the exclusive ownership of the federal government.<sup>93</sup> However, the NNPC (on behalf of the government), acquires participatory interests in the concession and the relationship and interests of the parties to the JV are characterized by a combination of the OML and three separate agreements namely the participation agreement, the JOA and the heads of agreement.<sup>94</sup> These three agreements define the relationship between the federal government (represented by the NNPC) and the oil producing companies.<sup>95</sup>

The participation agreements disclose the respective interests of the NNPC and the oil companies in the concession.<sup>96</sup> The participation agreements under JVs are essentially the same in substance but may vary in detail because they are individually negotiated by the parties to the concession.<sup>97</sup> The JOA, on the other hand, sets out the legal relationship that governs the parties’ operational and administrative relations under the concession.<sup>98</sup> Specifically, the JOA lays down the rules and procedure for the joint development of the concession area and the property jointly owned by the parties to the concession.<sup>99</sup> Under the JOAs, the oil company is designated the operator and is responsible for the conduct of all joint venture arrangements in a prudent manner.<sup>100</sup> However, the NNPC reserves the right to be operator.<sup>101</sup> The third agreement – the heads of agreement – are short but extremely important documents between the parties that lay down the general principles

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<sup>92</sup> Petroleum Act, *supra* note 62 at s 2 (1) (c).

<sup>93</sup> 1999 Constitution, *supra* note 60 at s 44(3).

<sup>94</sup> Omorogbe, Oil and Gas, *supra* note 88 at 47.

<sup>95</sup> Yinka Omorogbe, “The Legal Framework for the Production of Petroleum in Nigeria” (1987) 5 J Energy Nat Resources L 273 at 277 [Omorogbe, Legal Framework].

<sup>96</sup> *Ibid.* The interest acquired by the NNPC (on behalf of the federal government) is referred to as “participating interest” and it includes a participating interest in the OML, the fixed and movable assets of the oil company in Nigeria and the working capital applicable to the operations of the OML.

<sup>97</sup> *Ibid.*

<sup>98</sup> *Ibid* at 279; Omorogbe, Oil and Gas, *supra* note 88 at 48.

<sup>99</sup> Omorogbe, Oil and Gas, *ibid.* The term “joint property” under the Nigerian JOA includes expenditure for all activities and services of the oil company such as staff salaries, housing scheme, gratuities, pensions etc. However, the extent of NNPC’s interference with the internal management of the oil company is for the purpose of monitoring the oil company’s compliance with Nigerian laws. For additional details on the operating agreements, see Martin M Olisa, *Nigerian Petroleum Law and Practice* (Ibadan: Fountain Books Ltd, 1987) at 83-93.

<sup>100</sup> Omorogbe, Legal Framework, *supra* note 95 at 279.

<sup>101</sup> *Ibid* at 286.

intended to govern the offtake, scheduling and lifting agreements for crude oil.<sup>102</sup> In addition to these three agreements, a Memorandum of Understanding (MOU) is also entered into by the parties.<sup>103</sup> The MOU sets out the commercial terms of the JV including the manner in which revenues from the JV are allocated between the partners such as the payment of taxes and royalties.<sup>104</sup> Generally, the NNPC holds a sixty percent (60%) interest in all the JVs except the JV operated with Shell Petroleum Development Company (SPDC) where the NNPC holds a 55% participatory interest on behalf of the federal government.<sup>105</sup>

For corporations under the JV arrangement, petroleum profits tax (PPT) is imposed at the rate of eighty-five percent (85%) on the corporation's chargeable profit.<sup>106</sup> The corporation's "chargeable profit" is described as its assessable profits based on petroleum operations carried out within each accounting period less the deductions allowed under the PPTA.<sup>107</sup> However, a tax rate of sixty-five point seven five percent (65.75%) is applicable to the chargeable profits of corporations that are within their first five years of business.<sup>108</sup> After the initial five years, the chargeable profits of the corporation are taxed at the general rate of eight-five percent (85%).

Due to funding pressure from the JV arrangements, the federal government commenced the adoption of the PSC model as the preferred petroleum arrangement with oil companies.<sup>109</sup> PSCs have been defined as "an agreement under which a foreign company, serving as a contractor to the host country/its national oil company, recovers its costs each year from production and is further entitled to receive a certain share of the remaining production as payment in kind for the exploration risks assumed and the development service performed if there is commercial

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<sup>102</sup> *Ibid.*

<sup>103</sup> Yinka Omorogbe, "Fiscal Regimes" (Paper delivered at the Nigerian Extractive Industries Transparency Initiative Civil Society Capacity Building Workshop, at Presidential Hotel, Port Harcourt, Rivers State, 28 July 2005) [unpublished] at 9.

<sup>104</sup> *Ibid.*

<sup>105</sup> For details of the NNPC's participatory interests in the JV operations in Nigeria, see generally NNPC, "Joint Venture Operations", NNPC Business, online: < <http://www.nnpcgroup.com> >.

<sup>106</sup> PPTA, *supra* note 69 at s 21

<sup>107</sup> *Ibid.*, s 9. The PPTA in s 9(4) describes "assessable profits" as adjusted profits less the deductions allowed in s 16 of the Act (for instance loss incurred by a company during a previous accounting period is an allowable deduction) while chargeable profits is defined in s 9(5) as assessable profits less deductions allowed under s 20 of the PPTA (which include annual allowances and petroleum investment allowance).

<sup>108</sup> PPTA, *supra* note 69 at s 21 (2). The initial tax rate is to enable the company recover its pre-production costs.

<sup>109</sup> KPMG Brief, *supra* note 76 at 7. This model was adopted in 1993 and all new government contracts with oil companies since that time have been PSCs. As a result of the way Nigeria's oil and gas industry has evolved, most onshore operations today are JVs, and most deep water offshore operations are PSCs.

discovery”.<sup>110</sup> In practical terms, the oil producing country (or national oil company) owns the concession and engages the oil producing companies as contractors to conduct petroleum operations on behalf of itself and the country.<sup>111</sup> However, the contractor bears all exploration and development risk and is exclusively responsible for financing the costs of the whole petroleum operation which includes the exploration, development and production.<sup>112</sup> If the exploration is successful and oil is discovered in commercial quantities, the contractor recovers the exploration and development costs and will be entitled to reasonable profit upon commencement of commercial production.<sup>113</sup> If the exploration is unsuccessful, the contractor will bear all the losses.

In Nigeria, deep water and frontier oil exploration operations utilize PSCs while the main onshore exploration and production activities are conducted under JVs.<sup>114</sup> Consequently, most of the PSC fields in Nigeria are located offshore. Given the location of the PSC fields, a separate legislation called the *Deep Offshore and Inland Basin Production Sharing Contracts Act* (DOIBPSCA) regulates oil production activities in these fields.<sup>115</sup> The DOIBPSCA defines a PSC as “any agreement or any arrangements made between the Corporation or the Holder and any other petroleum exploration and production company or companies for the purpose of exploration and production of oil in the Deep Offshore and Inland Basins”.<sup>116</sup> The first Nigerian PSC was the Ashland Oil PSC which was signed between Ashland Petroleum Corporation and NNPC in 1973 with Ashland as the designated contractor.<sup>117</sup>

Under the DOIB PSC arrangement, the ownership of the OPL and the OML is held entirely by the NNPC, which engages the petroleum and exploration company as a contractor to conduct petroleum operations on behalf of itself and the NNPC.<sup>118</sup> The oil company, as contractor finances the entire cost of exploration and can only recoup such costs in the event of a commercial discovery.<sup>119</sup> If oil is discovered and extracted under the PSC arrangement, a quantum of the oil

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<sup>110</sup> Gao Zhiguo, *International Petroleum Contracts: Current Trends and New Directions* (London: Graham & Trotman, 1994) at 72.

<sup>111</sup> Francisca Nlerum, “Reflections on Participation Regimes in Nigeria’s Oil Sector” (2010) 6 NCLR 145 at 157 [Nlerum].

<sup>112</sup> *Ibid.*

<sup>113</sup> *Ibid.*

<sup>114</sup> *Ibid.*

<sup>115</sup> DOIBPSCA, *supra* note 89.

<sup>116</sup> *Ibid.*, s 18.

<sup>117</sup> Omorogbe, Legal Frameworks, *supra* note 95 at 279-80.

<sup>118</sup> DOIBPSCA, *supra* note 90, s 18; KPMG Brief, *supra* note 76 at 7.

<sup>119</sup> DOIBPSCA, *ibid.*, s 8 (1-2).

is allocated to the NNPC that will generate proceeds equal to the royalty payable under the concession (referred to as “royalty oil”).<sup>120</sup> After royalty oil is paid, the oil company will be allocated a portion of the oil produced that is *sufficient* to reimburse the operating costs incurred by the company (referred to as “cost oil”).<sup>121</sup> Thereafter, a portion of the remaining oil is allocated to the NNPC as petroleum profits tax to enable the NNPC pay the applicable income tax on behalf of itself and the contractor in accordance with the provisions of the PPTA (referred to as “tax oil”).<sup>122</sup> For companies under the PSC arrangement, the contractor is subject to a petroleum profits tax at 50% of chargeable profit for the *whole duration* of the contract.<sup>123</sup> The balance of the oil, if any (after cost, tax and royalty have been paid), is shared between the parties in accordance with the terms of the PSC agreement (referred to as “profit oil”).<sup>124</sup> Notably, the tax oil is also split between the parties in the same ratio as the split of profit oil stated in the terms of the PSC.<sup>125</sup> Thus, royalties, recovery costs, taxes and profits under the PSC are paid in kind and not cash.

As under the Canadian tax system, Nigerian oil and gas corporations are also entitled to claim certain deductions in the computation of their taxable profits. For PPTA purposes, all expenses that are “wholly, exclusively and necessarily” incurred for petroleum operations are allowable deductions for computing adjusted profit.<sup>126</sup> Examples of such expenses are royalties on exported crude oil, exploration costs, transportation costs, and shipping costs. Upon arriving at the adjusted profit after taking these allowable deductions into consideration, the assessable profit is determined by taking into account prior year losses yet to be recouped by the company.<sup>127</sup> Where such losses cannot be relieved from the current adjusted profits such unrelieved losses can be carried forward indefinitely to subsequent tax years.<sup>128</sup>

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<sup>120</sup> *Ibid*, s 7. Whatever remains after these deductions is shared among the parties by the ratio stated in their PSC and is called “profit oil”.

<sup>121</sup> *Ibid*. In addition to cost oil, there is a payment of royalty (royalty oil) which is fixed according to the location of the particular oil field such that the deeper the concession is from onshore, the lower the royalty rate that will be applicable to such concession.

<sup>122</sup> *DOIBPSCA, ibid*, s 9.

<sup>123</sup> *DOIBPSCA, ibid*, s 3(1); *PPTA, supra* note 69 at s 22.

<sup>124</sup> *DOIBPSCA, ibid*, s 10.

<sup>125</sup> *DOIBPSCA, ibid*, s 12.

<sup>126</sup> *PPTA, supra* note 69 at s 10.

<sup>127</sup> *Ibid*, s 16.

<sup>128</sup> *Ibid*.

### 2.2.1.2 Companies Income Tax

In addition to JVs and PSCs arrangements discussed above, a third contractual arrangement in Nigeria's petroleum industry is the service contracts (SCs).<sup>129</sup> A SC could either be a risk-service, pure-service or a technical assistance agreement.<sup>130</sup> Under the risk-service arrangement, the oil producing country owns the concession as well as the petroleum discovered while the oil company who is engaged as the contractor bears all the risks.<sup>131</sup> Pure-service and technical assistance agreements, on the other hand, are simply contracts for work - the contractor is brought in to perform defined services or tasks and is compensated accordingly. Unlike the risk-service contracts, the risks under the pure-service and technical assistance agreements are borne by the government.<sup>132</sup>

In 1987, Nigeria had eleven (11) SCs with IOCs and NNPC in the nature of risk-service contracts.<sup>133</sup> However, SCs are no longer popular in the Nigerian oil and gas industry. Presently, the contract between the NNPC and Agip Energy & Natural Resources (AENR) which was first signed in 1979 is the only active risk-service contract in Nigeria's petroleum industry.<sup>134</sup> Under the Nigerian SCs, the concession is held by the NNPC while the oil company (contractor) provides the required technical expertise and finances the exploration and development operation.<sup>135</sup> The initial term of the contract is two (2) or three (3) years and is renewable at the option of the NNPC for an additional term of two (2) years.<sup>136</sup> If commercial discovery is made within the term of the contract, the exploration and development costs are recoverable and the contractor is entitled to compensation for the risk taken and remuneration for the services rendered.<sup>137</sup> Conversely, if there

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<sup>129</sup> Nlerum, *supra* note 111 at 161. Note that an oil company may have different arrangements with the government.

<sup>130</sup> *Ibid.*

<sup>131</sup> Omorogbe, Oil and Gas, *supra* note 88 at 42.

<sup>132</sup> *Ibid* at 43-4. The pure-service or technical assistance agreements are usually used in the areas of proven reserves such as the oil rich Middle East countries like Saudi Arabia, Qatar, Venezuela, Kuwait, and Bahrain. See Nlerum, *supra* note 111 at 162.

<sup>133</sup> Omorogbe, Legal Frameworks, *supra* note 95 at 281.

<sup>134</sup> National Petroleum Investment Management Services, "Nigeria Dynamic Fiscal Regime", NAPIMS, online: <<http://www.napims.com>> accessed on 25 August, 2015.

<sup>135</sup> Omorogbe, Legal Frameworks, *supra* note 95 at 281.

<sup>136</sup> Lawrence Atsegbua, "Acquisition of Oil Rights under Contractual Joint Ventures" (1993) 37:1 J Afr L 10 at 21 [Atsegbua].

<sup>137</sup> *Ibid.*



is no commercial discovery within the initial term of the contract, the contract is terminated and the exploration costs are lost.<sup>138</sup>

Even though the SCs were designed for the purpose of improving PSCs, the SCs differ from PSC in some respects.<sup>139</sup> The major distinctions are the duration and the modes of recovery of costs and remuneration under the two arrangements. Generally, SC arrangements are usually for shorter durations than the PSC arrangement.<sup>140</sup> In terms of recovery of costs and remuneration, contractors under SCs are remunerated in cash (a fixed amount) derived from the sale of the concession's available oil unlike PSC contractors that are remunerated with crude oil.<sup>141</sup> However, there may be provisions under the SC allowing the contractor to receive remuneration or recoup the capital expenditure and other operating costs in crude oil.<sup>142</sup> In addition, the terms of a SC may also give a contractor "the first option to purchase the crude oil produced".<sup>143</sup> Nevertheless, the contractor does not have a participation share and does not acquire any title to the crude oil produced under the SC.<sup>144</sup>

As regards taxes, the contractor is treated differently under the SC as opposed to the JVs and PSCs. The contractor is not liable to tax under the PPTA because PPT is only payable by a company engaged in petroleum operation which is defined as "[t]he winning or obtaining ... of petroleum in Nigeria ... by a company on its own account...".<sup>145</sup> Given that the oil company under the SC does not hold any participating interest in the concession, it does not win, or obtain the petroleum "on its own account".<sup>146</sup> Thus, the oil company's status as a *contractor* is underscored and the oil company is liable to tax on its remuneration under the CITA at the rate of thirty percent (30%).<sup>147</sup> However, the NNPC is liable to pay PPT as well as all royalties due on the contract area since it holds the concession for the petroleum operations.<sup>148</sup>

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<sup>138</sup> *Ibid.*

<sup>139</sup> *Ibid.*

<sup>140</sup> *Ibid.* PSCs in Nigeria are usually for a term of 20 years while the term for SCs is about 5 years.

<sup>141</sup> Atsegbua, *supra* note 136 at 20-1.

<sup>142</sup> Omorogbe, Legal Frameworks, *supra* note 95 at 281-82.

<sup>143</sup> *Ibid.*

<sup>144</sup> Atsegbua, *supra* note 136 at 22.

<sup>145</sup> *Ibid.*

<sup>146</sup> *Ibid.*

<sup>147</sup> *Ibid.*; Omorogbe, Legal Frameworks, *supra* note 95 at 282.

<sup>148</sup> Omorogbe, Legal Frameworks, *ibid* at 282.

In addition to oil companies under SC arrangement, companies operating in the downstream and services sector of the Nigerian petroleum sector are also assessed to income tax at the rate of thirty percent (30%) of their chargeable profit under the CITA. Furthermore, activities of upstream companies (such as under JVs and PSCs arrangements) that are not covered under “petroleum operations” are also taxable under the CITA.<sup>149</sup>

Where an oil and gas corporation is a resident company in Nigeria, the corporation is liable to tax on its *worldwide income* which includes profits accruing in, derived from, brought into or received in Nigeria.<sup>150</sup> On the other hand, a non-resident oil and gas corporation is liable to tax at the rate of thirty percent (30%), only on the *income derived from its operations in Nigeria*.<sup>151</sup> To determine the income attributable to a non-resident corporation’s “operations in Nigeria”, a deemed profit rate of 20% is applied on the corporation’s total revenue derived from Nigeria in a particular tax year,<sup>152</sup> thus, resulting in an effective tax rate of 6% of turnover for non-resident companies.<sup>153</sup>

Even though companies taxed under the CITA also have deductible expenses for determination of taxable income, the range of such expenses is not as wide as deductible expenses under PPTA. However, the CITA compensates for the limited deductible expenses through its lower tax rate and its wide range of fiscal incentives for gas utilization projects. For instance, downstream companies involved in gas utilization have a tax holiday period for an initial three years which can be extended for an additional two years subject to performance of the business.<sup>154</sup> In addition to the tax holidays, companies involved in gas utilization projects also have an investment capital allowance at a rate of 15% for qualifying capital expenditure (QCEs).<sup>155</sup>

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<sup>149</sup> KPMG Brief, *supra* note 76 at 12

<sup>150</sup> CITA, *supra* note 73 at s. 105 defines a “Nigerian company” as any company incorporated under the CAMA while a “foreign company” is defined as any company that is established under any law in force in a territory or country outside Nigeria. These foreign companies are generally referred to as non-resident entities. See also, CAMA, *supra* note 73 at s 54.

<sup>151</sup> CITA, *supra* note 73 at s. 55.

<sup>152</sup> PricewaterhouseCoopers, “Taxation of foreign companies operating in Nigeria”, online: PricewaterhouseCoopers <<http://www.pwc.com>>. That is, there is a presumption that the company’s deductible expenses and capital allowance amounts to 80% of its turnover.

<sup>153</sup> CITA, *supra* note 73, s 30. That is, 30% (CIT rate) on 20% deemed profit results in an effective tax rate of 6% of turnover of the non-resident company.

<sup>154</sup> CITA, *supra* note 73 at s 39.

<sup>155</sup> *Ibid.*

### 2.2.2 Royalties and Other Applicable Taxes

In addition to the taxes above, royalty payments are levied on corporations involved in petroleum operations upon commencement of production.<sup>156</sup> The applicable rate of royalty depends on the water depth in which the upstream corporation carries out its petroleum operations. The highest applicable rate for royalty in Nigeria's oil and gas industry is 20% for on-shore production and the lowest rate is 0% for water depths in excess of 1,000 metres.<sup>157</sup> As mentioned earlier, royalties are paid under PSC arrangements by allocating royalty oil to the federal government through the NNPC.<sup>158</sup>

In addition to corporate taxes and royalty payments, oil and gas companies are subject to certain indirect taxes and levies. The major indirect taxes include Tertiary Education Tax (TET), Withholding Tax (WHT), Value Added Tax, Niger-Delta Development Commission levy and import duties to mention a few.<sup>159</sup>

Resident oil and gas corporations are liable to pay TET on assessable profits in each tax year.<sup>160</sup> However, non-resident corporations and unincorporated entities are exempted from TET. This tax is assessed at 2% of a company's assessable profits in addition to the PPT or corporate income tax liability of a company. However, this tax is an allowable deduction for purposes of arriving at adjusted profits for companies liable to tax under the PPTA.

Another indirect tax is the WHT. WHT is an advance payment of tax levied on certain income for which payers are entitled to demand a withholding tax credit note. Such income include dividends, interest, fees, commissions and certain payments in respect of contracts.<sup>161</sup> Resident and non-resident companies that make a payment of an eligible income to another party are required by law to deduct withholding tax (WHT) from the payment and remit the sum to the relevant tax authority.<sup>162</sup> The applicable WHT rate is either five percent (5%) or ten percent (10%) depending on the type of payment (i.e., the nature of transaction) and whether the beneficiary of such payment

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<sup>156</sup> *Petroleum (Drilling and Production) Regulations*, LFN 1990, c 350, reg 61 [PDRR] and buttressed by s 9 of PPTA.

<sup>157</sup> *Ibid.*

<sup>158</sup> *Supra* note 121.

<sup>159</sup> This list above is not exhaustive and only includes the most common taxes and levies.

<sup>160</sup> This is levied pursuant to *Nigerian Tertiary Education Trust Fund (Establishment) Act*, LN 2011, s 1.

<sup>161</sup> The legal basis of the imposition of this tax include *Withholding Tax Regulations* being s 78-81 of CITA as well as PPTA, *supra* note 69 at s 56 for upstream companies.

<sup>162</sup> PPTA, *ibid.*

is a natural or artificial person.<sup>163</sup> However, a reduced WHT rate of seven point five (7.5%) is applicable to non-resident companies where Nigeria has a double tax treaty with the recipient country.<sup>164</sup> The WHT deducted at source from non-resident companies in respect of interest, rent, dividend, and royalty constitutes the final tax liability due from such companies.<sup>165</sup> However, WHT is not applicable to dividends that are declared from profits on which PPT has been paid as such income is regarded as franked investment income.<sup>166</sup>

Value added tax (VAT) is also applicable to the oil and gas corporations at the rate of 5% on taxable goods and services.<sup>167</sup> Like the GST applicable in Canada, some supplies are VAT exempt while some have a 0% tax rate.<sup>168</sup> For instance, oil exports, supply of plant, machinery and equipment that are purchased within or outside Nigeria for gas utilization in the downstream petroleum operations are exempted from VAT.<sup>169</sup>

Additionally, oil and gas corporations are also liable to pay the Niger-Delta Development Commission (NDDC) levy. Due to the environmental degradation in the Niger-Delta (the major oil producing area of Nigeria), the NDDC imposes a levy of 3% on the total annual budget of all onshore and offshore oil producing companies as well as gas processing companies operating in the Niger-Delta area of Nigeria.<sup>170</sup> The objective of the levy is to compensate the residents of the Niger Delta area for the environmental degradation caused by oil exploration activities.

### **2.2.3 Oil and Gas Tax Administration in Nigeria**

Nigeria's tax administration for oil and gas corporations maintains a single tax administrative structure for corporate taxes as the state revenue agencies do not have jurisdiction over corporation

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<sup>163</sup> CITA, *supra* note 73 at s 78(2); KPMG Brief, *supra* note 76 at 13. Where the beneficiary is natural person, the WHT is payable to the State Inland Revenue Service while those for artificial persons like corporations, are payable to the Federal Inland Revenue Service.

<sup>164</sup> Even though the Tax Treaties (with the exception of the Tax Treaties with South Africa and China) have not been formally amended to reflect the reduced rate of 7.5% specified in the 1999 Budget pronouncement, the tax authorities have been implementing it in Nigeria. See KPMG, "Nigeria Fiscal Guide 2014/2015" (December 2014), online: KPMG Nigeria <<http://www.kpmg.com>> at 5.

<sup>165</sup> CITA, *supra* note 73 at s 23 (1) (k), see also, s 78 (4), s 79 (4), s 80 (4).

<sup>166</sup> CITA, *supra* note 73 at s 78 (3), s 79 (3), s 80 (3).

<sup>167</sup> VAT Act, *supra* note 75 at s 2.

<sup>168</sup> *Ibid*, see 1<sup>st</sup> Schedule, Part III.

<sup>169</sup> *Ibid*, see item 1<sup>st</sup> Schedule, Part I.

<sup>170</sup> *Niger-Delta Development Commission (Establishment etc) Act*, LN 2000, s 14 [NDDC Act].

taxes.<sup>171</sup> Although the federal government participates as a major stakeholder in the general administration of oil and gas resources through various agencies,<sup>172</sup> tax administration is carried out *exclusively* by the federal government through the FIRS.<sup>173</sup> The FIRS is the national tax authority charged with the responsibility for assessment, collection and general administration of the direct and indirect taxes in Nigeria's petroleum industry.<sup>174</sup> These taxes include PPT, CIT, VAT, WHT, TET and royalties.

Like the Canadian self-assessment system of taxation, Nigerian oil and gas corporations that are taxed under the CITA also have the responsibility to complete and file income tax returns with the FIRS.<sup>175</sup> However, companies involved in upstream petroleum operations that are taxed under the PPTA are required to submit audited financial statements and tax computations to the FIRS for review. Upon review of these documents, the FIRS issues notices of assessment to the upstream petroleum companies. Where there is any dispute relating to assessment under any of the two regimes, the Tax Appeal Tribunal has the responsibility to settle such tax disputes.<sup>176</sup>

#### **2.2.4 Imminent Tax Reforms in the Nigerian Petroleum Industry**

An overview of Nigeria's petroleum industry is incomplete without the mention of the major imminent reforms in this industry. This is because these imminent reforms are reflective of the need and desire for oil and gas reforms in Nigeria. Given the reformatory agenda of the Petroleum Industry Bill ("PIB"),<sup>177</sup> this bill has been described as the most notable among the imminent reforms in Nigeria's petroleum industry. For instance, some stakeholders have referred to this bill

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<sup>171</sup> *Federal Inland Revenue Service (Establishment) Act*, LN 2007, s 2 [*FIRSEA*]; Federal Inland Revenue Service, "Tax Types", online: Federal Inland Revenue Service < <http://www.firs.gov.ng> > [FIRS, Tax Types].

<sup>172</sup> The federal government participates through the national oil company called the Nigerian National Petroleum Corporation (NNPC). Other stakeholders include the Federal Ministry of Petroleum Resources, the Department of Petroleum Resources, Ministry of Mines and Steel Development, as well as the Ministry of Environment.

<sup>173</sup> FIRS, Tax Types, *supra* note 171

<sup>174</sup> *FIRSEA*, *supra* note 171 at s 2. The various State Internal Revenue Service (SIRS) and the Local Government Revenue Committees are saddled with the responsibility of assessment and collection of taxes at the state and local government levels respectively.

<sup>175</sup> *1999 Constitution*, *supra* note 60, s 24 (f); FIRS, "Self-Assessment Regulations", online: Federal Inland Revenue Service < <http://www.firs.gov.ng> >.

<sup>176</sup> *FIRSEA*, *supra* note 171 at s 59(2).

<sup>177</sup> SB 205, *Petroleum Industry Bill 2012*, 7th Sess, National Assembly June 2011- June 2015, (second reading 7 March 2013) [PIB]. If passed into law, the omnibus feature of the PIB is expected to repeal certain principal petroleum statutes including the Petroleum Act and the Petroleum Profit Tax Act. If passed into law, this bill is expected to positively impact the industry by restructuring existing legislation and establishing new institutions to govern the operations of the petroleum sector.

as the “most authentic piece of legislation that would overhaul the petroleum industry” while others have described the bill as Nigeria’s first major attempt at oil and gas reforms since its commencement of oil exploration.<sup>178</sup> Given that this bill is expected to introduce substantial changes to the Nigerian oil and gas fiscal regime in the immediate future, the bill is noteworthy in any discourse relating to the current state of the Nigerian oil and gas industry.

Based on the draft provisions of the PIB, there is a remarkable level of optimism for its passage as the bill is expected to effect major changes in the oil and gas industry. For instance, the transitional provisions of the current version of the bill is set to repeal certain principal petroleum statutes including the Petroleum Act and the Petroleum Profit Tax Act in order to consolidate Nigeria’s petroleum laws.<sup>179</sup> In addition to repealing these Acts, some of the other tax related changes proposed in the PIB include an introduction of a self-assessment regime for upstream companies<sup>180</sup> and a replacement of the PPT with Nigerian Hydrocarbon Tax (NHT).<sup>181</sup> For instance, sections 299 and 313 of the bill imposes NHT on profits of any company engaged in upstream operations at the rate of “50% for onshore and shallow water areas”; and “25% for bitumen, frontier acreages and deep water areas” during each accounting period.<sup>182</sup> Where a company’s petroleum operations falls in both onshore and deep water geographical areas that are subject to different tax rates (50% and 25%), then, the NHT is to be levied on the proportionate parts of the profits arising from such operations.<sup>183</sup> In addition to the introduction of the NHT, the PIB also proposes to make upstream companies liable to tax under the CIT at the rate of thirty percent 30%.<sup>184</sup> By implication, the PIB proposes to replace Nigeria’s current single tier tax system (PPT) applicable to upstream companies with a two tier tax regime (NHT and CIT). Therefore, upstream companies under the PIB regime will be liable to pay resource tax and

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<sup>178</sup> Jonathan Nda-Isaiah, “Seventh Senate on the Threshold of History” *Leadership* (7 January 2015), online: <<http://leadership.ng>>. This article notes that upon the passage of the PIB, the bill will be the “master reference law” that governs the Nigerian petroleum industry; Marie Müller, “Revenue Transparency to Mitigate the Resource Curse in the Niger Delta? Potential and reality of NEITI”, online: (2010) Occasional Paper V, Bonn: Bonn International Centre for Conversion < <https://www.bicc.de>> Müller referred to the PIB as the first major oil and gas reform in Nigeria’s oil and gas industry since its commencement of exploration

<sup>179</sup> PIB, *supra* note 177, s 354 (1).

<sup>180</sup> *Ibid*, s 327

<sup>181</sup> *Ibid*, s 299

<sup>182</sup> *Ibid*, s 299 and s 313

<sup>183</sup> *Ibid*, s 313 (2).

<sup>184</sup> PIB, *supra* note 177 at s 353 (1).

corporate income tax as opposed to the current regime where they are liable to pay only resource tax (PPT).

In terms of objectives, there are eleven (11) major objectives of the PIB.<sup>185</sup> Some of these key objectives include the creation of a conducive business environment for petroleum operations, establishment of efficient and effective regulatory institutions for petroleum operations and promotion of the Nigerian content in the petroleum industry.<sup>186</sup> This omnibus nature of the PIB has been noted as the PIB's most promising and problematic feature as it has resulted in years of disputes between federal lawmakers, the petroleum ministry and other major stakeholders in Nigeria's petroleum industry.<sup>187</sup> For instance, the PIB proposes to replace and remove certain incentives that are applicable to oil companies under the current tax regime. Under the current regime, oil companies under the PSC arrangement with the federal government are entitled to investment tax credits (ITC) and investment tax allowances (ITA) at 50% of asset costs which act to reduce, respectively, the tax or taxable profits paid by those companies.<sup>188</sup> Similarly, companies under JV arrangements are also entitled to Petroleum Investment Allowance (PIA) which is also aimed at reducing the taxable profits under JV arrangements.<sup>189</sup> However, the PIB intends to replace the ITCs and ITAs with a General Production Allowance (GPA) without a corresponding replacement for PIA even though JV operations are currently entitled to this incentive under the PPTA.<sup>190</sup> Other proposed changes in the bill include the reduction of penalty for non-payment of tax from the current 200% which is applicable under the PPTA to 10% under the PIB.<sup>191</sup> The PIB also proposes the creation of two new regulatory agencies called the Upstream Petroleum Inspectorate (UPI) and the Downstream Petroleum Regulatory Agency (DPRA), both organized as government owned corporate entities<sup>192</sup>

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<sup>185</sup> *Ibid*, s 1.

<sup>186</sup> *Ibid*.

<sup>187</sup> Weneso Orogun, "Petroleum Industry Bill: Issues Delaying Its Passage (1)" *Leadership* (23 September 2014), online: <<http://leadership.ng>>.

<sup>188</sup> *PPTA*, *supra* note 69 at s 22. The incentive is called an "investment tax credit" if the PSC is a pre-1 July 1998 PSC and an "investment tax allowance" if the PSC is a post-1 July 1998 PSC.

<sup>189</sup> *Ibid*, 2<sup>nd</sup> Schedule, para 5.

<sup>190</sup> *PIB*, *supra* note 177 at 5<sup>th</sup> Schedule, para 1 (c) (i-ii).

<sup>191</sup> *Ibid*, s 336

<sup>192</sup> *Ibid*, ss 13, 43.

Even though the text of the PIB suggests a positive and upward potential for growth in the Nigerian petroleum industry, the uncertainty about the delayed passing of the bill has capped investment in Nigeria's oil and gas industry under the current regime.<sup>193</sup> Given that predictability of the regulatory and fiscal regime of any industry is needed to generate new investment, the delayed passage of the PIB discourages investment in the oil and gas industry.<sup>194</sup> In order to determine future foreign investment into the Nigerian petroleum sector, certainty of the regulatory and fiscal terms proposed in the PIB is, to a large extent, very important. For instance, certainty of the regulatory and fiscal regime is required for new "deep water" investment – which is the production region with potentially the *most* scope for further oil exploration in Nigeria.<sup>195</sup> Consequently, a number of upcoming projects which may be worth billions of dollars will be delayed until the passage of the PIB.<sup>196</sup>

Apart from the delayed passage of the PIB, its passage into law also has some potential concerns for stakeholders in the oil and gas industry. For instance, some stakeholders have noted that some propositions in the current version of PIB could stifle future investments in Nigeria's oil and gas industry. One of the major IOCs in Nigeria noted that some of the fiscal terms in the bill could translate to a loss of about \$185 billion in new projects for the Nigerian petroleum industry.<sup>197</sup> The primary reason that has been cited for the potential loss of investment by most stakeholders is the potential increase in government take under the PIB regime. A projection by the NNPC indicates that the PIB aims "to boost accruals to government coffers from the deep water offshore operations from the current level of 32 percent to 72.3 percent".<sup>198</sup> Perhaps, the proposed increase in taxation under the PSC is instructive in buttressing the NNPC's projection. This is because deep water PSCs that currently pay PPT at the rate of fifty percent (50%) will be liable to NHT and CIT at a cumulative tax rate of about fifty-five percent (55%) under the PIB.<sup>199</sup> That is, NHT for deep water

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<sup>193</sup> KPMG, "Oil and Gas In Africa: Africa's Reserves, Potential and Prospects" (2013), online: KPMG Nigeria <<https://www.kpmg.com>> at 9 [KPMG Africa].

<sup>194</sup> *Ibid.*

<sup>195</sup> *Ibid.*

<sup>196</sup> *Ibid.*

<sup>197</sup> Clara Nwachukwu, "PIB: Legacy legislation begging for passage" *Vanguard* (8 January 2014), online: <<http://www.vanguardngr.com>> [Nwachukwu].

<sup>198</sup> NNPC, "PIB: Government to Reap over N300 Billion Annually", NNPC News and Update, online: <<http://www.nnpcgroup.com>>.

<sup>199</sup> KPMG, "Petroleum Industry Bill 2012: Highlights of the Fiscal Provisions", (August 2012), online: <<http://www.kpmg.com/Global>>



PSCs at the rate of twenty-five percent (25%) plus CIT at the rate of thirty percent (30%) results in a five percent (5%) increase in tax under the PIB regime.<sup>200</sup>

In addition to an increase tax rate, current stakeholders in Nigeria's oil and gas industry have argued that the PIB will create "one of the world's harshest production sharing contract" as the fiscal regime under the bill indicates that the Nigerian government's take comprising of royalties, taxes and NNPC's profit oil will amount to a total of ninety-six percent (96%) - which is one of the highest in the world.<sup>201</sup> In addition to the regime for PSCs, some stakeholders have observed that the proposed terms for JVs under the PIB are also considerably onerous to international oil companies (IOCs).<sup>202</sup> This relative increase in government intake under the proposed PIB regime is likely to leave investors with limited profit incentive for further investment.

However, the claims by the IOCs that Nigeria's take under the PIB is one of the highest in the world have been considered an exaggeration based on findings that indicate that government's take for PSCs is within the world average.<sup>203</sup> This is particularly noteworthy because a critical appraisal of the PIB indicates that some of these fiscal provisions also provide certain fiscal benefits for the IOCs. For instance, the replacement of the PPT with NHT and CIT under the PIB is also beneficial to the IOCs (and not only the NNPC) because IOCs operating in deep water PSCs would no longer be liable to pay PPT at fifty percent (50%) on gross revenue but will be liable to pay only NHT at twenty-five percent (25%) on gross revenue and thirty percent (30%) CIT on net profits.<sup>204</sup> In real terms, this would result in an effectively lower tax liability for the IOCs. Similarly, IOCs operating in onshore or shallow PSCs that are currently liable to PPT at eighty-five (85%) will have a five percent (5%) reduction in their tax rate because they will be liable to a cumulative tax rate of eighty percent (80%) under the PIB.<sup>205</sup> That is, NHT for onshore or shallow PSCs at fifty percent (50%) and CIT at the rate of thirty percent (30%). Consequently,

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<sup>200</sup> PIB, *supra* note 177, s 313 for NHT and s 353 (1) for CIT.

<sup>201</sup> Nwachukwu, *supra* note 197.

<sup>202</sup> Memorandum from Mobil Producing Nigeria Ultd to the House Joint Committee on the Petroleum Industry Bill, online: <<http://www.babalakinandco.com/documents>> at 8–10. Specifically, the PIB proposes to increase government take under the JV arrangement by 3%.

<sup>203</sup> For an overview of the pre-PIB and PIB fiscal regime, see Ijeoma Melphord Oji, *Would the Nigerian Government Take for Production Sharing Contracts in the Proposed Petroleum Industry Bill (PIB) Be Among The Highest in the World?* (MSc Thesis, Robert Gordon University, 2013) [Unpublished] at 67 [Oji].

<sup>204</sup> *Ibid* at 70.

<sup>205</sup> *Ibid* at 65; PIB, *supra* note 177, ss 313, s 353 (1).

the slight increase in government take (from 50% under PPTA to 55% under PIB) in relation to the deep PSCs has a corresponding decrease of 5% (from 85% under PPTA to 80% under PIB).

Even though some of the proposed terms in the PIB may mitigate the problems discussed in 1.3.1 above, the aforementioned concerns in the current provisions of the PIB and the absence of tailor-made solutions to some of the previously identified problems could endanger the achievement of the wider objectives of this proposed legislation. In order to fully realize the objectives of the PIB, the current version of the PIB ought to be reviewed to ensure that its terms are flexible enough to encourage investment while guaranteeing optimal returns for the government.

## **2.3 Legal Considerations for the Proposed Reforms**

Given the unique features of oil and gas taxation in Canada and Nigeria, it is useful to examine some aspects of both tax systems that can limit or improve the prospects of successful reforms. Recognizing the material distinctions between the two jurisdictions could serve as a metric for identifying areas where modification may be required and the extent of such modification to improve the chances for a successful transfer of Canadian tax measures into Nigeria's tax system.<sup>206</sup> For the purpose of this thesis, the extent of government participation in the ownership of mineral rights as well as the system of making laws in both countries will be examined.

### **2.3.1 Ownership of Mineral Rights and Government Participation**

Under the *Constitution Act, 1867*, both the federal government and the provincial or territorial governments regulate mining activities in Canada.<sup>207</sup> The majority of mineral rights in Canada are owned by the province, territorial or federal governments while the remainder of the mineral rights are held by individuals.<sup>208</sup> As a result, corporations that wish to carry out petroleum prospecting

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<sup>206</sup> Alan Watson, "Comparative Law and Legal Change", (1978) 37 Cambridge LJ 313. Watson rightly notes that substantial modifications are necessary for proper integration of foreign laws in the recipient country.

<sup>207</sup> *Constitution Act, 1867*, *supra* note 3, s 109 allows Canada's founding provinces to retain their title to publicly owned natural resources within their boundaries while Crown lands and mineral rights in Canadian territories remained vested with the federal government. See generally, William D Moull, "Natural Resources: Provincial Proprietary Rights, the Supreme Court of Canada, and the Resource Amendment to the Constitution" (1983) 21 Alta L Rev 472; William D Moull, "Section 92A of the Constitution Act, 1867" (1983) 61 Can Bar Rev 715. For the authority of territorial and federal governments to regulate mineral resources, see generally William D Moull, "Natural Resources and Canadian Federalism: Reflections on a Turbulent Decade" (1987) 25:2 Osgoode Hall LJ 411; Ramsey Hart, "Introduction to Legal Framework for Mining in Canada", (18 July 2012), online: <<http://www.miningwatch.ca>>

<sup>208</sup> Ownership of mineral rights in aboriginal lands have subsequently been vested in the aboriginal peoples by virtue of *Constitution Act, 1867*, *supra* note 3, ss 25,35. See also John Dobra, "Divergent Mineral Rights Regimes: A Natural

or exploration activities are required to obtain an exploration licence and other necessary permits from the relevant owner of the mineral rights.<sup>209</sup> That is, the respective governments retain the ownership of the oil and gas resources but grant development rights to corporations for exploration or prospecting activities. In regulating the development rights, the federal, provincial and territorial governments have distinct authority to issue licences, permits or grant leases to corporations that wish to explore or prospect for oil on their respective lands.<sup>210</sup>

In contrast to the Canadian ownership structure, the Nigerian constitution vests *absolute* title of all mineral resources in the federal government of Nigeria.<sup>211</sup> As a result, there is no private or state ownership of petroleum resources.<sup>212</sup> The federal government grants oil exploration, oil prospecting licence and oil mining leases to corporations intending to carry out such activities in Nigeria.<sup>213</sup> Although the state governments eventually get some part of the revenue derived from oil and gas operation, the federal government retains *exclusive* ownership of mineral rights in the Nigerian petroleum industry.<sup>214</sup>

Another major distinction between Nigeria and Canada's petroleum industries is the existence or non-existence of a state-owned national oil company. As earlier mentioned, Nigeria has a state-owned national oil company (NNPC) through which the federal government conducts commercial activities in the petroleum industry.<sup>215</sup> In contrast, Canada does not have a state-owned national oil company. Even though Canada once had a state-owned national oil company called Petro-

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Experiment in Canada and the United States Yields Lessons", online: (2014) Fraser Institute <<http://www.fraserinstitute.org>>; EY, Tax Guide, *supra* note 9 at 94.

<sup>209</sup> *Canada Oil and Gas Operations Act* RSC 1985, c O-7 s 4 provides that, "[n]o person shall carry on any work or activity related to the exploration or drilling for or the production, conservation, processing or transportation of oil or gas in any area to which this Act applies unless ... that person is the holder of an operating Licence" or some other form of authorization. Section 72.1 of the same Act states that the Act "applies to every interest or right in oil or gas acquired or vested before the coming into force of this section."

<sup>210</sup> For instance, *Territorial Lands Act* RSC 1985, c T-7 s 12 of the Territorial Lands Act permits the Governor in council to "make regulations for leasing of mining rights in, under or on territorial lands and the payment of royalties"; *Crown Minerals Act*, RSS 1984-85-86, c C-50.2 s 4 & s 5 grants the minister authority to issue licenses and permits (Crown dispositions) to person in order to explore or prospect for Crown minerals.

<sup>211</sup> *Petroleum Act*, *supra* note 62, s 1; 1999 Constitution, *supra* note 60, s 44 (3).

<sup>212</sup> *Ibid.*

<sup>213</sup> *Petroleum Act*, *supra* note 62 at s 2.

<sup>214</sup> 1999 Constitution, *supra* note 60, s 162.

<sup>215</sup> NNPC Act, *supra* note 87, s1.

Canada between 1975 and 1990, this company was partly privatized in 1991 and became fully privatized in 2004.<sup>216</sup>

### 2.3.2 Legislative and Taxing Powers

The Parliament is the supreme legislative authority in Canada, consisting of the Crown (who is represented by the Governor General), the Senate and House of Commons.<sup>217</sup> Legislative powers required for the control of mineral rights is constitutionally vested in the federal government and the provincial governments.<sup>218</sup> Even though the federal government has broad constitutional powers with respect to direct and indirect taxation, the *Constitution Act, 1982* also grants the provincial legislatures specific taxing powers with respect to natural resources in the respective provinces.<sup>219</sup>

However, the process for passing bills into laws (including tax laws) at the provincial and federal levels of the Canadian governments are quite different. At the federal level, Canada operates a bicameral legislature such that bills must pass through the Senate and House of Commons before it becomes law.<sup>220</sup> Canadian provinces, on the other hand, operate a unicameral legislature such that passage of bills are done by one legislative branch.<sup>221</sup>

Like Canada, the federal government of Nigeria also operates a bicameral legislature.<sup>222</sup> The highest law making body is the National Assembly, which consists of the Senate and House of Representatives.<sup>223</sup> Similarly, the state governments also operate a unicameral legislature like Canadian provinces as passage of bills are within the purview of the House of Assembly alone.<sup>224</sup> However, the federal government has *exclusive* legislative powers in relation to taxation of oil and

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<sup>216</sup>*Petro-Canada Public Participation Act*, SC 1991, c10 at preamble; Canada, Parliament of Canada, “Federal Commercialization in Canada” by Allison Padova, (Ottawa: Economics Division, Library of Parliament, 2005) online: <<http://www.parl.gc.ca>>

<sup>217</sup> *Constitution Act 1982*, *supra* note 4, s 17.

<sup>218</sup> See generally *Constitution Act 1982*, *supra* note 4, ss 91,92(A).

<sup>219</sup> *Ibid.* See especially s 92 (A) (4) which gives provinces the power to make laws for taxing resources.

<sup>220</sup> Canada, Parliament of Canada, “Parliamentary Business: General Information on Legislation”, online: <<http://www.parl.gc.ca>>.

<sup>221</sup> Public Works and Government Services of Canada, “Legislature, Legislative Assembly, House of Assembly, National Assembly”, (7 September 2012), Public Works and Government Services of Canada website, online: <<http://www.btb.termiumplus.gc.ca>>. The legislative branches are referred to as the legislative assembly, national assembly, or house of assembly.

<sup>222</sup> 1999 Constitution, *supra* note 60, s 4(1).

<sup>223</sup> *Ibid.*

<sup>224</sup> *Ibid.*, s 4(7).

gas corporations. This is because control of such resources is on the exclusive legislative list, thereby vesting legislative capacity on all matters relating to the petroleum industry in the National Assembly.<sup>225</sup> Unlike provincial governments in Canada, the state governments in Nigeria do not have *any* constitutional powers to make laws (including tax laws) for Nigeria's petroleum industry.

Despite the exclusivity of legislative capacity for petroleum resources in Nigeria, Canada and Nigeria appear to have similar law making powers and procedures. Consequently, the distinctions between the two legislative structures are very important but not necessarily significant to pose substantial challenges to the proposed tax reforms. Since both governments operate a bicameral legislature at the federal level, the Canadian legislative model provides a rich perspective for the Nigerian government to follow in terms of implementing the proposed recommendations.

The importance of considering the key distinctions between these two jurisdictions before proposing recommendations for reforms from Canada to Nigeria cannot be overemphasized. Given that Nigeria has a state-owned oil company and does not have a similar structure for ownership of mineral rights, the prospective administrative measures derived from Canada's system must be modified such that the dominant role of the federal government is considered. Similarly, the legislative aspects of the proposed tax measures also need to acknowledge the absence of a corresponding provincial taxing power for state governments in Nigeria. Given the distinctions between the oil and gas industry in the two jurisdictions, the next chapter explores the possibility of transplanting laws from Canada into Nigeria's legal system.

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<sup>225</sup> *Ibid*, s 44(3) vests the ownership of mineral rights in the Federal Government. See also Second Schedule Part I Item 39&59 on legislative capacity.

## CHAPTER THREE

### LEGAL TRANSPLANT THEORIES: AN APPROACH TO OIL AND GAS REFORMS IN NIGERIA

Comparative law theorists have consistently emphasized that, “[d]omestic law cannot always adequately deal with problems in its own legal system”.<sup>1</sup> Many of these theorists contend that exploring laws in other legal systems enlarges the “supply of solutions” available to solve a particular legal problem.<sup>2</sup> Even though the possibility of exporting laws across jurisdictions is a highly contested issue in several comparative law scholarship,<sup>3</sup> the rate of globalisation in the world today reveals an unavoidable mobility of laws among jurisdictions. The aspect of comparative law that considers the transfer of legal rules from one system to another is intricately linked to the concept of “transplants”. According to Alan Watson, the process of borrowing legal rules from one legal system to another is called “legal transplants”.<sup>4</sup> Watson – the foremost exponent of legal transplants, explains that legal borrowing may be from within the same legal system, for instance from negligence in torts to negligence in contract, or the borrowing may be from another legal system entirely, as contemplated in this thesis.<sup>5</sup>

Since this thesis intends to explore possible “supply of solutions” for Nigeria’s oil and gas reforms by looking at Canada’s petroleum industry, it is important to explore the views of scholars and

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<sup>1</sup> Kai Schadbach, “The Benefits of Comparative Law: A Continental European View” (1998) 16 BU Int’l L J 331 at 350 [Schadbach].

<sup>2</sup> *Ibid* at 350.

<sup>3</sup> See generally, Alan Watson, *Legal Transplants: An Approach to Comparative Law* 2<sup>nd</sup> ed. (Atlanta: University of Georgia Press, 1993) [Watson, *Legal Transplants*]; Alan Watson, “Legal Transplants and Law Reform” (1976) 92 Law Q Rev 79 [Watson, *Law Reform*]; Alan Watson, “Comparative Law and Legal Change”, (1978) 37 Cambridge LJ 313 [Watson, *Comparative Law*]; Alan Watson, “The Birth of Legal Transplant” (2013) 41:3 Ga. J. Int’l & Comp L 605 [Watson, *The Birth*]; Otto Kahn-Freund, “On Uses and Misuses of Comparative Law” (1974) 37 Mod L Rev 1 [Kahn-Freund, *Uses and Misuses*]; Pierre Legrand, “The Impossibility of ‘Legal Transplants’” (1997) 4 Maastricht J Eur & Comp L 111 [Legrand, *Impossibility*]; Pierre Legrand, “What ‘Legal Transplants?’” in D. Nelken and J. Feest (eds.) *Adapting Legal Cultures* (Oxford: Hart Publishing, 2001) [Legrand, *What Legal Transplants?*]; Anthony Forsyth, “The ‘transplantability’ Debate in Comparative Law and Comparative Labour Law: Implications for Australian Borrowing from European Labour Law”, (2006) Centre for Employment and Labour Relations Law, online: <<http://www.law.unimelb.edu.au>>; William Ewald, “Comparative Jurisprudence (II): The Logic of Legal Transplants” (1995) 43 Am J Comp L 489.

<sup>4</sup> Watson, *Legal Transplants*, *ibid* at 21.

<sup>5</sup> Alan Watson, “Aspect of Reception of Law” (1996) 44:2 Am J Comp L 335 at 335. See also Jonathan B Weiner, “Something Borrowed for Something Blue: Legal Transplants and Evolution of Global Environmental Law” (2001) 27 Ecology L Q 1295 at 1297. Weiner describes borrowing within the same legal system as horizontal legal borrowing while he describes the borrowing from national to international law or vice-versa as vertical legal borrowing.

theorists that discuss the prospects of transferring laws from one jurisdiction to another. Since the focus of this thesis is corporate taxation in the oil and gas industry, this chapter looks at legal transplants in the context of tax law and also considers the three major schools of thought on legal transplant theories to determine the possibility of transfer of laws between Nigeria and Canada.

### 3.1 Legal Transplant Theories

The concept of transplanting laws from one place to another is not a new phenomenon but has been explored long ago in the writings of legal scholars like Baron De Montesquieu, Roscoe Pound and Albert Kocourek.<sup>6</sup> While the development of theories of comparative law may not have been the central purpose of these scholars' writings, their work discussed different aspects of the transference of law between states and have become part of legal transplant scholarship. The earliest among these writings is the work of Montesquieu who explored the relationship between local conditions and imported law.<sup>7</sup> Montesquieu considered legal transplants of national laws as unusual because each country has its own unique features which suits its people.<sup>8</sup> He noted that "[l]aws should be so appropriate to the people for whom they are made that it is very unlikely that laws of one nation can suit another".<sup>9</sup> Even though Montesquieu's view has become a premise upon which some of the later legal transplant scholars (such as Kahn-Freund) have based their work, other schools of legal transplant theories have emerged over the years.<sup>10</sup>

There are three major competing views on the transferability of laws across jurisdictions. These are the views of Alan Watson, Pierre Legrand and Otto Kahn-Freund. While Watson holds an optimistic view that legal transplants are a feasible and efficient method of law reforms,<sup>11</sup> Legrand takes an extreme pessimistic position and contends that laws cannot be transferred from one jurisdiction to another.<sup>12</sup> Kahn-Freund leads the third school of thought and this school contends that even though legal transplants are possible, the knowledge of the social, economic and political

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<sup>6</sup> Charles De Secondat Baron De Montesquieu, *The Spirit of Laws*, translated by Thomas Nugent, revised by JV Pritchard (London: G Bell & Sons Ltd, 1914) [Montesquieu]; Roscoe Pound, "The Theory of Judicial Decision" (1923) 36:6 Harv L Rev 641; Albert Kocourek, "Factors in the Reception of Law" (1935-1936) 10 Tul L Rev 209.

<sup>7</sup> Montesquieu, *ibid* at ch 3.

<sup>8</sup> *Ibid*.

<sup>9</sup> *Ibid* at 8.

<sup>10</sup> For a brief literature review on legal transplant, see Thi Mai Hanh Do, "Transplanting Common Law Precedents: An Appropriate Solution for Defects of Legislation in Vietnam (Part 2)" (2014) 7:26 Eur Sci J 48 at 52-3 [TMH Do]

<sup>11</sup> Watson, *Legal Transplants* *supra* note 3 and Watson, *Law Reforms*, *supra* note 3.

<sup>12</sup> Legrand, *Impossibility*, *supra* note 3.

context of the foreign law can influence the success of the transplant in the recipient jurisdiction. In applying these views to the principal argument in this thesis, Watson's views suggest that Canadian laws can be transferred into the Nigerian legal system with relative ease while Legrand implies that such borrowing of laws is an impossibility. Perhaps, Kahn-Freund would argue that transfer of laws are possible between the two jurisdictions only to the extent that the law reformer acknowledges the social, economic and political context of the prospective Canadian measures before attempting to adopt Canadian laws in Nigeria. Given these competing views on the legal transplant approach for reforms being contemplated in this thesis, it is crucial to examine these three schools of thought in order to identify the premise for the arguments made by each school and weigh the strength and weaknesses of their arguments.

### **3.1.1 Alan Watson's School of Thought**

According to Watson, "laws" are made for the purpose of addressing the society's needs.<sup>13</sup> Even though these laws guide social activities in a particular society, Watson cautions that "law does *not* reflect totally the society in which it operates. Instead, much of it is borrowed from other systems."<sup>14</sup> In explaining his view, Watson states that, "the two most startling, and at the same time most obvious, characteristics of legal rules are the apparent ease with which they can be transplanted from one system-or society to another, and their capacity for long life."<sup>15</sup> In citing historic examples of the transplant of laws from one society to another, Watson draws on the "great legal export" of the common law of England to different parts of the world including United States, Australia, New Zealand, India and large parts of Canada.<sup>16</sup>

Watson discussed the ease with which legal transplants can occur and centred his arguments on three major premises. First, Watson asserts that, "law possesses a life and vitality of its own".<sup>17</sup> Secondly, Watson states that in addition to legal rules being part of the social structure of a society, legal rules "also operate on the level of ideas".<sup>18</sup> Thus, laws are borrowed because a recipient jurisdiction has identified the *apparent benefits* in the *idea* of a particular foreign legal rule and

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<sup>13</sup> Watson, *Comparative Law*, *supra* note 3 at 313. He use the term "society" to refer to the persons who inhabit a particular territory.

<sup>14</sup> Watson, *The Birth*, *supra* note 3 at 607 [emphasis added].

<sup>15</sup> Watson, *Comparative Law*, *supra* note 3 at 313.

<sup>16</sup> *Ibid* at 314.

<sup>17</sup> *Ibid* at 315.

<sup>18</sup> *Ibid*.



not because the rule “was an inevitable consequence of the social structure” of the donor’s jurisdiction.<sup>19</sup> The third premise of Watson’s argument is hinged on the first two premises. Watson contends that the best approach to understanding and knowing “laws”, their purpose and the demands on them, is through the history of the legal rules, their origin, their development, their transformation and ultimately, their application in different legal systems.<sup>20</sup>

According to Watson, borrowing of laws from one jurisdiction to another, “helps the new law to become acceptable because it has a recognized pedigree” derived from its application in its jurisdiction of origin.<sup>21</sup> To Watson, the relationship between one legal system and another as a result of borrowing is the “heart of comparative law”.<sup>22</sup> Watson’s views on legal transplants suggest that certain laws within the Canadian legal system can be transferred with relative ease into Nigeria’s legal system regardless of the peculiarities that may exist between both jurisdictions.

### **3.1.2 Pierre Legrand’s School of Thought**

In sharp contrast to Watson, who believes in the possibility of legal transplants, Legrand argues that laws cannot be transferred across jurisdictions because every law has a cultural identity. Specifically, Legrand states that, “[r]ules are just not what they are represented as being by Watson. And, because of what they effectively are, rules cannot travel. Accordingly, ‘legal transplants’ are impossible”.<sup>23</sup> In Legrand’s opinion, a rule is not entirely self-explanatory but derives its meaning from the way its interpreter understands the context within which the rule arises.<sup>24</sup> Therefore, the meaning of a rule is a “function of the interpreter’s epistemological assumptions which are themselves historically and culturally conditioned.”<sup>25</sup>

Since the meaning of a rule (as decided by an interpreter) is an indispensable element of the rule or law, Legrand states that no form of words purporting to be a rule can be completely devoid of

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<sup>19</sup> *Ibid.*

<sup>20</sup> *Ibid* at 316.

<sup>21</sup> Watson, *The Birth*, *supra* note 3 at 607.

<sup>22</sup> Watson, *Comparative Law*, *supra* note 3 at 316.

<sup>23</sup> Legrand, *What Legal Transplants?*, *supra* note 3 at 57

<sup>24</sup> *Ibid* at 58.

<sup>25</sup> *Ibid*; see also Legrand, *Impossibility*, *supra* note 3 at 114. Here, Legrand reiterates that “rules” as a concept, are never devoid of their social and cultural connections because the interpreters who give meaning to these rules have their social and cultural prejudices.

semantic content.<sup>26</sup> Therefore, Legrand argues that “there is nothing to show that the same inscribed words will generate the same idea in a different culture” when such rules are transplanted.<sup>27</sup> In order to transport a rule or word from one jurisdiction to another without any form of distortion, Legrand contends that the entire language around such rule must be transported as well.<sup>28</sup> In quoting another author (Hoffman), Legrand notes that, “in order to transport a single word without distortion, one would have to transport the entire language around it”.<sup>29</sup> So for a rule to maintain its original meaning in a host (receiving) jurisdiction, the words should have the same significance they had in the donor jurisdiction from which the law was borrowed. This is because “[a]s the understanding of a rule changes, the meaning of the rule changes. And, as the meaning of the rule changes, the rule itself changes.”<sup>30</sup> Consequently, Legrand contends that one cannot effectively say that legal transplant has occurred unless the words in a rule have the *same* significance they had in the donor jurisdiction.<sup>31</sup> In simple terms, Legrand suggests that legal transplants are impossible because legal transplantation can only occur if the audience in the donor legal system are transported to the host’s legal system.

To Legrand, the “transplant” does not happen because the meaning of the rule, which is a key element of its identity “stays behind” in the jurisdiction from which the rule was borrowed.<sup>32</sup> Thus, Legrand states that, “[a]t best, what can be displaced from one jurisdiction to another is, literally, a *meaningless* form of words”.<sup>33</sup> Legrand concludes that, “law is a part of the symbolic apparatus through which entire communities try to understand themselves better...unless the comparatist can learn to think of law as a culturally-situated phenomenon ... comparison rapidly becomes a pointless venture”.<sup>34</sup> As a corollary to Legrand’s point of view, the rules governing Canada’s oil and gas industry are culturally-situated even though such rules seem technical and devoid of any apparent socio-cultural undertone. Consequently, the effects of such borrowed rules in Nigeria may differ given the dichotomy between the two jurisdictions. In effect, Legrand suggests that the

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<sup>26</sup> Legrand, *Impossibility*, *supra* note 3 at 114.

<sup>27</sup> Legrand, *What Legal Transplants?* *supra* note 3 at 61.

<sup>28</sup> That is, given the subjectivity in the interpretation of a rule, the context of the rule in the jurisdiction of origin is essential if the rule is to maintain its identity. Legrand, *Impossibility*, *supra* note 3 at 117.

<sup>29</sup> *Ibid* at 117. Here, Legrand quotes Eva Hoffman, *Lost in Translation* (London: Minerva, 1991) at 175.

<sup>30</sup> Legrand, *Impossibility*, *supra* note 3 at 117; Legrand, *What Legal Transplants?* *supra* note 3 at 61.

<sup>31</sup> Legrand, *Impossibility*, *ibid*.

<sup>32</sup> Legrand, *What Legal Transplants?*, *supra* note 3 at 61.

<sup>33</sup> Legrand, *Impossibility*, *supra* note 3 at 120 [emphasis in original].

<sup>34</sup> Legrand, *What Legal Transplants?*, *supra* note 3 at 68.

“meaning” of Canadian tax laws or measures cannot survive the journey into Nigeria’s legal system; thus, transplantation is impossible.

### **3.1.3 Otto Kahn-Freund’s School of Thought**

The third school of thought is that of Kahn-Freund, whose work centered on the use of comparative law as a tool for law reform.<sup>35</sup> In providing context for his propositions, Kahn-Freund identified three objectives “pursued by those who use foreign patterns of law in the process of law making”, namely: (i) the objective of “preparing the international unification of law”;<sup>36</sup> (ii) the objective of “giving adequate legal effect to a social change shared by a foreign country with one’s own country”;<sup>37</sup> and (iii) the objective of “promoting at home, a social change which foreign law is designed either to express or produce”.<sup>38</sup> This thesis concerns itself with the third objective advanced by Kahn-Freund.

The major proposition of Kahn-Freund’s views on legal transplant is that “there are degrees of transferability”.<sup>39</sup> In explaining the concept of “transplantation”, Kahn-Freund uses the metaphor of the transfer of a kidney to a human host and the transfer of a carburettor to another vehicle.<sup>40</sup> He states that one may reasonably inquire whether the kidney can be adjusted to the new body (host) or whether the new body will reject it, however, “to ask these questions about the carburettor is ridiculous”.<sup>41</sup> Using this metaphor, Kahn-Freund suggests that there are some rules which are mechanical in nature and are therefore easier to transplant than others. On the other hand, some other rules are more organic in nature and are therefore more difficult to transplant. He postulates the existence of a continuum where rules are easier or more difficult to transplant depending on how deeply rooted they may be in the donor’s jurisdiction.<sup>42</sup> He considers the organic and mechanical categories as the terminal points of the continuum and notes that the transfer of legal rules does not belong to either of these (extreme) terminal points.<sup>43</sup> However, the rules which are

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<sup>35</sup> Kahn-Freund, *Uses and Misuses*, *supra* note 3 at 1.

<sup>36</sup> *Ibid.*

<sup>37</sup> *Ibid.*

<sup>38</sup> *Ibid.*

<sup>39</sup> *Ibid* at 6.

<sup>40</sup> *Ibid* at 5-6.

<sup>41</sup> *Ibid* at 6.

<sup>42</sup> *Ibid* at 13.

<sup>43</sup> *Ibid* at 6.

closest to the “organic” end of the continuum are rules that are designed for the purpose of allocation of power, rulemaking, decision making, and most importantly, policy making power.<sup>44</sup>

Drawing on the work of Montesquieu, Kahn-Freund partially agrees with Montesquieu that the geographical, cultural, climatic and environmental differences among jurisdictions would make it “un grand hazard” (a great coincidence) if laws can be transplanted between countries.<sup>45</sup> However, Kahn-Freund posits that the question of “whether” or “how far” rules and institutions are transferable “have changed since Montesquieu's day, but any attempt to use a pattern of law outside the environment of its origin continues to entail the risk of rejection”.<sup>46</sup> He adds that, “[t]he consciousness of this risk will not, I hope, deter legislators ... from using the comparative method” because one “cannot take for granted that rules or institutions are transplantable”.<sup>47</sup>

In his arguments, Kahn-Freund rightly notes that the obstacles of transplantation are formidable and proposes certain measures to reduce the risks of “rejection” in the transplant process.<sup>48</sup> In his view, the use of comparative method in the legislative process “requires a knowledge not only of the foreign law, but also of its social, and above all its political, context”.<sup>49</sup> In emphasizing the political element, Kahn-Freund notes three major features of political differentiation that directly impacts the viability of legal transplants: (i) political interests (for instance, the differences between the communist and non-communist world and that between dictatorships and democracies in the capitalist world); (ii) disparities in the forms of democratic government such as the presidential and parliamentary variants (particularly because separation of powers among the legislative, executive and judicial arms of government under these variants are different); and (iii) the influence of organized groups in the making and maintenance of legal institutions.<sup>50</sup> Given this background, Kahn-Freund’s views suggest that the *knowledge* of the social and more importantly, the political context of Canadian laws by comparison to the Nigerian context is the key element for transferability. The failure to acknowledge these contexts could “entail the risk of

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<sup>44</sup> *Ibid* at 17.

<sup>45</sup> He referred to Montesquieu’s “The Spirit of Law”. See Montesquieu, *supra* note 6. See Kahn-Freund, *Uses and Misuses*, *ibid* at 6-8.

<sup>46</sup> *Ibid* at 27.

<sup>47</sup> *Ibid* at 20.

<sup>48</sup> *Ibid* at 27.

<sup>49</sup> *Ibid*.

<sup>50</sup> *Ibid* at 11-2. Here, Kahn-Freund cites the example of the legal profession’s rejection of the English jury system which was proposed for adoption in certain European countries in the 19<sup>th</sup> century.

rejection” of such laws in Nigeria’s legal system. Thus, his conclusion indicates that the fate of the prospective recommendations are hinged on their social and political elements.

### 3.1.4 The Transferability Debate

From the prospective arguments above, one can deduce that Watson implicitly believes in the ease of legal transplants, Legrand insists on the impossibility of legal transplants while Kahn-Freund concedes that there are degrees of transferability. It is apparent that the three schools of thought have different notions of “success” of legal transplants.<sup>51</sup> Between Watson and Kahn-Freund, the major difference of opinion appears to be one of “degree” of transferability rather than “possibility” of transplant. In his reaction to Kahn-Freund’s arguments, Watson argues that neither the similarities between the donor and recipient countries nor the political context embedded in a particular law have any significant impact on its transferability.<sup>52</sup> In Watson’s view, the success of a legal transplant is basically dependent on the *desire* of the recipient country for such reform.<sup>53</sup> Watson opines that a legal reformer should focus on the suitability of a foreign *idea* in meeting the needs of his country rather than “political, social or economic context of the foreign law.”<sup>54</sup>

In contrast to the above, the Watson/Legrand divergence of opinion appears to be hinged on their perspectives of the basic conception of the law. Legrand identified Watson’s failure to distinguish between the concept of laws and legal rules as a major flaw in Watson’s argument.<sup>55</sup> Legrand also notes that Watson appears to have an unrealistic view of the “ease” with which laws can be transplanted. However, a strong and compelling rebuttal to Legrand’s contention is that Watson acknowledges that substantial modifications are necessary for proper integration of foreign laws

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<sup>51</sup> For a robust discussion on assessing success of legal transplants. See John Gillespie, “Towards a Discursive Analysis of Legal Transfers into Developing East Asia” (2008) 40 NYU J Int’l L & Pol 657 at 688.

<sup>52</sup> Watson, *Law Reforms*, *supra* note 3 at 83. In this article, Watson illustrates the practical aspect of legal transplantation using the adoption of the Roman law by the Western Europe in the Middle Ages. He states that despite the divergence of legal systems, the transplantation was successful. Thus concluding that “systematic knowledge” of the “donor system” is redundant.

<sup>53</sup> *Ibid.* Watson illustrates this point using Japan’s adoption of German succession and family law and finds that the success of the legal transplant was hinged on Japan’s desire for such laws rather than their knowledge of the political context of German rules.

<sup>54</sup> Watson, *Legal Transplants*, *supra* note 3 at 17 and Watson, *Law Reforms* *supra* note 3 at 79. Particularly, Watson states that, “[s]uccessful borrowing could be achieved even when nothing was known of the political, social or economic context of the foreign law.”

<sup>55</sup> Legrand, *Impossibility*, *supra* note 3 at 111-13.

in the recipient country. In addition, Watson's views also considers the viability of a prospective rule as dependent on (1) the desire of the recipient country for reforms and (2) the suitability of the foreign idea in meeting the needs of the recipient country. Thus, one can reasonably argue that Watson's arguments are more concerned about the "*idea of the law*" rather than the concept of "laws" or "rules" in the strict sense as contemplated by Legrand.

Legrand, in his own arguments seems to imply that the major purpose of transplanting laws is because "law reformers on occasion find it convenient, presumably in the interest of economy and efficiency, to adopt a pre-existing form of words which may happen to have been formulated outside of the jurisdiction within which they operate".<sup>56</sup> Not only is this contention erroneous, it also limits the arguments made by Legrand. Since laws are borrowed across jurisdictions for *several* reasons, his contention limits his arguments to only transplants that are carried out for "economy and efficiency" reasons. Also Legrand appears to contradict his own arguments on the "impossibility" of legal transplants when he concludes (and quotes Kahn-Freund) that "[t]he use of comparative law for practical purposes becomes an abuse only if it is informed by a legalistic spirit which ignores this context of the law".<sup>57</sup> The implication of Legrand's conclusion is that comparative law for practical purposes *is not* an abuse if it is *informed* by a legalistic spirit and *acknowledges* the context of law. Thus, the use of comparative law is not *entirely* "impossible" as suggested in Legrand's arguments.

Like the first two schools (Watson's and Legrand's), the third school has also been subject to criticism, with the most notable critique coming from Alan Watson. In challenging Kahn-Freund's reliance on Montesquieu's views, Watson states that "Montesquieu badly – very badly – underestimated the amount of successful borrowing which had been going on, and was going on in his day".<sup>58</sup> As an example, Watson cites the reception of Roman law in Western Europe and notes that one cannot simply accept Montesquieu's claim that it is a great coincidence (*un grand hazard*) if the rules of one nation suits another.<sup>59</sup> Contrary to Kahn-Freund's assumptions, Watson reiterates that a reformer should focus on the apparent benefits of the foreign idea.<sup>60</sup> Watson adds

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<sup>56</sup> *Ibid* at 121.

<sup>57</sup> For Kahn-Freund, see Kahn-Freund, *Uses and Misuses*, *supra* note 3 at 27; For Legrand, see Legrand, *Impossibility*, *supra* note 3 at 124.

<sup>58</sup> Watson, *Law Reforms*, *supra* note 3 at 80.

<sup>59</sup> *Ibid*.

<sup>60</sup> Watson, *Comparative Law*, *supra* note 3 at 313.

that even if the reformer gets the foreign law wrong, such error or omission does not adversely affect the usefulness of the idea.<sup>61</sup>

From the arguments of the three schools of thought, there appears to be a general consensus that these three schools acknowledge that a “transplanted law” will not have the exact identity it had in its originating jurisdiction given certain modifications that will occur in the process of borrowing laws from one legal system to another. While the nature and extent of “modification” may be the dilemma of a prospective law reformer, such factors could also determine, to a large extent, the fate of any legal transplant process.

Like the concept of legal transplant itself, the debate on legal transplant theories is also not a new phenomenon. Several authors and scholars have also explored the transferability debate in their work. For instance, Professor Stein analysed the debate between Watson and Kahn-Freund.<sup>62</sup> He suggested that the difference in their perspectives on the ease of legal transplant is in the “eye of the beholder”.<sup>63</sup> Shen conducted a brief analysis of Kahn-Freund and Watson’s view on legal transplants in relation to a proposition by Chinese scholars and officials that China can borrow or transplant Hong Kong laws regarding market economy.<sup>64</sup> He concluded by acknowledging the possibility of such transplant and noted that the proposed transplant is “China’s own will” for the purpose of the country’s modernisation.<sup>65</sup> Perju looked at legal transplants in the context of constitutional law and concluded that “comparative constitutional law as a field can benefit from engaging with transplant debate in comparative law”.<sup>66</sup> Waller in his work on neo-realism and the international harmonization of law looked at the transferability of law from one nation and culture to another particularly in relation to competition laws in the United States and the European Union.<sup>67</sup> Waller concluded that “[e]ach society should implement its unique version [of competition laws] with a set of carefully considered indigenous laws, not a set of rules that

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<sup>61</sup> *Ibid* at 315.

<sup>62</sup> Eric Stein, “Uses, Misuses – and Nonuses of Comparative Law” (1977) 72:2 Nw UL Rev 198.

<sup>63</sup> *Ibid* at 203.

<sup>64</sup> Zongling Shen, “Legal Transplant and Comparative Law”, (1999) 51:4 RIDC 853.

<sup>65</sup> *Ibid* at 857.

<sup>66</sup> Vlad Perju, “Constitutional Transplants, Borrowing and Migrations” (2012) Boston College Law School Faculty Papers, in M Rosenfeld & GIUA Sajo, eds, *Oxford Handbook of Comparative Constitutional Law*, (Oxford: Oxford University Press, 2012) at 46.

<sup>67</sup> Spencer Weber Waller, “Neo-Realism and the International Harmonization Law: Lessons from Anti-Trust”, (1994) 42 U Kan L Rev 557 at 561.

represents the vision and voice of another”.<sup>68</sup> Thi Mai Hanh Do evaluated the transplant of common law precedents as a solution for defects in Vietnamese legislation and concluded that “borrowing common law precedents can convincingly be an effective solution for addressing the gaps of Vietnamese legislation”.<sup>69</sup>

In bringing the antecedents of the use and interpretation of legal transplant theories closer to the present context, the works of Owusu and Odumosu are instructive. Specifically, these two writers considered legal transplant theories in the context of oil and gas industries in Sub-Saharan Africa. Owusu explored legal transplant in relation to regulation of operational pollution from oil and gas activities in Ghana.<sup>70</sup> He argued that “[t]ransplanted rules or concepts have flourished particularly in the oil and gas context”.<sup>71</sup> He noted that a “supply of solutions” for the regulation of operational pollution can be transferred from Norway to Ghana.<sup>72</sup> Odumosu, on the other hand, compared Nigeria’s gas flaring regulations with that of Alberta, Canada.<sup>73</sup> In arguing for the “possibility of some beneficial transfer”, Odumosu noted that “[e]ven if the regulatory framework for gas flaring reductions employed in Alberta cannot be transferred to Nigeria ... the problems that have arisen and the mechanisms applied in problem solving [in Alberta]... would provide possible solutions in Nigeria”.<sup>74</sup>

While the aforementioned conclusions from the proposed use of legal transplants in Sub-Saharan Africa appear optimistic, the different conclusions on legal transplant in other parts of the world make it apparent that there is no singular or straight forward approach to applying legal transplant theories to the different areas of law. Based on the diverse interpretations and conclusions in the preceding paragraphs, one can reasonably conclude that the recognition of the areas of law for which legal transplant is possible or factors that can influence the success, failure or the receptiveness of such borrowed law is not an exact science. Consequently, an assessment of the legitimacy of legal transplants as a tool for reform should be performed on a case-by-case basis.

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<sup>68</sup> *Ibid* at 604.

<sup>69</sup> TMH Do, *supra* note 10 at 65.

<sup>70</sup> Emmanuel Kofi Owusu, *Regulation of Operational Pollution from Offshore Oil and Gas Activities in Ghana: Tales from Norway* (LL.M Thesis, University of Calgary, 2005) [Unpublished] at 1 [Owusu].

<sup>71</sup> *Ibid* at 19.

<sup>72</sup> *Ibid*.

<sup>73</sup> Ibironke Tinuola Odumosu, *Reforming Gas Flaring Laws in Nigeria: The Transferability of the Alberta Framework* (LL.M Thesis, University of Calgary, 2005) [Unpublished] at 1 [Odumosu].

<sup>74</sup> *Ibid* at 58-9.



Based on this reasoning, this thesis explores the viability of legal transplants for Nigeria's petroleum sector reforms. Rather than attempting to develop a grand or universal theory of transplantation, the thesis concedes that there is no such thing as an easy or straightforward transplant. Therefore, this thesis adopts a pragmatic approach by considering the different schools of thought and applying them to the proposed transplant between Canada and Nigeria. In order to put the aforementioned transplant theories into practical context, the next section explores the viability of legal transplants for Nigeria's oil and gas reforms.

### **3.2 Exploring the Viability of Legal Transplants for Nigeria's Oil and Gas Reforms**

In assessing the possibility of exporting Canadian laws to Nigeria for the purpose of oil and gas reforms, the evolution of Nigeria's legal system is very instructive. This is because the reception of the English common law into Nigeria's legal system in 1863 lends credence to the viability of legal transplant between both countries.<sup>75</sup> By virtue of colonization, the Nigerian legal system has its origin in the English Common Law and legal tradition.<sup>76</sup> Ever since, the development of Nigeria's post-colonial legal system has been significantly influenced by its colonial history. Even though some have argued that the laws in operation during the colonial era were *given* to Nigeria by virtue of colonialism, there is a consensus that "the common law, doctrines of equity, and statutes of general application in England on January 1st 1900" were in essence *received* into the Nigerian legal system and were applicable in Nigeria *because* of Nigerian legislation to that effect.<sup>77</sup> Nevertheless, not all aspects of English law were seamlessly received into Nigeria.

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<sup>75</sup> Remigius N Nwabueze, "The Dynamics and Genius of Nigeria's Indigenous Legal Order" (2002) 1 Indigenous LJ 153 at 156 [Nwabueze]. It was noted that the British administered the common law of England in the colony of Lagos in 1863 for the purpose of facilitating the administration of the colony. Since that time, Nigerian Law has been built on this foundation of English law such that English laws co-exists with local laws subject to the test of validity. For an overview of the history of Nigeria's legal system, see Akintunde Olusegun Obilade, *The Nigerian Legal System* (London: Sweet and Maxwell, 1979).

<sup>76</sup> Jadesola Lokulo-Sodipe, Oluwatoyin Akintola & Clement Adebamowo, "Legal Basis for Research Ethics Governance in Nigeria", (5 March 2014), Training and Resources in Research Ethics Evaluation, online: <<http://elearning.trree.org>>. These writers note that colonization brought about "the attendant incidence of reception to English law through the process of legal transplant".

<sup>77</sup> For the Nigerian reception statute, see Nwabueze, *supra* note 75 at 156. The legislation being referred to here is the *Interpretation Act*, Laws of the Federation of Nigeria and Lagos 1958, c 89, s 45(1) which provided that, "[s]ubject to the provisions of this section and except in so far as other provision is made by any federal law, the common law of England and the doctrines of equity, together with the statutes of general application that were in force in England on the 1<sup>st</sup> day of January, 1900, shall be in force in Lagos and, in so far as they relate to any matter within the exclusive legislative competence of the Federal legislature, shall be in force elsewhere in the Federation." See especially Edefe Ojomo, "Sources of Law: The Application of English Law in Nigeria" (April 2014) online: <<http://www.yararena.org>> at 2-3 for the contention that the law was "given" to Nigeria.

Notably, certain aspects of Nigeria's family and succession customary laws which lacked conformity with received English law were met with some resistance and are currently still in operation despite the existence of alternative received English law in these specific areas of law.<sup>78</sup>

Despite the existence of some resistance to received English law, Nigeria's English law reception statute – the *Interpretation Act*<sup>79</sup> – indicates that Nigeria's legal system supports the notion of borrowing legal rules from external legal systems. Section 32 of this legislation not only affirms the continued relevance of received English law in Nigeria's legal system, it also clarifies the *scope* of application of English law given the pluralistic nature of Nigeria's legal system.<sup>80</sup> Even though the *Interpretation Act* came into being as a result of colonization – which in the strict sense involved the transfer of laws between a host and a recipient jurisdiction – such legal transfers resulting from colonization were *imposed* during the occupation of the colonized countries. Thus, legal transfers resulting from colonization are distinct from legal transplant which is a product of *voluntary* reform process such as the kind contemplated in this thesis.

In addition to the *Interpretation Act*, a number of foreign laws have not only played significant roles in policy making in other sectors of the Nigerian economy but have also been *successfully* applied in these industries. For instance, a recent study that looked into the application of legal transplants in Nigeria's telecommunications sector noted that “the transplantation of rules, law and regulations from one country to another is possible and has occurred in the context of the Nigerian telecommunications sector”.<sup>81</sup> This indicates that the use of legal transplant as an approach to policy making is not alien to Nigeria's legal system.

From the foregoing, it is perhaps arguable that the current petroleum regulations in Nigeria's oil and gas industry are also a product of legal transplant. Based on the precedents set out in the preceding paragraphs, this thesis contemplates that legal transplants can continue to “occur” in the

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<sup>78</sup> For instance, the customary law of succession is currently still applicable to men married under customary laws that die intestate. See Nwabueze, *supra* note 75 at 185-6.

<sup>79</sup> This aforementioned reception provision is now cited as *Interpretation Act*, LFN 2004, c 123, s 32 with some modifications.

<sup>80</sup> The current statute provides that, “[s]ubject to the provisions of this section and except in so far as other provision is made by any Federal law, the common law of England and the doctrines of equity, together with the statutes of general application that were in force in England on the 1st day of January, 1900, shall, in so far as they relate to any matter within the legislative competence of the Federal legislature, be in force in Nigeria.”

<sup>81</sup> Chukwudiebube B Opata, “Contextual Transplants in the Regulation of Nigerian Telecommunications Sector”, (2012) SSRN 1 at 54.

context of the Nigerian oil and gas industry. In addition to the instances above, the prospects for “continued” legal transplants in the oil and gas industry are particularly high because the prospective rules originate from Canada - which shares some socio-political similarities with Nigeria. Even though the two jurisdictions operate two variants of democratic systems of government, both jurisdictions have elements of federalism in their systems of government.<sup>82</sup> Specifically, the Preamble to the *Constitution Act, 1867* states that the provinces of Canada are “federally united” under the Crown.<sup>83</sup> As a result, the responsibility for governance is shared by the federal, provincial and municipal governments.<sup>84</sup> This federal nature of the Canadian system of government is very similar to Nigeria’s federalism. Being a federal republic, Nigeria also has “federal state” features that are similar to the Canadian structure.<sup>85</sup> Thus, certain roles performed by provincial governments can be substituted for state governments subject to statutory restrictions present in Nigerian oil and gas legislations and Nigeria’s legal system as a whole. Furthermore, the similarities between the Canadian and Nigerian oil and gas industry as discussed in 1.3.2 also lend additional credence to the possibility of transplants occurring in the context of Nigeria’s oil and gas industry. Thus, this thesis contends that the knowledge of how the Canadian oil and gas industry resolves certain matters in its petroleum industry can be transplanted to enable Nigeria to develop more effective concepts for resolution of similar problems in its oil and gas industry. Given that the thesis proposes the use of the tax system for reforms, the next section looks at tax transplants as a category of legal transplants.

### 3.3 Tax Transplants Literature

The term “tax transplant” has been used in describing the application of legal transplants to tax law. The concept of legal transplant as an approach for policy making has been discussed by different scholars and applied in comparative tax law scholarship.<sup>86</sup> In terms of definition, tax

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<sup>82</sup> Canada operates a parliamentary democracy while Nigeria operates a presidential democracy. See *Constitution Act, 1867*, 30 & 31 Vict, c 3, reprinted in RSC 1985, Appendix II, No 5, s 17 [*Constitution Act, 1867*] for Canada and *Constitution of the Federal Republic of Nigeria 1999*, LFN 2004, c C23, s 130 (2) [*1999 Constitution*] for Nigeria.

<sup>83</sup> *Constitution Act, 1867*, *ibid* at Preamble.

<sup>84</sup> *Constitution Act 1982*, being Schedule B to the *Canada Act 1982* (UK), 1982, c 11, ss 91, 92. [*Constitution Act, 1982*].

<sup>85</sup> Nigeria is divided into 36 states and 1 territory.

<sup>86</sup> Carlo Garbarino, “Tax Transplants and Circulation of Corporate Tax Models”, (2009) Bocconi Legal Studies Research at 1 (for alternative citation see also (2011) 2 Brit Tax Rev 159) [Garbarino, *Tax Models*]; Jinyan Li, “Tax Transplants and Local Culture: A Comparative Study of the Chinese and Canadian GAAR.” (2010) 11:2 Theor Inq L 655 [Li, *Tax Transplant*]; Irma Johanna Mosquera Valderrama, “Legal transplants and comparative law” (2004) 2 J Int’l L 261.

transplants refer to the process of “transplantation of tax laws from one country to another.”<sup>87</sup> Despite the apparent discursive failure in comparative tax law, the concept of tax transplants have been explored in various sources of comparative tax scholarship.<sup>88</sup> Carlo Garbarino’s contribution to this field of comparative tax law is particularly instructive because he examines legal transplants in the context of corporate taxes as contemplated in this thesis.<sup>89</sup>

According to Carlo Garbarino, there are two major types of corporate transplants – simple corporate tax transplant and hybrid corporate tax transplant.<sup>90</sup> Garbarino describes the simple corporate tax transplant as “tax transplants in the strict sense.”<sup>91</sup> According to him, this type of transplant occurs where the prospective law retains its *function* in the recipient country such that the *operative rule* in both countries are identical.<sup>92</sup> An example of a simple tax transplant is the tax exemption of cross-border corporate dividends and capital gains among European Union (EU) member states.<sup>93</sup> In this case, the tax exemption rule maintains its function in the EU Member states because the rule exempts the (same) tax liability that would otherwise have been payable on corporate dividends and capital gains in each of these member states. Therefore, the operation of the rule in these states are uniform and identical.

On the other hand, the hybrid corporate tax transplant occurs when a *new function* is generated as a result of substantial modification of the prospective law by the recipient country. Garbarino describes hybrid corporate tax transplant as when the “imported operative rule is modified

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<sup>87</sup> Li, *Tax Transplant*, *ibid* at 655.

<sup>88</sup> Marian Y Omri, “The Discursive Failure in Comparative Tax Law”, (2010) 58:2 Am J Comp L at 1. The author states that scholarship on comparative tax laws “fail to produce even the faintest form of paradigmatic discourse” because comparative tax scholars have “refrained from addressing theoretical assertions made by their colleagues.” Thus, he attempts to construct a framework for comparative tax law debates based on existing scholarship. For sources of tax transplant scholarship, see *supra* note 86.

<sup>89</sup> Garbarino, *Tax Models*, *supra* note 86 at 2-3; Carlo Garbarino, “An Evolutionary Approach to Comparative Taxation: Methods and Agenda for Research”, (2009) 57:3 Am J Comp L at 677; Carlo Garbarino, “Comparative Taxation and Legal Theory: The Tax Design Case of the Transplant of General Anti-Avoidance Rules”, (2010) 11:2 Theor Inq L 765 [Garbarino, Comparative Taxation].

<sup>90</sup> Garbarino, *Tax Models*, *supra* note 86 at 14.

<sup>91</sup> *Ibid*.

<sup>92</sup> *Ibid*. Garbarino illustrates using country A, B and C. In his illustration, a simple corporate tax transplant occurs when, “when a corporate tax mechanism is imported from country C (exporting country) for example, into country A and country B (importing countries). The mechanism imported in country A and country B has a common origin as it comes from country C, and has the same function as it retains the function originally found in country C. In this situation, after the transplant the operative rule in the different countries is the same.”

<sup>93</sup> *Ibid*.

substantially in the process of being transplanted.”<sup>94</sup> He clarifies that the modification can be as a result of *direct change* or *subsequent change*.<sup>95</sup> Direct change occurs when the prospective law is received *subject* to substantial modifications.<sup>96</sup> An example is the American Controlled Foreign Corporation (CFC) rules which have been adopted by some EU Member States with modifications as to the type of income or companies subject to the CFC rules. On the other hand, subsequent change occurs when (despite literal implantation of the prospective law) there is a different operative rule as a result of “local interpretation by administrative agencies or courts.”<sup>97</sup> An example of “subsequent change” is the adoption of progressive system of taxation by East European countries and the (subsequent) consequential implementation of flat taxes in East European countries due to inadequacies of tax administration in those countries.<sup>98</sup> This thesis contemplates a substantial adoption of hybrid corporate tax transplants and a very limited adoption of simple tax transplants in proposing recommendations for Nigeria’s oil and gas sector reforms.

Given the legal transplant approach to reforms discussed above, the next chapter of this thesis discusses the preferred tools for the proposed transfer of laws between Canada and Nigeria. Specifically, chapter four examines the use of the tax system for non-tax policy implementation and policy measures that increase the likelihood of success of tax transplants between the two jurisdictions.

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<sup>94</sup> *Ibid* at 16.

<sup>95</sup> *Ibid*.

<sup>96</sup> *Ibid*. Gabarino opines that direct change “occur[s] when there is reception by a country of a statutory mechanism through the importing and implementation of same/similar legislation but with significant modifications.”

<sup>97</sup> *Ibid*.

<sup>98</sup> *Ibid*.

## CHAPTER FOUR

### USING THE TAX SYSTEM AS A TOOL FOR PUBLIC POLICY

Over the years, the most celebrated set of criteria for evaluating tax policy and the preferred starting point when evaluating tax principles are the canons of equity, certainty, convenience and economy put down by Adam Smith.<sup>1</sup> While these canons of taxation have been universally accepted and acknowledged in various discussions and tax literature; some scholars have simply adopted these principles in the strict sense, some others have modified certain aspects of these principles while others have come up with additional principles for evaluating a good tax system.<sup>2</sup> For instance, the Carter Commission, which has been noted as the “best blueprint” for evaluating “normative tax theory”<sup>3</sup> identified equity, neutrality, certainty, simplicity, flexibility, transparency and accountability as the criteria for an efficient tax system.<sup>4</sup> Similarly, the Organization for Economic Cooperation and Development (OECD) in its report that discussed “Tax Framework Conditions” identified neutrality, efficiency, certainty, simplicity, effectiveness, fairness and flexibility as criteria for evaluating a good tax system.<sup>5</sup> In addition to the above, contemporary scholars such as Professors Hogg, Magee and Li, recognize the principles of equity, neutrality, simplicity as the traditional criteria in evaluating tax policy.<sup>6</sup> Even though the criteria adopted in the aforementioned scholarship are at variance given the specific principle(s) included in each

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<sup>1</sup> Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Vol 2 (Oxford: Oxford University Press., 1976) [Smith] at 825-27; For identification of the principles as the most celebrated and a good starting point for evaluation, see generally Philip D Oliver, *Tax Policy: Readings and Materials*, 2d (New York: Foundation Press/Thomson West, 2004) at 2; ACCA, “Tax Principles from Adam Smith to Barack Obama”, (2009) Association of Chartered Certified Accountants (ACCA) Policy Paper, online: <<http://www.nctbpu.org>>.

<sup>2</sup> For a general discussion on the canons of taxation that have been modified, accepted or generated, see Clinton Alley & Duncan Bentley, “A Remodeling of Adam Smith's Tax Design Principles”, (2005) 20 *Austl Tax F* 579 at 586-8 [Alley & Bentley].

<sup>3</sup> Stanley L Winer & Walter Hettich, “The Structure of the Sieve: Political Economy in the Explanation of Tax Systems and Tax Reform” (1988) 26:2 *Osgoode Hall L J* 409 at 417.

<sup>4</sup> Canada, *Report of the Royal Commission on Taxation* (Ottawa: Queen's Printer, 1966) Vol 2 [Carter Commission] ch 1.

<sup>5</sup> OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions*, Committee on Fiscal Affairs, (Paris: OECD, 2001) at 230.

<sup>6</sup> For example, see Peter W Hogg, Joanne E Magee & Jinyan Li, *Principles of Canadian Income Tax Law*, 8<sup>th</sup> ed (Toronto: Carswell, 2010) at 40-45; Institute on Taxation and Economic Policy, “Tax Principles: Building Blocks of a Sound Tax System”, online: (August 2011) <<http://www.ieanea.org>> at 1; Eden Lorraine, “Equity and Neutrality in the International Taxation of Capital”, (1988) 26:2 *Osgoode Hall LJ* 367-408; Tamara Larre, “Taxing Personal Injury Damages: Tax Policy Analysis from the Canadian Perspective”, (2010) 58:3 *Can Tax J* 577 at 587 refers to these three concepts as the “traditional criteria”; David Duff, “Recognizing or Disregarding Close Personal Relationships Among Adults? The Report of the Law Commission of Canada and the Federal Income Tax”, (2002) 50:3 *Can Tax J* 1021 at 1023, Duff refers to them as the “technical tax policy criteria”.

grouping, it is apparent that there is a considerable overlap among the principles for taxation provided in these references and among other tax literature in general. However, if the number of times the principles relating to equity, neutrality, certainty, convenience, economy are quoted is any guide, one can reasonably conclude that adherence to these principles influence, to a large extent, the realisation of the objectives of a good tax system.

In terms of equity, the Carter Commission considered the equitable distribution of the burden of taxation as the primary objective of the tax system.<sup>7</sup> An equitable distribution of tax burdens is one that shows some degree of progressivity with respect to income such that taxpayers with higher incomes pay more taxes in proportion to their income.<sup>8</sup> That is, the burden of taxation in a tax system should be equally distributed among taxpayers.<sup>9</sup> According to Adam Smith, tax liability should be proportionate to a taxpayer's income so that there is *equality of sacrifice* among the taxpayers. Smith states that "[t]he subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."<sup>10</sup>

Conceptually, there are two basic principles that can be used to determine how equitably tax systems perform.<sup>11</sup> The first is the principle of horizontal equity and the second is vertical equity.<sup>12</sup> Horizontal equity simply states that taxpayers with the same income should pay equal taxes.<sup>13</sup> That is, taxpayers with *equal income status* should pay the same amount of taxes.<sup>14</sup> On the other

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<sup>7</sup> Carter Commission, Vol 2, *supra* note 4 at 17; Alley & Bentley, *supra* note 2 at 600.

<sup>8</sup> Jorge Martinez-Vazquez, "Mexico: An Evaluation of the Main Features of the Tax System", online: (2001) Int'l Center for Pub Pol'y <<https://ideas.repec.org>> [Martinez - Vazquez].

<sup>9</sup> Smith, *supra* note 1.

<sup>10</sup> *Ibid* at 825.

<sup>11</sup> Carter Commission, Vol 1, *supra* note 4 at 4-5; Martinez-Vazquez, *supra* note 8.

<sup>12</sup> Carter Commission, *ibid*.

<sup>13</sup> Carter Commission, *ibid* at 4.

<sup>14</sup> Joseph J Thorndike & Dennis J Ventry, eds *Tax Justice: The Ongoing Debate* (Washington D.C, United States: The Urban Institute, 2002) at 258 [Thorndike & Ventry]; Alvin Rabushka & Niels Veldhuis, "A Flat Tax for Canada", online: (2007) Fraser Institute at 148 <[www.fraserinstitute.org](http://www.fraserinstitute.org)>; Jane G Gravelle & Sean Lowry, "Restrictions on Itemized Tax Deductions: Policy Options and Analysis", online: (2013) at 36-7 <<http://graphics8.nytimes.com>>. Assuming equal status is defined by income, then, horizontal equity has been achieved when taxpayers with the same "before-tax income" also have the same "after-tax income". However, it has been noted that horizontal equity may be compromised due to the existence of tax breaks such as deductions and incentives which could result in similar taxpayers having different tax liabilities. For instance, similar companies may have different tax liability if one engages in research and development and takes advantage of applicable research and development tax credits. Thus, allowing certain deductions or giving certain incentives by the government can result in a difference in tax payments between two taxpayers who may otherwise be considered economically similar. However, these deductions and incentives are not necessarily problematic if they are tools used to achieve certain government policy objectives.

hand, vertical equity states that tax liability of taxpayers in a good tax system should increase when income increases and decrease when income decreases.<sup>15</sup> This vertical distribution of tax burdens can be progressive, regressive, or proportional in nature with respect to the income of the taxpayer.<sup>16</sup> While the index used to measure the concept of “equality” or “inequality” of horizontal and vertical equity has been a subject of debate in several literature, such debate is beyond the scope of this thesis.<sup>17</sup> However, it is important to note that these concepts of vertical and horizontal equity are not mutually exclusive.<sup>18</sup> The two concepts are inextricably linked because “[v]ertical equity ... cannot be defined without horizontal equity norms, as it must deal with differential treatment of people who, to begin with, have been grouped on horizontal equity grounds.”<sup>19</sup>

The criterion of neutrality is closely related to the principle of equity discussed above. Neutrality of the tax system means that, “taxes should avoid distorting the workings of market mechanisms”.<sup>20</sup> Basically, the criterion suggests that the tax system should strive to be neutral so that decisions are generally made on their economic merits and not necessarily for tax reasons.<sup>21</sup> However, there are instances (as will be discussed in the next section) where departure from the principle of neutrality in the tax system is inevitable and intentional for the purpose of achieving government objectives.<sup>22</sup> For instance, the government may deliberately create distortion by taxing

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<sup>15</sup> Carter Commission, Vol 1, *supra* note 4 at 4-5; Martinez-Vazquez, *supra* note 8.

<sup>16</sup> Martinez-Vazquez *ibid*; For classification of vertical equity under proportional, progressive and regressive, see Paul R McDaniel & James R Repetti, “Horizontal and vertical equity: the Musgrave/Kaplow Exchange” (1992) 1 Fla Tax Rev 607 at 610 [Musgrave/Kaplow]. A taxpayer’s tax burden is proportional when the taxpayer’s liability increases directly with income. For instance, a 10% increase in the taxpayer’s earnings will result in a 10% increase in tax liability. On the other hand, tax burdens are regressive when tax rates decrease as the income of the taxpayer decreases. For instance, a 10% decrease in the taxpayer’s earnings will result in a 10% decrease in tax liability. A taxpayer’s burden is considered progressive when the tax system adopts tax brackets such that taxpayers pay taxes based on the tax bracket into which their income places them. Each tax bracket will have a different tax rate, with higher income brackets paying the highest percentages or rate of tax.

<sup>17</sup> Musgrave/Kaplow, *ibid*; Thorndike & Ventry, *supra* note 14; Marcus C Berliant & Robert P Strauss *Horizontal Equity, Uncertainty and Economic Well-being* (London: University of Chicago Press, 1985) at 179-214; Musgrave A Richard, “Et, Ot and Sbt” (1976) 6:1 J Pub Econ 3 at 3-16 [Musgrave].

<sup>18</sup> Thorndike & Ventry, *supra* note 14 at 9; Musgrave/Kaplow *supra* note 16 at 608.

<sup>19</sup> Musgrave, *supra* note 17 at 4.

<sup>20</sup> Neil Brooks, “The Changing Structure of the Canadian Tax System: Accommodating the Rich” (1993) 31:1 Osgoode Hall Rev 138 at 184 [Brooks].

<sup>21</sup> For instance, in a good tax system, taxpayers would choose between regular milk and skimmed milk based on their personal preferences and the cost of these dairy products. If legislators impose a tax on regular milk but not on skimmed milk, there is a high probability that people would factor the additional cost implication of the taxes into their choice about which type of milk to consume. This may result in such consumers opting for a less desirable type of milk because it was cheaper. In this case, it means that the tax system may have influenced the decisions of consumers of such dairy products.

<sup>22</sup> United Kingdom, Parliament of United Kingdom, “Principles of tax policy”, Parliament of UK website, (15 March 2011) online: < <http://www.publications.parliament.uk> > [UK, *Principles*].



polluting industries more heavily than other industries in order to correct certain behaviours.<sup>23</sup> Consequently, the practical implication of the principle of neutrality is that the only distortions in the tax system should be a conscious and intentional act of the government.

In addition to equal distribution of the tax burden and avoiding distortions, the criterion of certainty simply asserts that the imposition of taxes ought to be definite and not arbitrary such that taxpayers have sufficient information on their rights and obligations, under the relevant tax law.<sup>24</sup> According to Smith, “[t]he tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.”<sup>25</sup> This need for certainty in the tax system was echoed in the Carter Commission report which stated that the “taxpayer should be able to determine promptly, *with great certainty* and at modest cost, the tax consequences of a proposed course of action before making a decision”.<sup>26</sup> This means that in a good tax system, the scope of taxes should be clear and the taxpayers must be able to determine the exact amount they ought to pay as well as the time and method for payment. In addition, the certainty of taxes reduces the possibility of exploitation of the tax system by both the taxpayer and the government.<sup>27</sup>

The criterion of certainty is a crucial attribute of a tax system and is sometimes considered in the same context as the concept of stability while evaluating the cornerstones of a good tax system.<sup>28</sup> This is because a tax system that is certain is most likely also considered stable. The stability of the tax system directly affects the confidence of investors in government policy, particularly in the petroleum industry where long-term projects are the norm.<sup>29</sup> Likewise, a tax system that changes frequently or changes in an unpredictable manner may seriously affect future development projects in the industry. It has been argued that a tax system that is subject to frequent changes “tends to increase political risk and reduce the value placed by investors on future income

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<sup>23</sup> UK, Principles, *ibid*.

<sup>24</sup> Smith, *supra* note 1 at 825-26.

<sup>25</sup> *Ibid*.

<sup>26</sup> Carter Commission, Vol 2, *supra* note 4 at 14 [emphasis added].

<sup>27</sup> SN Chand, *Public Finance*, Vol 1 (New Delhi: Atlantic Publishers & Distributors (P) Ltd, 2008) at 100. Chand states that the certainty of taxes ensures that the taxing authority cannot exploit the taxpayer.

<sup>28</sup> Carole Nakhle, *Petroleum Taxation: Sharing the Oil Wealth: A Study of Petroleum Taxation Yesterday, Today and Tomorrow* (New York: Routledge, 2008) at 13-14 [Nakhle]; Association of Chartered Certified Accountants, “Certainty in Tax”, ACCA website, online: <<http://www.accaglobal.com>> at 1.

<sup>29</sup> Nakhle, *ibid*.

streams.”<sup>30</sup> Thus, a stable tax system results in the reduction or elimination of a risk factor as the certainty and stability of the tax system gives existing and prospective investors one less variable to worry about.

The canon of convenience considers the interest of the taxpayer with respect to tax compliance. The mode and timings of tax payment in a good tax system should be convenient to the taxpayer. According to Smith, “[e]very tax ought to be levied at the time, or in the manner in which it is most likely to be convenient for the contributor to pay it.”<sup>31</sup> Thus, this canon suggests that payment of taxes should not be structured in a manner that will cause unnecessary hardship to the taxpayers. For instance, tax liability on rental income should be payable at the time the taxpayer is expected to receive the rental income.<sup>32</sup>

The canon of economy implies that the administrative costs of tax collection should be kept at a minimum level. Smith stresses that, “[e]very tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state.”<sup>33</sup> This suggests that tax administration and compliance should be cost-effective for both the government and taxpayers. This principle is closely related to the principle of certainty because uncertainties or complexities in tax laws could increase the compliance costs for taxpayers in the determination of their tax liability. In the same vein, uncertainties in the tax system could also increase the cost of tax administration for the government with respect to the verification of amounts stated by the taxpayer.

#### **4.1 The Concept of Tax Expenditures**

While a good tax system should substantially conform to the above canons of taxation, there are circumstances where deviation from such principles are necessary for the purpose of achieving some government policy objectives.<sup>34</sup> Brooks rightly notes that, “[p]resumably, most people would agree that the fairest, most neutral, and simplest tax system would be no tax system at all”.<sup>35</sup>

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<sup>30</sup> *Ibid.*

<sup>31</sup> Smith, *supra* note 1 at 826.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid* at 827.

<sup>34</sup> Eric J Toder, Bernard Wasow & Michael P Ettlinger, *Bad Breaks All Around: The Report of the Century Foundation Working Group on Tax Expenditures* (New York: The Century Foundation Press, 2002) at 35 [Toder, Wasow & Ettlinger].

<sup>35</sup> Brooks, *supra* note 20 at 180.

This is because the tax system is an instrument for achieving certain social and economic policy objectives in addition to its principal function of revenue generation.<sup>36</sup> As mentioned in the preceding section, these social and economic policy objectives are realised through the tax system by applying preferential tax treatments which are designed to favour certain industries, activities or categories of persons.<sup>37</sup> According to Surrey, these preferential tax measures could be in different forms such as “permanent exclusions from income, deductions, deferrals of tax liabilities, credits against tax, or special rates.”<sup>38</sup> Such measures are often described as tax subsidies, tax incentives or tax expenditures (TEs).<sup>39</sup> This is because the objectives of such policies are achieved at the cost of *lower tax revenue* to the government.<sup>40</sup> Thus, the term “expenditure” is premised on the fact that the opportunity cost of using the tax system as a public policy tool is the revenue forgone by the government.<sup>41</sup>

As pointed out in preceding paragraphs, consistent conformity with the aforementioned principles of taxation is impossible and policymakers have to accept a certain level of distortion as inevitable. This is because conformity with certain canons of taxation may be undesirable if policymakers intend to promote specific objectives or goals like encouraging charitable contributions or other activities that aim to promote the welfare of the society. Examining ways that the tax system approaches or departs from these canons can be a helpful lens for arriving at balanced solutions to the range of tax policy and economic problems identified in Nigeria’s petroleum sector.

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<sup>36</sup>See generally, Mark Horton & Asmaa El-Ganainy, “Fiscal Policy: Taking and Giving Away”, online: (2012) International Monetary Fund Publication <<http://www.imf.org>> at 2; Leonard E Burman, “Is the Tax Expenditure Concept Still Relevant?” (2003) 56:3 Nat’l Tax J 613 at 613.

<sup>37</sup> Stanley S Surrey & Paul R McDaniell, *Tax Expenditures* (Cambridge, MA: Harvard University Press, 1985) at 3 [Surrey, Tax Exp].

<sup>38</sup> Surrey, Tax Exp, *ibid* at 3. See also, Toder, Wasow & Ettlinger *supra* note 34 at 37.

<sup>39</sup> Surrey, Tax Exp, *ibid* at 27; B Anderson, “Tax Expenditures in OECD Countries” (*PowerPoint presentation delivered at the Asian Senior Budget Officials meeting*, January 2008) at 10-11 [Anderson].

<sup>40</sup> OECD, *Choosing a Broad Base - Low Rate Approach to Taxation*, Tax Policy Studies No. 19, (Paris: OECD, 2010) [OECD, Choosing].

<sup>41</sup> OECD Choosing, *ibid* at 76.

#### 4.1.1 Positive Aspects of Tax Expenditures as a Tool for Law Reform

The use of the tax system as a tool for achieving social and economic objectives as opposed to alternative policy tools<sup>42</sup> has been a topic of debate in economic and tax scholarship.<sup>43</sup> Some scholars have stated that using the tax system is advantageous because (i) it is more administratively efficient and cost-effective for achieving government objectives;<sup>44</sup> (ii) it limits the probability for abuse or fraud;<sup>45</sup> and (iii) it promotes private decision making as opposed to government decision making.<sup>46</sup>

In terms of administrative efficiency, the Organisation for Economic Co-operation and Development (OECD) noted that, “where relevant information is already reported by the taxpayer through the tax system, that information can be used at *lower marginal administrative cost* than through duplicated reporting to a spending agency”.<sup>47</sup> In terms of limited probability for abuse or fraud, it has also been argued that TEs maximize access to the eligible beneficiaries and minimize potential fraud in the achieving policy objectives.<sup>48</sup> Some have also noted that the availability of existing information in the tax system helps in confirming eligibility as opposed to other verification mechanisms of direct spending programs.<sup>49</sup> Another argument in favour of TEs as an approach for achieving government objectives is that it is less prescriptive than government

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<sup>42</sup> These tools can be in form of direct spending programs which can be structured as direct government grants, subsidies, loans, etc. See Surrey, Tax Exp, *supra* note 37 at 3; Stanley S Surrey, *Pathways to Tax Reform: The concept of Tax Expenditures* (Cambridge, MA: Harvard University Press, 1973) at 129 [Surrey, Pathways]; they could also be in form of regulations, see United States, Government Accountability Office, “Tax Expenditures: Background and Evaluation Criteria and Questions”, (January 8 2013) online: <<http://www.gao.gov>>

<sup>43</sup> See generally, Lisa Phillips, Neil Brooks & Jinjay Li eds, *Tax Expenditures: State of the Art: Selected Proceedings of the Osgoode 2009 Conference on Tax Expenditures and Public Policy in Comparative Perspective* (Toronto, Ont: Canadian Tax Foundation, 2009); Surrey Pathways, *supra* note 42 at 129-54; Canada, Office of the Parliamentary Budget Officer, “Federal Tax Expenditures: Use, Reporting and Review” by Jacques Jason (2011), online: <<http://www.pbo-dpb.gc.ca>> [Jacques]; Toder, Wasow & Ettlinger, *supra* note 34 at 37; Hanna Polackova Bixi, Christian MA Valenduc & Zhicheng Li Swift *Tax Expenditures--Shedding Light on Government Spending through the Tax System: Lessons from Developed and Transition Economies* (Washington, DC: World Bank Publications, 2004) at 3-6 [Bixi, Valenduc & Swift].

<sup>44</sup> Jacques, *ibid* at 2; OECD, *Tax Expenditures in OECD Countries*, Budgeting and Public Expenditures, (Paris: OECD, 2010) at 24 [OECD 2010]; Anderson, *supra* note 39 at 8.

<sup>45</sup> OECD 2010, *ibid*; Toder, Wasow & Ettlinger, *supra* note 34 at 58 states that TE maximizes access and minimizes fraud.

<sup>46</sup> Bixi, Valenduc & Swift, *supra* note 43 at 3; Anderson, *supra* note 39. Anderson states that TE can provide a wide range of taxpayer choice, with limited bureaucratic interference.

<sup>47</sup> OECD 2010, *supra* note 44 at 24-31 [emphasis added]; Jacques, *supra* note 43 at 2; Bixi, Valenduc & Swift, *supra* note 43 at 59 states that “tax incentives are a preferable means of subsidy if eligibility criteria are linked to data already reported on tax returns”.

<sup>48</sup> Bixi, Valenduc & Swift, *supra* note 43 at 58; OECD 2010, *supra* note 44 at 25

<sup>49</sup> Bixi, Valenduc & Swift, *ibid*; OECD 2010, *ibid*.

programs because it accommodates individual preferences especially in relation to specific economic and social goals.<sup>50</sup> Perhaps this is why the OECD stated that “there are conditions under which tax expenditures are most likely to be successful, or even the best, policy tools to achieve [government] objectives”.<sup>51</sup>

#### **4.1.1.1 Unfavourable Aspects of Tax Expenditures as a Tool for Law Reform**

Despite the positive aspects mentioned above, there are some unfavourable aspects of using the tax system as a tool of public policy.<sup>52</sup> For instance, some scholars have countered that using TEs can increase tax administrative and compliance costs.<sup>53</sup> Specifically, the report of the Century Foundation Working Group on Tax Expenditures<sup>54</sup> argued that TEs make the tax laws complex because they require “numerous distinctions” with respect to qualifying activities or taxpayers.<sup>55</sup> The group found that such complexity in the tax laws not only raises compliance costs for taxpayers but also makes it more difficult and costly for the tax authorities to administer tax laws.<sup>56</sup> Similarly, some scholars have also stated that TEs reduce the fairness of the tax system because they are usually regressive in nature.<sup>57</sup> Others have also noted that the reason why TEs are politically attractive alternative is because they are not subject to regular scrutiny<sup>58</sup> and are difficult to estimate as opposed to direct spending programs.<sup>59</sup> As a result of the conflict between these arguments and the arguments in favour of TEs identified above, it is instructive that a legal reformer explores established framework for verifying whether the tax system is the best approach for achieving the intended policy objectives.

#### **4.1.2 Methods of Evaluating Tax Expenditures**

Perhaps, the major conclusion that can be drawn from the benefits and drawbacks of TEs discussed above is that there are conditions under which TEs are the best policy tool and others where TEs

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<sup>50</sup> OECD 2010, *ibid* at 25.

<sup>51</sup> *Ibid* at 24.

<sup>52</sup> See generally, Toder, Wasow & Ettlinger, *supra* note 34 at 12; OECD Choosing, *supra* note 40 at 75; Jacques, *supra* note 43.

<sup>53</sup> For increased administrative and compliance costs, see OECD Choosing, *ibid* at 76.

<sup>54</sup> Toder, Wasow & Ettlinger, *supra* note 34 at page 12.

<sup>55</sup> *Ibid*.

<sup>56</sup> *Ibid*. It was also stated that despite the possibility of using tax software by taxpayers, the multiplicity of the special provisions makes it more difficult for taxpayers to understand how their tax liability have been computed.

<sup>57</sup> Toder, Wasow & Ettlinger, *supra* note 34 at 12; fairness is also cited in OECD 2010, *supra* note 44 at 25-6.

<sup>58</sup> Anderson, *supra* note 39 at 8; Bixi, Valenduc & Swift, *supra* note 43 at 2.

<sup>59</sup> Anderson, *ibid*; OECD 2010, *supra* note 44 at 27.

are the least viable tool for achieving government objectives. Thus, for effective utilization of TEs, there is a need to assess program objectives on a case-by-case basis.<sup>60</sup> A 2014 European Commission report on the use of TE in European Union (EU) member states suggests that an evaluation of the efficiency of TEs requires identifying different policy areas and assessing “how tax expenditures could – or not – help meet given economic objectives in these areas.”<sup>61</sup> Since this thesis contemplates implementing the proposed reforms through the tax system, it is particularly important to evaluate the propriety of using TEs for petroleum sector reform in Nigeria.

Due to the fact that the parameters for appraising TEs are numerous and multidimensional, the task of evaluating TEs is a very challenging one.<sup>62</sup> According to the OECD, the “evaluation of tax expenditures may be difficult, but a more serious problem may be the failure to try.”<sup>63</sup> The OECD suggests that a thorough assessment of TEs should consider its efficacy, effectiveness, distributional impact as well as its compliance and administrative costs in relation to possible policy alternatives that could achieve the same social and economic objectives.<sup>64</sup> The OECD classified the framework for evaluating TEs into two broad categories – ex-ante assessments and ex-post evaluations.<sup>65</sup> The ex-ante assessment is described as the evaluation that takes place *before* the introduction of a TE while the ex-post evaluation is conducted *after* the TE has been in operation for a number of years.<sup>66</sup> These two categories involve the evaluation of TE in terms of various parameters including, but not limited to, the revenue costs or value of the TE to the government,<sup>67</sup> its performance in terms of meeting policy objectives,<sup>68</sup> and its economic relevance.<sup>69</sup>

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<sup>60</sup> Toder, Wasow & Ettlinger *supra* note 34 at 66; David A Weisbach & Jacob Nussim, “The Integration of Tax and Spending Programs”, (2003) 113 Yale LJ 955 at 961 [Weisbach & Nussim].

<sup>61</sup> A A Kalyva et al, “Tax Expenditure in Direct Taxation in EU Member States”, (2014) European Economy Occasional Papers 207, Brussels, online: < [http://ec.europa.eu/economy\\_finance](http://ec.europa.eu/economy_finance) > at 17 [EU Member].

<sup>62</sup> EU Member, *ibid* at 12; Bixi, Valenduc & Swift, *supra* note 43 at ch 2; OECD Choosing, *supra* note 40 at chp 3; Toder, Wasow & Ettlinger, *supra* note 34 at 60.

<sup>63</sup> OECD 2010, *supra* note 44 at 29.

<sup>64</sup> OECD Choosing, *supra* note 40 at 92.

<sup>65</sup> *Ibid* at chp 3.

<sup>66</sup> *Ibid* at 76; Ireland, Department of Finance, “Report on Tax Expenditure with Guidelines: Incorporating Department of Finance Guidelines for Tax Expenditure”, (October 2014) online :< <http://www.budget.gov.ie> > at chp 3 [Ireland].

<sup>67</sup> In this regard, the OECD suggests (i) the revenue forgone method, (ii) the revenue gain method and (iii) the outlay equivalence method. See generally, EU Member states, *supra* note 61 at 12; Bixi, Valenduc & Swift, *supra* note 43 at 7; OECD Choosing, *supra* note 40 at chp 3.

<sup>68</sup> Bixi, Valenduc & Swift, *supra* note 43 at ch 2.

<sup>69</sup> EU Member states, *supra* note 61 at 3.

The ex-ante assessments and ex-post evaluations conducted in this thesis draws on the key evaluation questions suggested in the recent guidelines developed by the Ireland Department of Finance.<sup>70</sup> Given the numerous methods available for TE evaluation, the Irish Department of Finance (like other scholars) recognized the challenges in finding a comprehensive framework for such exercise and sought to fill this gap in literature by developing a concise framework in terms of key evaluation questions to be asked during the ex-ante and ex-post process of evaluation.<sup>71</sup> These guidelines were developed based on a review of several economic literature on tax expenditures as well an analysis of international approaches to tax expenditure evaluation.<sup>72</sup> Since these guidelines also draw on the OECD's parameters for evaluation of tax expenditures in different countries including Canada, United States and Germany, the guidelines provide a robust and comprehensive criteria for evaluating TEs.<sup>73</sup> While a detailed assessment on all possible dimensions of TE evaluation is beyond the scope of this thesis, this thesis explores the major elements of the ex-ante and ex-post evaluation methods.

#### **4.1.2.1 Ex-ante Assessment**

The ex-ante assessment considers whether or not to introduce a new TE into a tax system and focuses on the rationale behind the government's intervention in a particular area of public policy, the planning of the policy as well as the design of the policy.<sup>74</sup> Thus, this assessment is a very useful tool for evaluating Canadian fiscal measures before they are introduced into the Nigerian legal system. According to the OECD, the ex-ante assessment involves three stages. The first stage relates to examining the need which the new TE intends to address and the suitability of using the tax system for that particular objective. The second stage deals with identifying and setting the objectives of the proposed TE. The last stage relates to appraising the use of the tax system as the tool for achieving the objectives against other alternative policy options.<sup>75</sup>

In order to address the above considerations, there are five (5) major areas which should be assessed before the introduction of a new TE.<sup>76</sup> These areas relate to the objective of the TE, the

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<sup>70</sup> Ireland, *supra* note 66 at 8.

<sup>71</sup> *Ibid* at 2

<sup>72</sup> *Ibid*.

<sup>73</sup> *Ibid* at 30-5.

<sup>74</sup> Ireland, *ibid*; OECD Choosing, *supra* note 40 at 76.

<sup>75</sup> OECD Choosing, *ibid* at 76-7.

<sup>76</sup> Ireland, *supra* note 66 at 8-10.

market failure the TE proposes to address, the efficacy of the TE in achieving the policy objectives, the likely economic impact of the TE as well as the expected cost of the TE.<sup>77</sup> These are discussed further in the subsequent paragraphs.

***i. What objective does the TE aim to achieve?***

Prior to introduction of a TE, the desired outputs, outcomes and possible targets which the government intends to address through the tax system should be very clear.<sup>78</sup> For instance, the objective of the proposed TE can be to increase research and development in the oil and gas industry or to assist the small and medium scale enterprises in the oil and gas sector. Ideally, the objectives of a TE should be “specific, measurable, achievable, relevant and time-bound (SMART)”.<sup>79</sup> This is because such objective(s) provide a benchmark with which to assess the proposed TE after its implementation. These objectives are also instrumental for identifying the alternative policy options that may be available to the government to deliver the policy objectives.<sup>80</sup> The failure to identify clear objectives at this introductory stage makes it difficult to describe, examine and assess the consistency of the proposed policy with other government policies.<sup>81</sup>

***ii. What market failure is being addressed?***

In addition to identifying the objectives of the proposed TE, it is also necessary to justify the government’s intervention in relation to the policy objective.<sup>82</sup> In other words the ex-ante assessment should examine: (i) whether there is a need for government intervention in the area of the proposed policy<sup>83</sup> and (ii) why and how a tax break would address that need.<sup>84</sup> Thus, an ex-ante assessment must confirm that the proposed TE addresses an actual need which is consistent with the government’s policy priorities.<sup>85</sup>

***iii. Is a TE the best approach to address the market failure?***

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<sup>77</sup> *Ibid* at 8-9.

<sup>78</sup> OECD Choosing, *supra* note 40 at 76

<sup>79</sup> *Ibid.*

<sup>80</sup> *Ibid.*

<sup>81</sup> Ireland, *supra* note 66 at 8.

<sup>82</sup> *Ibid.*

<sup>83</sup> OECD Choosing, *supra* note 40 at 76.

<sup>84</sup> *Ibid.*

<sup>85</sup> Brixi, Valenduc & Swift, *supra* note 43 at 19.



Even though the existence of a market failure could provide a strong justification for the government's intervention in the area of the proposed policy, it does not imply that the tax system is the most efficient means to remedy the market failure.<sup>86</sup> This is because there could be other alternative policy options available to the government for addressing the market failure.<sup>87</sup> Thus, the ex-ante assessment must consider whether a TE is the *most appropriate* method of government intervention.<sup>88</sup> This can be done by comparing the benefits and limitations of TEs with alternative delivery options.<sup>89</sup> The comparison can be done in terms of accessibility of the proposed TE to beneficiaries, administrative cost of implementing the policy as well as the similarity of the TE with existing policy intervention in order to avoid duplication of policy measures.<sup>90</sup>

**iv.      *What economic impact is the TE likely to have?***

Upon identifying the objective(s), the market failure and the suitability of the proposed TE, it is important to assess the expected impact of the TE.<sup>91</sup> This can be done by looking at the *design* of the TE in terms of meeting the policy objectives as well as the influence the TE will have on connected sectors of the economy.<sup>92</sup> Such an evaluation can be conducted by drawing on the result of impact assessments conducted on similar (existing) TEs within or outside the jurisdiction in which the proposed policy is to be implemented.<sup>93</sup> This stage of the ex-ante assessment should also “set out criteria against which the impact and efficiency of the scheme will be evaluated at the ex-post stage.”<sup>94</sup> This is particularly important so that arrangements for the collection of the necessary data that will be used in the ex-post stage can be put in place at the introductory stage of the TE program.<sup>95</sup>

**v.        *How much is the TE expected to cost?***

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<sup>86</sup> Ireland, *supra* note 66 at 9.

<sup>87</sup> *Supra* note 42.

<sup>88</sup> Ireland, *supra* note 66 at 9.

<sup>89</sup> *Ibid.*

<sup>90</sup> *Ibid.*

<sup>91</sup> *Ibid* at 11.

<sup>92</sup> *Ibid.*

<sup>93</sup> *Ibid.*

<sup>94</sup> *Ibid.*

<sup>95</sup> *Ibid.*

An ex-ante assessment should also examine the opportunity cost of implementing the policy through the tax system.<sup>96</sup> According to the OECD, the “revenue foregone” method is the most practical approach for estimating the expected costs of the proposed TE.<sup>97</sup> This revenue forgone method considers the cost of the TE in monetary terms.<sup>98</sup> The calculation in monetary terms is based on the assumption that the behaviour and revenues from other taxes remain constant.<sup>99</sup> Even though the calculation fails to acknowledge the behavioural aspects of the tax incentive and any likely interactions the TEs may have with other TEs, it provides an *estimate* of the revenue lost or voluntarily waived by the government as a result of departure from the normal system of taxation.<sup>100</sup> However, a cost-analysis of tax measures that will be proposed in this thesis is a highly specific exercise which is beyond the scope of this thesis. Thus, the thesis would place more reliance on first four questions in evaluating the suitability of the proposed tax measures in Nigeria’s legal system.

#### **4.1.2.2 Ex-post Evaluation**

As earlier mentioned, ex-post evaluations are the assessments that review the efficacy of an existing TE.<sup>101</sup> These ex-post evaluations are conducted after a particular TE has been in operation for a number of years.<sup>102</sup> This thesis uses the ex-post evaluation to assess (existing) Canadian measures in order to determine their efficacy within Canada’s legal system before transplanting to Nigeria. The primary focus of the ex-post evaluation is to assess the impact and continuing relevance (or otherwise) of the TE.<sup>103</sup> A major connection between the ex-post and ex-ante evaluations is that “the more effort that went into the ex-ante evaluation in terms of identifying methods for the ex-post evaluation and setting up the necessary data collection processes, the easier it will be to undertake the ex-post evaluation.”<sup>104</sup> Therefore, an ex-post analysis is less complicated where the necessary ex-post evaluation framework was considered during the ex-ante assessment of the TE.

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<sup>96</sup> *Ibid.*

<sup>97</sup> *Ibid.*

<sup>98</sup> *Ibid* at 18.

<sup>99</sup> *Ibid* at 11.

<sup>100</sup> *Ibid.*

<sup>101</sup> OECD Choosing, *supra* note 40 at 76.

<sup>102</sup> Ireland, *supra* note 66 at 12.

<sup>103</sup> *Ibid.*

<sup>104</sup> *Ibid.*

There are four (4) key themes in the review of the existing TEs under the ex-post assessment.<sup>105</sup> These themes are relevance, cost, impact and efficiency of the TEs.<sup>106</sup> Similar to the ex-ante assessment, the Irish report also came up with questions that are instrumental in conducting an ex-post evaluation of TEs in Canada's oil and gas tax system.<sup>107</sup>

**i. *Is the TE still relevant?***

An ex-post evaluation provides an opportunity to assess the consistency of the TE with government policy priorities to determine if the TE *realistically* addresses an actual need.<sup>108</sup> One of the steps in evaluating the continued relevance of a TE entails looking at the primary objective(s) of the TE and taking into account the social and economic conditions or current policy priorities of the government.<sup>109</sup> Such primary objectives of the TEs are usually set out in policy documents including budget papers, news releases or minutes of legislative committee meetings and debates etc.<sup>110</sup> Evaluating these objectives is instrumental for verifying whether the TE remains valid given changes in the economy, relevant market, industry or the government's policy priorities, since the introduction of the TE.<sup>111</sup>

In addition to the above, an ex-post assessment may also consider other policy interventions such as direct expenditures or regulations that may have been initiated since the inception of the particular TE that is being reviewed.<sup>112</sup> This is because the existence of alternatives that address the policy objectives of the TE under review could call into question the need for the scheme.<sup>113</sup> Thus, the changes in the external environment of a TE should also be taken into account in assessing the continued relevance of such expenditure.<sup>114</sup>

**ii. *How much did the TE cost?***

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<sup>105</sup> *Ibid* at 12-14.

<sup>106</sup> *Ibid.*

<sup>107</sup> *Ibid.*

<sup>108</sup> Brixi, Valenduc & Swift, *supra* note 43 at 19.

<sup>109</sup> *Ibid* at 20.

<sup>110</sup> *Ibid.*

<sup>111</sup> Ireland, *supra* note 66 at 12.

<sup>112</sup> *Ibid.*

<sup>113</sup> *Ibid.*

<sup>114</sup> *Ibid.*

According to the OECD, there are three methods for calculating costs associated with TEs namely, the revenue forgone method, the revenue gain method and the outlay equivalence method.<sup>115</sup> The revenue forgone method estimates the cost of the TE in terms of the *monetary amount* the TE is recorded as costing to the government.<sup>116</sup> It calculates the loss in government revenue incurred, as a result of the TE *while holding all other factors constant*.<sup>117</sup> The cost of a particular tax credit using the revenue forgone method will be the actual monetary amount of the tax credit. For instance if the amount of a particular tax credit claimed is \$10, the cost of the tax credit to the government is also \$10 using the revenue forgone method. Therefore, a tax credit's estimated cost is the figure derived from the *actual take-up* of the expenditure.<sup>118</sup> With respect to a tax deduction the revenue forgone is dependent on the take up rate and the marginal tax rate of the taxpayer.<sup>119</sup> However, the assumption of unchanged behaviour and unchanged revenues from other taxes makes the revenue forgone method theoretically inadequate to provide an accurate cost estimation of a TE.<sup>120</sup> This is because the estimation "ignores the behavioural aspects of a tax incentive and ignores any possible interaction with other tax expenditures."<sup>121</sup>

Alternatively, the cost of TEs could be measured by the amount of the revenue gained when repealed.<sup>122</sup> This estimation method is called the final revenue loss (gain) method and it calculates the potential increase in tax revenue if certain TEs are discontinued.<sup>123</sup> Unlike the revenue forgone method, this method considers the behavioural effects arising from the discontinuation of such TE.<sup>124</sup> Specifically, it considers the behavioural effects on the taxpayers, the potential impact the discontinuance may have on the overall level of economic activity as well as the effects (of the discontinuance) on revenues from other taxes.<sup>125</sup> Thus, the method is expected to accurately reflect the amount of revenue that would be raised by the government if a TE is removed from the tax system.<sup>126</sup>

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<sup>115</sup> *Ibid* at 19; OECD Choosing, *supra* note 40 at 46.

<sup>116</sup> Ireland, *supra* note 66 at 18.

<sup>117</sup> OECD Choosing, *supra* note 40 at 46 [emphasis added].

<sup>118</sup> *Ibid*.

<sup>119</sup> *Ibid*.

<sup>120</sup> *Ibid*; Ireland, *supra* note 66 at 18.

<sup>121</sup> Ireland, *ibid*.

<sup>122</sup> Brixi, Valenduc & Swift, *supra* note 43 at 163.

<sup>123</sup> *Ibid* at 185.

<sup>124</sup> *Ibid*; Ireland, *supra* note 66 at 18.

<sup>125</sup> Brixi, Valenduc & Swift, *supra* note 43 at 163.

<sup>126</sup> Ireland, *supra* note 66 at 18.

The third estimation method, called the outlay equivalent method, attempts to estimate an existing TE based on the cost of a direct expenditure which would achieve the same policy objectives.<sup>127</sup> That is, it considers the cost of the TE in terms of the cost of delivering the same policy objectives outside the tax system.<sup>128</sup>

Despite the shortcomings of the revenue forgone approach discussed above, this estimation method is still considered the most attractive approach for many governments for practical reasons. This is because most governments consider the approach as a relatively simple estimation method that does not require the process of collecting individual or government behavioural responses.<sup>129</sup> Considering that Canada uses the revenue forgone approach,<sup>130</sup> the thesis will adopt this same approach for evaluating the relevant TEs in Canada's tax system. However, the thesis acknowledges the (aforementioned) limitations to the accuracy of the revenue forgone estimates in evaluating the selected Canadian tax measures.<sup>131</sup>

### *iii. What was the impact of the TE?*

Evaluating an existing TE also entails ascertaining the impact of the TE. The measure of the impact of a TE can be determined by “establishing whether a tax expenditure has been successful in changing behaviour, improving performance or increasing economic activity over what would otherwise have been the case.”<sup>132</sup> It is important to note that the impact of a TE is closely related (but not synonymous) with its effectiveness. For instance, if a research and development (R&D) tax credit in the petroleum industry has a very high take-up rate amongst R&D active companies then such tax credit could be described as an effective scheme but for the tax credit to have an economic *impact*, the tax credit should have *encouraged* previously non-R&D active companies

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<sup>127</sup> *Ibid.*

<sup>128</sup> OECD Choosing, *supra* note 40 at 47.

<sup>129</sup> *Ibid* at 46.

<sup>130</sup> See especially, Canada, Office of the Auditor General of Canada, “Report 3 - Tax-Based Expenditures” (Ottawa: Auditor General of Canada 2015) at 3; Canada, Department of Finance, “Archived - Tax Expenditures and Evaluations 2010” (Ottawa: Department of Finance 2010); Bixi, Valenduc & Swift, *supra* note 43 at 107; OECD 2010, *supra* note 44 at 77.

<sup>131</sup> That is, it acknowledges the failure to measure behavioural impact and the assumption that other tax expenditure provisions remain constant.

<sup>132</sup> Ireland, *supra* note 66 at 12.

to engage in R&D and for existing R&D active companies to have increased levels of R&D investment.<sup>133</sup>

However, identifying the impact of a TE can be challenging because the situation that would have prevailed in the absence of TE is unknown.<sup>134</sup> Even though the TE beneficiaries can be asked through surveys whether their behaviour or activity (relating to the policy objective) changed as a result of the TE, such information cannot always be relied upon.<sup>135</sup>

*iv. Was the TE efficient?*

The question of efficiency of a tax measure focuses on the manner in which resources are allocated in an economy.<sup>136</sup> A particular economy is said to be operating efficiently when “resources are fully employed and [are] producing as much output as possible.”<sup>137</sup> While a TE may have been successful in terms of meeting its objectives, the success has to be set against the costs of the TE to determine its efficiency.<sup>138</sup> The measure of the efficiency of a TE should also be compared to the potential efficiency of other policy alternatives available to the government.<sup>139</sup>

Given the nature of reforms contemplated in this thesis, it is imperative to evaluate the prospective Canadian measures in terms of the ex-post assessment before recommending such measures for petroleum sector reforms in Nigeria. Similarly, it is also beneficial to examine the prospective measures in light of ex-ante evaluation in order to assess the propriety of introducing such measures into Nigeria’s legal and tax system. Based on the foregoing, the next chapter puts the ex-ante and ex-post assessments into practical use by adopting these methods to evaluate the recommendations for the proposed transplants.

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<sup>133</sup> *Ibid* at 13.

<sup>134</sup> *Ibid*.

<sup>135</sup> *Ibid*.

<sup>136</sup> Brix, Valenduc & Swift, *supra* note 43 at 21.

<sup>137</sup> *Ibid*.

<sup>138</sup> Ireland, *supra* note 66 at 13.

<sup>139</sup> *Ibid* at 14.

## **CHAPTER FIVE**

### **PROPOSING RECOMMENDATIONS FOR NIGERIA'S PETROLEUM SECTOR REFORMS**

In the preceding chapters, this thesis identified the need for petroleum sector reforms in Nigeria and highlighted the role of the tax system in the reform agenda of Nigeria's oil and gas industry. In addition to justifying the preference for Canada's oil and gas tax system as a comparator, this thesis also presented the views of three major legal transplant theorists and argued that there can be successful transfer of laws between Nigeria and Canada. While the proposed recommendations in this thesis are not necessarily the only transplants that could be useful for Nigeria's petroleum sector reforms, these measures have been selected because the examination of all the possible recommendations or alternatives will be beyond the scope of this thesis. More importantly, these measures have been chosen because they appear to address the problem areas in Nigeria's petroleum industry and are wholly or partly absent in Nigeria's current petroleum tax system. While the thesis does not suggest that the proposed recommendations are self-sufficient in addressing Nigeria's oil and gas industry inefficiencies, the thesis argues that the proposed measures are useful in mitigating these inefficiencies and have the potential to ultimately improve certain aspects of oil and gas tax administration in Nigeria.

This chapter identifies five measures in Canada's oil and gas tax regime that have the potential to specifically address the industry inefficiencies in Nigeria's oil and gas industry. To increase the likelihood of success of the proposed transplants, this chapter draws on the aforementioned ex-ante and ex-post TE assessments for each of the proposed fiscal measures to determine their viability to address the previously identified problems in Nigeria's oil and gas industry. This chapter also recognizes the distinctions identified in 2.3 above so as to make the recommendations more suitable for Nigeria's tax and legal system.

Even though the proposed recommendations are modified to increase the prospects for success, it is particularly problematic and difficult to make exact or accurate projections of the fate of these transplants due to paucity or unavailability of necessary data.<sup>1</sup> However, one can reasonably

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<sup>1</sup> This lack of available data is partly due to non-existence of the required data and/or the aforementioned poor management of available tax data in Nigeria.

speculate from the ex-post and ex-ante assessments that the proposed recommendations would have a reformative effect on the petroleum industry if properly adapted into Nigeria's legal and tax system.

The choice of the fiscal and administrative recommendations provided in this chapter are informed by the aforementioned inefficiencies in Nigeria's petroleum industry. Specifically, this chapter looks at: (i) the Scientific Research and Experimental Development (SR&ED) tax credit to address the problem of recurrent fuel shortages and inadequate technology; (ii) the Clean Energy Generation Equipment – Accelerated Capital Cost Allowance to promote the use of cleaner technology and reduce the adverse effects of oil exploration activities; (iii) Pollution Tax to address environmental degradation and its consequent effects; (iv) Informants Lead Program to address the problem of tax evasion and aggressive tax avoidance; and (v) Mandatory Reporting Standards for the Extractive Sector to address the problem of lack of transparency and accountability in Nigeria's oil and gas sector. These fiscal and administrative recommendations are currently applicable to oil and gas corporations in Canada and have considerable potential for reforming Nigeria's oil and gas industry.

## **5.1. Fiscal Measures for Nigeria's Petroleum Sector Reforms**

Drawing on the framework for assessing TEs provided in chapter four above, this section evaluates the first three fiscal measures (SR&ED, the Clean Energy Generation Equipment - Accelerated Capital Cost Allowance and Pollution Tax) to highlight the benefits and drawbacks of these measures within the Canadian tax system in order to provide suitable modifications before introducing the measures into Nigeria. Specifically, this section conducts ex-post evaluation on the fiscal recommendations to assess the efficacy of these expenditures within Canada's tax system and determine the viability of these TE in Nigeria's tax system by using the ex-ante assessment.

### **5.1.1. Scientific Research and Experimental Development (SR&ED) Tax Credit**

The SR&ED is federal tax incentive that was initiated in 1985 with the aim of encouraging research and development in all sectors of the Canadian economy.<sup>2</sup> It is administered by the CRA

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<sup>2</sup> Canada Revenue Agency, "Scientific Research and Experimental Development Tax Incentive Program" (19 September 2014), online: Canada Revenue Agency < <http://www.cra-arc.gc.ca> >.



and applicable to all Canadian businesses regardless of business size.<sup>3</sup> The broad categories of works that are eligible for this credit include basic research, applied research and experimental development.<sup>4</sup> However, a vast majority of claims by businesses are for “experimental development”.<sup>5</sup> Experimental development is described under the ITA as “work undertaken for the purposes of achieving technological advancement for the purposes of creating new, or improving existing, materials, devices, products or processes, including incremental improvements thereto.”<sup>6</sup> Specifically, some expenses that will qualify for the SR&ED tax credit are salaries or wages of employees directly engaged in SR&ED activities, the cost of materials for SR&ED activities such as scrapped parts, prototypes consumed while performing SR&ED, lease costs (excluding building leases or rent) incurred solely for the performance of SR&ED as well as eligible SR&ED expenditures incurred by contractors or other third parties performing SR&ED directly on behalf of the taxpayer.<sup>7</sup>

The benefits for eligible SR&ED expenditures are two-fold as eligible SR&ED work can be treated as an income tax deduction and also as an investment tax credit.<sup>8</sup> As an income tax deduction, the SR&ED tax credit allows immediate expensing of all allowable expenditures while as an investment tax credit (ITC), it can be used to reduce federal income tax liability.<sup>9</sup> Even though a corporation can claim both the income tax deduction and the investment tax credit on the *same* SR&ED expenditures, there are some specific differences in the computing the two components of the tax incentive.<sup>10</sup>

In terms of tax treatment for the ITC aspect of the program, ITCs are calculated by multiplying the amount of qualifying expenditure by the specified percentage. The applicable ITC rate for tax years that end after 2013 is 15% on qualified SR&ED expenditure while 20% is the applicable

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<sup>3</sup> Canada Revenue Agency, “SR&ED Investment Tax Credit Policy” (18 December 2014), online: Canada Revenue Agency website, online: <<http://www.cra-arc.gc.ca>>.

<sup>4</sup> *Income Tax Act*, RSC 1985, c1, s 248 (1) (5<sup>th</sup> Supp) [ITA]; Canada Revenue Agency, “What work qualifies for SR&ED tax incentives?” (18 December 2012), online: <<http://www.cra-arc.gc.ca>>.

<sup>5</sup> CPA Canada, “Appealing an SR&ED claim”, online: (2011) <<http://www.camagazine.com>>.

<sup>6</sup> ITA, *supra* note 4, s 248(1).

<sup>7</sup> Canada, Finance Canada “Consultation Paper: Tax Incentives for Scientific Research and Experimental Development” (October 2007), online: <<http://www.fin.gc.ca>> [Finance Canada].

<sup>8</sup> *Ibid*; Canada Revenue Agency, “Claiming SR&ED Incentives”, (3 June 2014) Canada Revenue Agency website, online: <<http://www.cra-arc.gc.ca>>.

<sup>9</sup> Finance Canada, *supra* note 7 at 3.

<sup>10</sup> *Ibid*.

rate for tax years that end before 2014.<sup>11</sup> Small businesses that do not exhaust their ITC can get a refund of their balance.<sup>12</sup> For other businesses, the ITC can be carried backward for up to 3 years and forward for up to 20 years, while unused income tax deduction can be carried forward indefinitely.<sup>13</sup>

#### **5.1.1.1. Ex-Post Evaluation**

The ex-post evaluation of the SR&ED program in this section is based on the relevance, cost, impact and effectiveness of the program as discussed in the preceding sections of this thesis. According to Canada's Department of Finance 1983 paper entitled "*Research and Development Tax Policies*", the main objectives of the SR&ED tax incentive program are to (i) "encourage research and development by the private sector in Canada";<sup>14</sup> (ii) "promote research and development activities that conform to sound business practices";<sup>15</sup> (iii) "provide tax incentives for research and development that, as much as possible, are for immediate benefit to businesses";<sup>16</sup> and (iv) "provide tax incentives for research and development that are as simple to understand and comply with and as certain in application as possible".<sup>17</sup>

In recent times, it has been argued that the SR&ED program has "become overly complicated and is no longer delivering incentives in a predictable, timely and cost-effective manner."<sup>18</sup> It has also been noted that the scope of the eligible expenditures for the SR&ED had significantly narrowed and the program has become less suited for achieving its primary objectives.<sup>19</sup> Another argument that has been made with respect to the program is that the CRA's focus appears to be more on compliance in terms of "interpretive positions and operational practices – rather than delivering incentives".<sup>20</sup>

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<sup>11</sup> *Ibid.*

<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid.*

<sup>14</sup> Kenneth J Murray, "Scientific Research and Experimental Development: A Program in Crisis?" (1995) 43:5 Can Tax Found J 1265 at 1266-7 [Murray].

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid.*

<sup>18</sup> Canadian Chamber of Commerce, "The Scientific Research and Experimental Development (SR&ED) Tax Incentive Program: Policy Brief", (2011) by Canadian Chamber of Commerce, Ottawa, Canada at 9 [CCC]

<sup>19</sup> *Ibid.*

<sup>20</sup> *Ibid.*

Perhaps the most notable review of Canada's SR&ED program in recent times is contained in the report of the expert panel led by Thomas Jenkins in 2011.<sup>21</sup> This panel was set up by the Canadian government in an effort to assess the effectiveness of its research and development programs as well as make recommendations that will promote research and development in Canada.<sup>22</sup> With specific reference to the SR&ED program, some of the shortcomings the panel noted include: (i) the government's spending on the program is not effectively targeted because the focus of the program was too narrow<sup>23</sup> and (ii) the government pays the SR&ED tax-credit benefits on a wider range of expenditures (such as labour, materials, contracts, equipment and overhead) compared to most other countries;<sup>24</sup> (iii) the SR&ED program is complex and the complexity results in excessive compliance costs;<sup>25</sup> (iv) the qualification for the tax-credit is uncertain and firms having to resort to retaining consultants diminishes the intended benefit of the program.<sup>26</sup>

Given the aforementioned criticisms, one might reasonably question the usefulness or efficacy of the SR&ED program. While this thesis acknowledges the uncertainty, complexity and other criticisms of the SR&ED tax incentive, the thesis also notes that there is a widespread consensus that the SR&ED tax incentive program should be maintained. Some reports on the SR&ED program which have criticized the program maintain that the SR&ED program is valuable and important because it encourages businesses to be innovative.<sup>27</sup> For instance, the aforementioned expert panel led by Thomas Jenkins stated that "[d]uring our extensive consultations, we learned about many Canadian success stories and heard from numerous entrepreneurs who said that [these] federal programs have served them well."<sup>28</sup> Perhaps this is why, rather than suggesting the elimination of the program, the panel made the following recommendations that aim to promote the effectiveness of the SR&ED program in Canada: (i) creating an Industrial Research and Innovation Council (IRIC) to deliver the federal government's business innovation programs; (ii)

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<sup>21</sup> Canada, Public Works and Government Services Canada, "Innovation Canada: A Call to Action: Review of Federal Support to Research and Development", (Ottawa: Publishing and Depository Services, 2011) [Jenkins Report].

<sup>22</sup> *Ibid* at E-7.

<sup>23</sup> *Ibid* at 6-12.

<sup>24</sup> *Ibid* at 6-10.

<sup>25</sup> *Ibid* at 6-8.

<sup>26</sup> *Ibid*.

<sup>27</sup> CCC, *supra* note 18 at 11; Certified General Accountants, "The Certified General Accountants Association of Canada's Submission to the Department of Finance and the Canada Revenue Agency", (Discussion Paper dated October 2012) online: < <http://www.cga-canada.org> > at 8; John Visser, "Are You Leaving Money On The Table? Understanding the SR&ED Tax Credit" (14 April 2014), online: <<http://go.galegroup.com>> [Visser].

<sup>28</sup> Jenkins Report, *supra* note 21 at E-2.

simplifying the SR&ED program by basing the tax credit for small and medium-sized businesses on labour-related costs; (iii) making business innovation a core government procurement objective; (iv) transforming the institutes of the National Research Council into a series of large-scale, collaborative centers involving business, universities and the provinces; (v) helping high growth, innovative firms access the risk capital they need through the Business Development Bank of Canada; and (vi) establishing a clear federal voice for innovation and work with the provinces to improve co-ordination and impact of R&D programs.<sup>29</sup>

Moreover, there have been recent attempts by the CRA to address certain administrative inefficiencies that have had adverse effects on the take up of the program. In 2014, it was reported that the CRA had demonstrated “a renewed commitment to the longevity of the [SR&ED] program and as such, to promoting Canada as a world-leader in scientific innovation and technological advancement.”<sup>30</sup> Particularly, certain initiatives recently introduced by the CRA were noted to provide additional support for taxpayers in benefitting from the program.<sup>31</sup> Specifically, it was noted that the CRA provided “additional guidance around eligibility requirements via online resources and pilot projects to help identify opportunities to improve efficiencies of the program and predictability for claimants.”<sup>32</sup> In addition to the online resources provided by the CRA, the CRA also has an income tax rulings and interpretation procedure through which the Income Tax Rulings Directorate unit of the CRA can issue advance income tax rulings and technical interpretations on which taxpayers can rely.<sup>33</sup> Therefore, the incidence of uncertainty in terms of eligibility for the SR&ED program is substantially mitigated as interested taxpayers can request for tax rulings and technical interpretations and also have access to these resources to predict their eligibility for the program.<sup>34</sup>

Drawing on the discussion in chapter four, the determination of the cost-effectiveness of the SR&ED is dependent on whether the increase in SR&ED investment (attributable to the SR&ED ITC or deduction) exceeds the amount of tax revenue forgone by the government. Using the

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<sup>29</sup> *Ibid* at E-9 to E-13.

<sup>30</sup> Visser, *supra* note 27.

<sup>31</sup> *Ibid*.

<sup>32</sup> *Ibid*.

<sup>33</sup> Canada Revenue Agency, *Interpretation Circular* IC70-6R6, “Advance Income Tax Rulings and Technical Interpretations”, (29 August 2014), online: Canada Revenue Agency website, online: < <http://www.cra-arc.gc.ca> >.

<sup>34</sup> *Ibid* at para 12-8.

revenue forgone approach, a 2007 analysis noted that the program had a modest (but encouraging) return of “about 11 cents per dollar of revenue forgone.”<sup>35</sup> Furthermore, the program has also had significant impact on businesses. For instance, the SR&ED program was reported to have provided over \$3.6 billion in tax assistance to over 23,000 taxpayers in 2012 alone.<sup>36</sup> In 2014, Canadian Manufacturers and Exporters – a body that promotes the interests of manufacturing and exporting firms in Canada noted that “the low level of corporate spending in research and development (R&D) ... is not entirely unexpected given the significant cuts to the Scientific Research and Experimental Development (SR&ED) program in recent years”.<sup>37</sup> Thus, the reduction in the program which was followed by decline in research and development investment by corporations suggests that the program has considerable influence on corporate spending on research and development. In addition to the above, the Jenkins report also acknowledged the usefulness of the SR&ED program by stating that, “[t]he program lowers the cost of R&D for firms, promotes greater investment in R&D, and makes Canada a more attractive place to locate R&D activity.”<sup>38</sup>

#### **5.1.1.2. Ex-Ante Assessment**

In deciding whether or not to introduce a program like the SR&ED program into Nigeria, the OECD identified three stages of the ex-ante assessment namely, an examination of the *need* which the SR&ED program would address, the proposed *objectives* of the program in Nigeria as well as the use of the tax system as the *tool* for achieving the objectives of the SR&ED program as opposed to using alternative policy options.

While the adoption of the SR&ED program for *all* the sectors in the Nigerian economy could be beneficial for promoting corporate research and development across the country, such application is likely to be more costly and challenging for the federal government as opposed to implementing the program in the oil and gas industry alone. As discussed in chapter one, recurrent fuel shortages as well as inadequate technology for oil exploration and tax administration are major challenges

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<sup>35</sup> Canada, Department of Finance, “An Evaluation of the Federal Tax Credit for Scientific Research and Experimental Development”, by Mark Parsons & Nicholas Phillips (September 2007), online: < <http://www.fin.gc.ca> >.

<sup>36</sup> Canada Revenue Agency News Release, “Canada Revenue Agency supports business innovation with new SR&ED tools and services” (6 Feb 2014), Government of Canada website online: < <http://news.gc.ca> >.

<sup>37</sup> Canadian Manufacturers & Exporters, “2014-15 Federal Budget Recommendations” (August 2014), online: <<http://cme-mec.ca>> at 4 [2014-15 Federal Budget]; Statistics Canada, “Spending on research and development, 2014 (intentions)” (17 October 2014) online: < <http://www.statcan.gc.ca> >.

<sup>38</sup> Jenkins Report, *supra* note 21 at E-9.

to the development of the petroleum industry in Nigeria. Incentivizing research and experimental development (technology) would be a positive influence in addressing these particular inefficiencies in the petroleum industry.

In terms of recurrent fuel shortages, this problem persists because Nigeria currently lacks the refinery capacity to meet fuel demand.<sup>39</sup> In practical terms, this lack of capacity results in Nigeria exporting about ninety percent (90%) of its crude oil and importing finished petroleum products at international prices.<sup>40</sup> Given the increased price of the imported finished products, the government sells the petroleum products to consumers at subsidized prices and reimburses the price difference to importers.<sup>41</sup> Thus, Nigeria is almost wholly reliant on imports of petroleum products despite its abundance of crude oil.

A combination of bureaucracy, corruption, mismanagement and chronic disrepair have been identified as some of the reasons for the failure of existing refineries.<sup>42</sup> Another reason that has been attributed for the failure of the refineries is the protection of the interests of powerful fuel importers – some of who are allegedly involved in a subsidy scam costing Nigeria billions of dollars a year.<sup>43</sup> Additionally, the unpredictability of the regulatory framework and political instability are also limiting factors to investment in new refineries.<sup>44</sup> Successive governments have attempted to tackle this problem by improving the capacity utilization of the four state-owned refineries but none of them have succeeded in doing so.<sup>45</sup> In addition to government efforts, the private sector have also made attempts to address this problem of low capacity utilization which is prevalent in Nigeria's oil refineries. However, some of the efforts of private companies to build and operate privately owned refineries have often been delayed or cancelled partly because of

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<sup>39</sup> Ludovica Iaccino, "Nigeria: Three out of Four Oil Refineries Resume Production As President Buhari Urged to End Fuel Subsidy", *International Business Times* (30 July 2015), online: <<http://www.ibtimes.co.uk>>.

<sup>40</sup> *Ibid.*

<sup>41</sup> *Ibid.*

<sup>42</sup> Simon Allison, "Profit in Paradox: Why Dangote's New Oil Refinery Makes Sense for Him, and Nigeria", *Daily Maverick* (3 March 2014), online: <<http://www.dailymaverick.co.za>>.

<sup>43</sup> "Nigeria's Dangote Signs Deal to Build Oil Refinery", Editorial, *BBC News* (4 September 2013), online: <<http://www.bbc.com/news>>.

<sup>44</sup> *Ibid.*

<sup>45</sup> "Towards a Private Oil Refinery Market in Nigeria", Editorial, *Business Day* (8 July 2014), online: <<http://businessdayonline.com>>.

uncertainties surrounding government's plans to deregulate the downstream sector of the petroleum industry.<sup>46</sup>

Understandably, there have been concerns that privatisation of refineries could result in the concentration of wealth in a small subset of the country and could ultimately aggravate an already apparent income gap in the population.<sup>47</sup> However, the current arrangement equally reveals that the government-owned and operated refineries is costing Nigerians colossal amounts of money in foreign exchange to the detriment of budget allocation for education, healthcare and other public goods.<sup>48</sup> For instance, it has been noted that “in 2011 alone, Nigeria reportedly spent \$ 760 million on refinery maintenance, and the operational capacity of the refineries hardly changed”.<sup>49</sup> Fortunately, there have been attempts by the NNPC to undertake public-private partnership projects to increase local refining capacity. Even though the public-private partnership arrangement may still be vulnerable to some of the problems that plague existing refineries, this thesis contends that incentivizing such public-private partnership arrangements through R&D incentives could increase their probability of success.<sup>50</sup>

While the problem of low refining capacity in Nigeria is much more complicated than issuance of tax incentives, this thesis recognizes that incentivizing R&D for the purpose of expanding local refining capacity is likely to fast-track the implementation of new refining projects while rehabilitating existing local refineries in Nigeria. Thus, this thesis contemplates that encouraging scientific research and development could improve the poor state of the oil refineries in Nigeria as the program has the potential of attracting and encouraging the investments that are necessary to renovate the poor condition of Nigeria's local refineries. Particularly, the proposed implementation of a SR&ED program can encourage local production and ultimately increase local availability of petroleum products.<sup>51</sup> That is, the tax relief that would be derived from the introduction of the SR&ED is likely to encourage existing oil investors to increase their investment in R&D and also attract prospective oil investors to invest in Nigeria's local refineries. As earlier

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<sup>46</sup> *Ibid.*

<sup>47</sup> Mathias Chika Mordi, “Nigeria Refineries: The Case for Privatization”, *Business Day* (10 April 2014), online: <<http://businessdayonline.com>>.

<sup>48</sup> *Ibid.*

<sup>49</sup> *Ibid.*

<sup>50</sup> *Ibid.*

<sup>51</sup> Henry Ridgwell, “Fuel Shortages in Nigeria Could Affect Economy, Election”, *Voice of America* (5 March 2015), online: <<http://www.voanews.com>>

discussed, scarcity of petroleum products has adverse effects on the different sectors of the Nigerian economy. Therefore, a program that has the potential for increasing or incentivizing local production of petroleum products is likely to be a positive influence that will ultimately reflect on all sectors of the economy.

In terms of the tax transplantation of the SR&ED program into Nigeria's legal system, this thesis recommends a hybrid tax transplant such that the objectives of the SR&ED program under the Canadian tax system are slightly modified to reflect only the targeted needs of Nigeria's petroleum industry.<sup>52</sup> Specifically, this thesis suggests that the objectives of the SR&ED variant in Nigeria's tax system should be: (i) to encourage research and development in the upstream sector of Nigeria's petroleum industry; (ii) to promote research and development activities for the local refining of petroleum products in Nigeria; (iii) to provide tax incentives for research and development that are for immediate benefit to all businesses in the petroleum industry; and (iv) to provide tax incentives for research and development that are as simple to understand and comply with and as certain in application as possible. Also, this thesis suggests that the program should have a specified duration within which its major objectives can be substantially achieved and its usefulness should be reviewed periodically to ensure its continued efficacy. It is expected that these objectives will encourage investment in research and development of Nigeria's petroleum industry.

On a related note, the recent introduction of automated tax filing indicates that businesses in the petroleum industry will require adequate technology in order to take advantage of the ITAS program. Perhaps the third objective stated above will incentivize oil and gas businesses to acquire the necessary resources and skills for compliance with the electronic filing system.

In terms of the best approach to promote R&D, there have been arguments in favour of direct funding of R&D programs through grants and loans as opposed to TEs. For instance, Surrey argued that TEs are an inferior method of implementing policy because TEs tend to have diverse features that lead to poor implementation.<sup>53</sup> Surrey was also of the view that TEs are upside-down subsidies because the value of the tax deductions increases in proportion to the marginal tax rate,

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<sup>52</sup> Murray, *supra* note 14.

<sup>53</sup> Stanley S Surrey, *Pathways to Tax Reform: The concept of Tax Expenditures* (Cambridge, MA: Harvard University Press, 1973) at 134-8 [Surrey, Pathways].



thus, wealthy individuals get more benefits than the poor.<sup>54</sup> It has also been argued that TEs place no limits on the amount of benefits a taxpayer may receive and tend to have loose eligibility requirements since taxpayers self-declare their eligibility and are mostly challenged only if they happen to be audited.<sup>55</sup> In addition to these arguments, the Jenkins report also stated that, “many leading countries in innovation rely much less than Canada on indirect tax incentives as opposed to direct measures”.<sup>56</sup> Thus, the panel assessed the two approaches for implementation of R&D programs.<sup>57</sup> With respect to direct spending programs, the panel noted that the principal advantage of implementing R&D programs as direct spending program is that direct spending programs can be channelled to specific projects, industries or regions.<sup>58</sup> However, the report also noted that direct spending programs (i) involve more rigorous selection and evaluation process; (ii) can result in higher administration costs for government and compliance costs for beneficiaries; and (iii) can raise concerns about the propriety of governments “picking winners” among the corporate applicants.<sup>59</sup> While TEs were noted to be less amenable to being channelled to specific policy objectives, the Jenkins report noted that TEs were advantageous because: (i) they are non-discriminatory and widely available across different sectors, industries and activities; (ii) they are generally easier and cheaper to implement.

In addition to the advantages of TEs that were noted in the Jenkins report, the perceived flaws of TEs for implementing government objectives of this nature can be overcome by designing tax expenditures to be implemented as direct expenditures.<sup>60</sup> In countering Surrey’s arguments, it has been noted that TE programs have different features from direct expenditure programs and should not be compared as if they were identical.<sup>61</sup> In response to the flaws of TEs, Weisbach and Nussim noted that “[i]f a tax expenditure has the same content as a direct spending program, it will not have the upside-down subsidy effect, it will not be open-ended, its eligibility criteria will be the same as those of a direct expenditure, and it will not be more complex than the direct spending

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<sup>54</sup> *Ibid.*

<sup>55</sup> David A Weisbach & Jacob Nussim, “The Integration of Tax and Spending Programs”, (2003) 113 Yale LJ 955 at 961 at 978 [Weisbach & Nussim].

<sup>56</sup> Jenkins Report, *supra* note 21 at E-3.

<sup>57</sup> *Ibid* at 6-3.

<sup>58</sup> *Ibid.*

<sup>59</sup> *Ibid.*

<sup>60</sup> Weisbach & Nussim, *supra* note 55 at 978.

<sup>61</sup> *Ibid* at 979.

program”.<sup>62</sup> According to Weisbach and Nussim, the choice of the tool with which to provide the R&D subsidy is a question of institutional design.<sup>63</sup>

By implementing the SR&ED program through a direct spending program, there is an advantage of a specialized agency that will approve a business plan and/or choose eligible projects.<sup>64</sup> Since tax authorities may not have the required specialization for verifying eligible projects, some have argued that TEs are not as viable as direct spending programs for subsidies of this nature.<sup>65</sup> Although direct spending programs have the advantage of targeting specific objectives and industries as contemplated in the proposed SR&ED program in Nigeria, tax authorities can also administer the SR&ED program through TEs. Where the program is structured like that of Canada whereby the TE is granted based on the company’s R&D expenditure, tax authorities can seamlessly administer the program since they already receive, monitor and verify such expenses from eligible companies when reviewing their tax returns.<sup>66</sup>

In addition to the above, the task of effectively addressing the problem of inadequate technology or poor refining capacity of refineries in Nigeria using a direct expenditure program is likely to be a resource intensive project. While this thesis acknowledges that greater expertise in the oil and gas industry or relevant fields could be beneficial for assessing eligibility for the program (as may be applicable under direct spending program), this thesis contends that it makes more economic sense for tax authorities to hire people with such expertise for this aspect rather than setting up a separate agency for administration of the program.<sup>67</sup> Furthermore, Nigeria also has a tax law interpretation procedure (similar to the Canada’s tax ruling and interpretation system) such that taxpayers can employ such resources whenever they have uncertainties as to their eligibility for the program, especially at the pilot stage of implementation.<sup>68</sup>

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<sup>62</sup> *Ibid.*

<sup>63</sup> *Ibid.*

<sup>64</sup> Noam Noked, “Integrated Tax Policy Approach to Designing Research & Development Tax Benefits”, (2014) 34:1 *Va Tax Rev* 109 at 153 [Noked].

<sup>65</sup> *Ibid.*

<sup>66</sup> *Ibid* at 154.

<sup>67</sup> *Ibid.*

<sup>68</sup> Federal Inland Revenue Service, “Tax Circulars”, online: FIRS Website <<http://www.firs.gov.ng>>. These are called FIRS information circulars and they are issued as a guide to all FIRS officials and stakeholders to provide clarity and certainty for tax laws and procedures.

While this thesis does not suggest that TE is the perfect approach for implementing SR&ED in Nigeria's oil and gas industry, the thesis considers the tax system as a more viable tool to administer the program in Nigeria rather than a direct spending program.<sup>69</sup> Since the proceeds from oil revenue over the years have not been channeled to address the industry inefficiencies that the SR&ED program aims to address, it is very unlikely that the government will initiate a direct spending program with similar objectives like the SR&ED. Secondly, the impact of the high tax rate of 85% imposed on companies engaged in upstream petroleum operations under the PPTA can be ameliorated to some degree if eligible companies claim the SR&ED incentive. A third reason for suggesting the implementation of the program through TEs is that the administration of the program through the tax system is cost-effective and administratively efficient since the FIRS can administer the program rather than creation of a new agency under the direct spending program. Given the federal government's dominant role in the industry, a direct spending program could equally raise concerns as to the government "picking winners" during the approval process. If properly implemented, the SR&ED program would also make Nigeria internationally competitive as many developed countries also utilize similar programs to stimulate research and development.<sup>70</sup>

As earlier mentioned, an accurate evaluation of the cost of this incentive in terms of revenue forgone approach is highly specific and beyond the scope of this thesis. However, this thesis contemplates that the program can induce capital investment which will ultimately increase government revenue in the long run. Based on the ex-post and ex-ante assessments of the SR&ED program above, this thesis considers that it is beneficial for Nigeria to adopt the *idea* behind the SR&ED program in order to enjoy the *apparent benefits* the program has to offer in the oil and gas industry.

For the purpose of clarity, it is very important to identify the specific *idea* or *apparent benefits* that are contemplated by this particular recommendation. This is because there are existing fiscal terms under Nigerian law that incentivize R&D in Nigeria. For instance, there are provisions that

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<sup>69</sup> The oil and gas industry currently has several specialized agencies which are yet to fully achieve their mandate. See KPMG, "KPMG Nigeria Oil and Gas Industry Brief" (June 2014), online: KPMG Nigeria <<http://www.kpmg.com>> at 10-1 [KPMG Brief]. Given the current state of the industry, it is not clear whether setting up a separate agency under a direct spending program would be beneficial for reform purposes or simply costly.

<sup>70</sup> 2014-15 Federal Budget, *supra* note 37 at 5.

indicate that up to a hundred and twenty percent (120%) of R&D expenses are tax deductible provided that such research and development is carried out in Nigeria.<sup>71</sup> Given that such provisions already grant tax deductions for R&D expenses, one may reasonably question which particular *idea* is being contemplated in this thesis or whether the *apparent benefits* of a SR&ED program will be of any additional benefit to Nigeria's oil and gas industry.

In addressing the aforementioned concerns, the following points are instructive. First, the *idea* being proposed in this thesis goes beyond the *general* notion that a "R&D program should be transplanted to Nigeria" (since Nigeria already has one), rather, it is the more *specific* idea that "the objectives of this particular R&D program (SR&ED) should be transplanted into Nigeria's petroleum industry". That is, this thesis looks at the possibility of adopting the specific *objectives* of the Canadian SR&ED program in Nigeria's oil and gas industry as opposed to possibility of implementing a general R&D program in Nigeria. Secondly, this thesis contemplates that such supplementary R&D program is likely to be of additional *benefit* for Nigeria's oil and gas industry for a number of reasons – (i) the objectives of the proposed program are industry specific and can be tailored to meet the current needs and structure of the oil and gas industry; (ii) the program is recommended as a temporary and short term measure, therefore, the government can fully realize the revenue forgone in the long run; and (iii) a specific incentive, albeit, supplementary, which is targeted at the problem of fuel shortages may be useful in offsetting the financial drain or mitigating the high risk with which such oil and gas investments are characterized.

### **5.1.2. Clean Energy Generation Equipment - Accelerated Capital Cost Allowance**

The Clean Energy Generation Equipment - Accelerated Capital Cost Allowance was introduced into Canada's income tax system in 2010.<sup>72</sup> This program encourages businesses to invest in clean energy generation and energy efficiency equipment by providing an accelerated capital cost allowance (CCA) on eligible expenses.<sup>73</sup> Generally, corporations are allowed to deduct CCA in

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<sup>71</sup> Nigerian Investment Promotion Commission (NIPC), "Investment Incentives", NIPC Invest in Nigeria, online: <<http://www.nipc.gov.ng>>.

<sup>72</sup> Pinto Odette & Rock Lefebvre, "Is the Capital Cost Allowance System in Canada Unnecessarily Complex?", online: (2013) <<http://ppm.cga-canada.org>> at 15.

<sup>73</sup> *Income Tax Regulations* CRC, c 945 s 402 Schedule II [ITR]. These clean energy generation assets are categorized under Classes 43.1 and 43.2 in Schedule II to the *Income Tax Regulations* (the "Regulations").

respect of the capital cost of depreciable property when computing their business income.<sup>74</sup> The general CCA claim for a class of depreciable property is based on a prescribed rate that is usually based on the useful life of such depreciable property. However, the clean energy generation program offers corporations that incur eligible assets an *accelerated* rate of depreciation of such property in order to promote the diversification of energy supply.

Under Canadian tax laws, the eligible clean energy generation assets are categorized under classes 43.1 and 43.2. Class 43.1 allows the cost of eligible assets to be deducted at an accelerated rate of 30% per year on a declining balance basis for properties acquired after February 21, 1994.<sup>75</sup> The Class 43.2 allows the cost of eligible assets to be deducted at a rate of 50% per year on a declining balance basis for properties acquired after February 22, 2005 and before 2020.<sup>76</sup> These qualifying assets include a variety of stationary equipment that generate energy by using renewable energy sources or fuels from waste, or equipment that make use of fossil fuels efficiently.<sup>77</sup> It is noteworthy that all businesses in all the sectors of Canada's economy that invest in specified clean energy generation and energy efficiency projects are eligible for this incentive.<sup>78</sup> However, for an asset to qualify for this incentive, the asset must be acquired, used and located in Canada.<sup>79</sup>

#### **5.1.2.1. Ex-Post Evaluation**

Similar to the ex-post evaluation of the SR&ED program, the ex-post evaluation of the clean energy generation program will be based on the relevance, cost, impact and effectiveness as discussed in the preceding chapter of this thesis. According to Canada's Department of Finance, the purpose of the clean energy generation incentive is to promote investments in equipment "*that can contribute to a reduction in harmful emissions and diversification of the energy supply.*"<sup>80</sup>

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<sup>74</sup> Natural Resources Canada, "Technical Guide to Class 43.1 and 43.2" (2013 Edition), online: <<http://www.nrcan.gc.ca/>> at 11 [NRC, Technical Guide].

<sup>75</sup> *Ibid* at 10; ITR, *supra* note 73 at Reg 1100 (1) (a) (xxix).

<sup>76</sup> NRC, Technical Guide, *supra* note 74 at 10.

<sup>77</sup> *Ibid* at 9. The current eligible equipment include high-efficiency cogeneration equipment, small hydroelectric facilities, wind turbines, wave and tidal power equipment, equipment generating electricity from eligible waste fuel, active solar equipment and equipment used to convert biomass into bio-oil to mention a few.

<sup>78</sup> Canada, Department of Finance Canada, "Supplementary Document to the Department's 2014–15 Report on Plans and Priorities (RPP) Regarding Sustainable Development", (7 March 2014), online: <<http://www.fin.gc.ca/>> at para 3 (B) (1) [Canada, Supplementary RPP].

<sup>79</sup> Marie Andree Beaudry, Jean-Guillaume Shooner & Nathaniel Lacasse, "Canadian Tax Considerations for Non-Resident Investors in Canadian Renewable Energy Projects", online: (2014) Canadian Energy Law <<http://www.canadianenergylaw.com>>.

<sup>80</sup> Canada, Supplementary RPP, *supra* note 78.

The aim of the government is to improve the after-tax rate of return on these investments by allowing the corporations to write-off the capital cost of the eligible assets at an accelerated rate as opposed to the costs being written-off over the useful life of the assets.<sup>81</sup>

Unfortunately, it is difficult to estimate how much the government spends on the clean energy generation program because verifiable data on cost of the program is very limited (perhaps due to the relative newness of the program). The 2014 report of TEs and evaluations prepared by Canada's Department of Finance which provides estimations and projections on TEs also confirms the paucity of data on the cost of the program.<sup>82</sup> The report indicates that there is no data available to support a meaningful estimate or projection for the clean energy generation program for that year.<sup>83</sup> However, Canada's budget plan for 2012 projected that the program would cost \$3 million and \$4 million in the 2014-2015 and 2015-2016 budget years respectively.<sup>84</sup> According to Canada's Economic Action Plan 2014, it is estimated that the clean energy generation program "will reduce federal revenues by a small amount in 2014–15 and by \$1 million in 2015–16".<sup>85</sup> Even though there is insufficient data to determine the cost of the program, the 2015-2016 projection potentially results in a \$3 million surplus for the government based on the 2012 and 2014 projections.

With respect to the impact and effectiveness of the clean energy generation program, Canada's Chamber of Commerce has noted that an accelerated capital cost allowance (ACCA) should be in place for at least five (5) years in order to give companies time to revise their business plans as well as make the investments to take advantage of the incentive.<sup>86</sup> Specifically, the Chamber of Commerce noted that "when limited to a short term, an ACCA is not as useful as it will do little to encourage investments that have long-term time horizons or complex environmental approvals processes."<sup>87</sup> Even though the efficacy of the program is expected to be measurable in the near

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<sup>81</sup> Natural Resources Canada, "Accelerated Capital Cost Allowance for Efficient and Renewable Energy Generation Equipment (Class 43.1)" (9 February 2015) online: <<http://oee.nrcan.gc.ca>>

<sup>82</sup> Canada, Department of Finance, "Tax Expenditures and Evaluations 2014" (Ottawa: Department of Finance 2014)

<sup>83</sup> *Ibid.*

<sup>84</sup> Canada, Government of Canada, "Archived - Budget 2012", (29 March 2012), online: <<http://www.budget.gc.ca>>

<sup>85</sup> Canada, Economic Action Plan 2014, "Tax Support for Clean Energy Generation", Canada Economic Action Plan website, online: <<http://actionplan.gc.ca>>.

<sup>86</sup> Canadian Chamber of Commerce, "Powering up Canadian prosperity: Growing the Energy-Sector Value Chain", (2010) by Canadian Chamber of Commerce, Ottawa, Canada at 9 [CCC, Powering]

<sup>87</sup> *Ibid* at 9.

future, it has been noted that the clean energy generation program provides direct environmental benefit by increasing the production and use of clean and renewable energy.<sup>88</sup>

#### **5.1.2.2. Ex-Ante Assessment**

Similar to Canada's ACCA, the Nigerian oil and gas tax system also has a capital allowance system. Under the current oil and gas tax regime in Nigeria, capital allowance can be claimed on four categories of assets or qualifying capital expenditure (QCE) items, namely – (i) capital expenditure on plant, machinery and fixtures; (ii) capital expenditure on pipelines and storage tanks; (iii) capital expenditure on building construction or works of permanent nature on buildings; and (iv) capital expenditure on drilling activities.<sup>89</sup> The type of capital allowance that is granted to corporations on these QCEs vary based on the objectives of the government in granting the incentives to the corporations. For instance, the “annual allowance” is granted on QCE to encourage crude oil exploration<sup>90</sup> while the “petroleum investment allowance” is a one-off allowance granted to corporations that acquire QCEs which are solely for petroleum operations.<sup>91</sup> In spite of the variety of capital allowance incentives available in Nigeria's current tax regime, there is the need to specifically incentivize the use of clean energy in all the sectors of Nigeria's petroleum industry.

Given that there are existing gas utilization incentives in Nigeria, it is possible to question the extent to which the ACCA for clean energy will be beneficial for Nigeria. Such concerns can be addressed by emphasizing the distinguishing feature of the proposed clean energy program. While the objectives of the program has substantial similarities with those of the existing measures, the scope of the clean energy program is significant. In specific terms, the clean energy ACCA is a unique measure which does not focus solely on utilization of gas but also extends to incentivizing the *general* use of clean energy in the petroleum industry whether or not the equipment is for gas

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<sup>88</sup> *Ibid* at 5.

<sup>89</sup> *Petroleum Profits Tax Act*, LFN 2004, c P13 Schedule II, para 1 (b) [PPTA].

<sup>90</sup> *Ibid* at Schedule II, para 6.

<sup>91</sup> *Ibid* at Schedule II, para 5. Other similarly structured programs that are relevant to the oil and gas industry include: investment tax credit (ITC) which is a tax-offset that is deductible from assessable tax and applicable to corporations under the PSC arrangement that signed their contract agreements prior to 1st July 1998; investment tax allowance (ITA) which is similar to the ITC but granted to corporations that signed their PSC after 1<sup>st</sup> July 1998 and deducted from assessable profit; and balancing allowance which is an allowance granted to petroleum corporations if the tax written down value of a QCE asset exceeds the income received by the company on the disposal of the OCE asset. See generally, Schedule II for details of other capital cost allowances.

utilization. Furthermore, the adoption of the clean energy ACCA is also useful for the reduction of associated gas flaring because they further incentivize the creation of outlets for gas utilization. Thus, the thesis considers the clean energy generation program as a viable recommendation for this purpose and recommends a similar program for Nigeria's oil and gas reforms.

In assessing the introduction of the clean energy generation program into Nigeria's tax system, this section also draws on the three stages identified by the OECD namely the *need* that the clean energy generation program would address, its proposed *objectives* in Nigeria and the propriety of the tax system as the *tool* for achieving the objectives of the clean energy program as opposed to using alternative policy options.

As discussed in chapter one, the problem of environmental degradation caused by oil exploration activities are major inefficiencies in Nigeria's petroleum industry. This thesis contemplates that the clean energy generation program can be instrumental in the reduction of gas flaring activities and environmental degradation in Nigeria. If properly implemented in Nigeria, the program will be an excellent tool for promoting technology investments and encouraging local development and commercialization of new and "clean" technologies for the utilization of associated gas in oil exploration.

Similar to the SR&ED program above, this thesis suggests the modification of the objective of the clean energy generation program prior to its introduction into Nigeria's legal system. Thus, the proposed objective of the program would be to encourage corporations to invest in equipment in the oil and gas industry "*that can contribute to the reduction in harmful emissions as well as assist with diversification of the energy supply in the oil and gas industry.*"<sup>92</sup>

In terms of approach, TEs are more cost-efficient for delivery of programs of this nature because they adopt an established mechanism for allocating economic resources and for communicating information about government policy.<sup>93</sup> Additionally, the ACCA method allows the oil and gas corporations to write off eligible assets faster in the earlier years (as opposed to the regular

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<sup>92</sup> Canada, Supplementary RPP, *supra* note 78

<sup>93</sup> See especially, David G Duff & E Ian Wiebe, "Tax expenditures to Limit the Growth of Carbon Emissions in Canada: Identification and evaluation" at 8:15 in Lisa Phillips, Neil Brooks & Jinjay Li eds, *Tax Expenditures: State of the Art: Selected Proceedings of the Osgoode 2009 Conference on Tax Expenditures and Public Policy in Comparative Perspective* (Toronto, Ont: Canadian Tax Foundation, 2009) [State of the Art].



depreciation of assets) and smaller amounts in the later years. In addition to the above, there are other significant tax advantages for implementing a clean energy program as a TE. Since Nigeria has an established administrative mechanism for capital allowance programs (as discussed above), such mechanism provide a model for the implementation of the ACCA for clean energy.

While one may legitimately question the fairness, equity or the need for additional capital allowance program in Nigeria's oil and gas industry, this thesis contends that Canada's ACCA program presents a viable approach to address the problems of gas flaring and oil spillages in oil producing communities in Nigeria. Drawing on the views of non-beneficiaries and accounting professionals in Canada to a similar CCA program which is applicable to the Canadian manufacturing industry, the perception of unfairness and inequity for such incentive is absent.<sup>94</sup> Specifically, it appears that such preferential tax treatments are commonly accepted as being essential for certain industries especially in special circumstances such as the economic recession that was plaguing the manufacturing industry at that time.<sup>95</sup> Thus, it is highly plausible (albeit not certain) that a similar perception will be held by Nigerians in respect of the ACCA for clean energy program given the extent of environmental degradation in the oil producing communities in Nigeria.

Even though the current capital cost allowance programs in Nigeria's petroleum industry already incentivize the purchase of (general) plants and equipment by petroleum corporations, these incentives do not directly address or promote the purchase of clean energy equipment. Therefore, this thesis recommends the ACCA as a complementary mechanism to the existing measures to encourage the use of clean energy for crude oil production in oil producing communities. Alternatively, the government can restructure the current annual allowance program for the purpose of achieving this objective. In addition to promoting clean energy in the petroleum industry, it is expected that the adoption of Canada's ACCA deduction for eligible equipment would be a valuable and effective tool for reducing the tax liability resulting from the higher tax rates that is applicable to upstream oil and gas corporations.

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<sup>94</sup> Odette Pinto, "Issue in Focus", (2013) Certified General Accountants Association of Canada Report, online: <<http://ppm.cga-canada.org>> at 11.

<sup>95</sup> *Ibid.*

Apart from obtaining an accelerated rate of depreciation on eligible equipment this thesis argues that implementation of this program would have a ripple effect on the economy as the increase in demand for clean energy generation machinery will also increase the profit margin for the equipment manufacturers of products such as solar panels and wind turbines.<sup>96</sup> Thus, implementing ACCA in Nigeria also has potential multiple benefits for the different sectors of the economy.

### 5.1.3. Pollution Tax

Given the adverse effects on the environment as well as the financial loss caused by gas flaring and oil spillages (pollutants) discussed in chapter one, the Nigerian federal government has made several attempts in the past to discourage the flaring of natural gas on the one hand as well as incentivize the utilization of associated gas derived during oil exploration activities on the other hand. For instance, the *Associated Gas Re-Injection Act*<sup>97</sup> imposes certain fines and penalties for flaring of gas and specifically prohibits the flaring of associated gas without the written permission of Nigeria's Minister for Petroleum Resources. Similarly, the *Petroleum (Drilling and Production) Regulations* under the *Petroleum Act*<sup>98</sup> makes it mandatory for oil producing companies to submit detailed plans for gas utilization within their first five years of operation in order to ensure that these companies have *cogent* plans for utilization of gas during exploration activities.

In addition to these administrative and legal requirements, there are also fiscal incentives available to companies that utilize gas rather than flare them into the atmosphere. For instance, corporations engaged in gas utilization projects that were previously taxed under the PPTA at eighty-five percent (85%) are now taxed under the CITA at the rate of 30%.<sup>99</sup> Additional incentives available to such companies also include a three-year tax holiday which is renewable for an additional two

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<sup>96</sup> CCC, Powering, *supra* note 86 at 5.

<sup>97</sup> See *Associated Gas Re-Injection Act*, LFN 2004, c A25 s 3(1) for the requirement for written permission from the Minister. This section prohibits, without lawful permission, any oil and gas company from flaring gas in Nigeria while s 4 stipulates the penalty for breach of permit conditions; *Niger-Delta Development Commission (Establishment etc) Act*, LN 2000, s 14 [NDDC Act]. Under the NDDC Act, the NDDC has a duty to liaise with oil and gas companies and advice stakeholders on the control of oil spillages, gas flaring and other related forms of environmental pollution.

<sup>98</sup> *Petroleum Act*, LFN 2004, c P10, [Petroleum Act]. Regulation 43 of the Petroleum (Drilling and Production) Regulations under this Act provides for mandatory submission of feasibility study from licensees and lessees for the utilization of natural gas (both associated and non-associated gas).

<sup>99</sup> *Petroleum Profits Tax Act*, LFN 2004, c P13 [PPTA] and *Companies Income Tax Act* LFN 2004, c. C21 [CITA].

years subject to satisfactory performance and tax-free dividends during the tax-holiday period. Such companies are also eligible for accelerated capital allowances at the rate of ninety percent (90%) in the first year of production for investment in plant and machinery with ten percent (10%) retention in the books after the tax holiday, fifteen percent (15%) additional investment capital allowance as well as royalty and tax exemption for the gas transferred from natural gas liquid facility (NGL) to the gas to liquid facility (GTL).<sup>100</sup>

As noted in chapter one, these incentives and other measures that have been adopted by the government to discourage pollution resulting from oil exploration activities have not had the desired effect. For instance, the 2010 Sustainability Report for Royal Dutch Shell Plc (a major oil company in Nigeria) noted that the oil company's gas flaring had a thirty-two percent (32%) increase from 2009 to 2010.<sup>101</sup> Despite the huge investment being made by the federal government in gas infrastructure, the most recent statistics indicate that the government's efforts have only resulted in an eight percent (8%) increase in domestic gas production between 2013 and 2014.<sup>102</sup> While this modest performance is encouraging, it is not commensurate to the huge investment being made by the government to curb the environmental degradation caused by oil exploration activities. In terms of sustainability of the current measures, some have noted that the fines and penalties are too light to act as a deterrent,<sup>103</sup> while others have expressed concerns as to the

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<sup>100</sup> Kayode Oladipo & Yuli Eyesan, "Unlocking Nigeria's Gas Potential" (16 March 2015) King & Wood Mallesons Publication at 29, online: <<http://www.savca.co.za>> [Oladipo & Eyesan]; For the legislative provisions, see especially *Finance (Miscellaneous Taxation Provisions) Decree No 18 of 1998* for the tax holidays, tax free dividends during the tax holiday, accelerated capital allowance for investment in plant and machinery, value added tax exemptions for plant and equipment; *Finance (Miscellaneous Taxation Provisions) (No 2) Decree No 19 of 1998* for allowable deduction on interest on loan. Such interest is tax deductible subject to the approval of the Minister of Finance; *Finance (Miscellaneous Taxation Provisions) Decree No 30 of 1999* for royalty and tax exemptions for gas transferred from NGL to GTL; *Nigeria Liquefied Natural Gas (NLNG) (Fiscal Incentives, Guarantees and Assurances) Decree, 1990* also makes provisions for tax holidays as well as other guarantees and assurances to encourage utilization of associated gas and liquefied natural gas in Nigeria. Currently, all the incentives for associated gas production are now also applicable to non-associated gas.

<sup>101</sup> Integrated Regional Information Networks, "Nigeria: Gas Flares still a Burning Issue in the Niger Delta", IRIN Website (8 March 2012), online: <<http://www.irinnews.org>> [IRIN]. This article also notes that the Shell's report attributed this poor index to the increase in oil exploration owing to a reduction in militant activities in the Niger Delta in that period. It was also noted that there was a 50% decrease in flaring from 2002 to 2010 but notes that this was also partially due to a decrease in oil extraction owing to militant activities; See also, Royal Dutch Shell Plc, "Sustainability Report 2010", online: <<http://reports.shell.com>> at 29.

<sup>102</sup> NNPC, "2014 Annual Statistical Bulletin", 2nd ed, (2014) NNPC Public Relations, Table 13.02.01 at 35-6, online: <<http://www.nnpcgroup.com>>

<sup>103</sup> IRIN, *supra* note 101.

preservation of these incentives under the PIB when it is passed into law.<sup>104</sup> Given the current uncertainty and the perceived ineffectiveness of these measures, this thesis recommends pollution tax as a predictable, definitive and uniform alternative to address the issue of environmental degradation resulting from oil exploration activities in Nigeria. Even though this thesis does not suggest that pollution tax is an infallible alternative to the current measures that are directed at the reduction of environmental degradation in Nigeria's oil and gas industry, the thesis notes that the pollution tax can be an effective component of Nigeria's clean energy policies.

Like the name implies, pollution taxes are charges levied on "polluters for the damages their actions cause the environment and others".<sup>105</sup> A prominent tax scholar – Stanley Surrey - also described pollution tax as "a charge imposed for every unit of pollutant discharged into the environment".<sup>106</sup> In terms of the adoption of pollution tax for reducing greenhouse gas emissions (GHGs), many industrialized countries favour imposition of carbon taxes to discourage such emission and promote clean energy.<sup>107</sup> Since GHGs are also one of the by-products of gas flaring in Nigeria, this thesis recommends the use of pollution taxes as a deterrence to GHG emissions and by extension, other pollutants in oil exploration in Nigeria.

Although Canada's current federal approach to climate change as a whole is perceived to be deficient domestically and internationally,<sup>108</sup> some provinces in Canada have been lauded for implementing pollution taxes in the form of carbon tax to reduce the release of carbon dioxide

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<sup>104</sup> SB 205, *Petroleum Industry Bill 2012*, 7th Sess, National Assembly June 2011- June 2015, (second reading 7 March 2013) [PIB]. For instance, the PIB intends to repeal the Associated Gas Re-injection Act which contains some of these incentives. Deloitte, "Doing Business in the Nigerian Oil & Gas Industry – Fiscal Compliance & Incentive Considerations (2)" (2014), Deloitte Inside Tax Week 48 Publication, online: <[www.deloitte.com/ng](http://www.deloitte.com/ng)>

<sup>105</sup> Nova Scotia, Finance and Treasury Board, "Charting a Path for Growth", Tax and Regulatory Review (Nova Scotia: November 2014), online: <<http://www.novascotia.ca>>.

<sup>106</sup> Surrey, Pathways, *supra* note 5342 at 156.

<sup>107</sup> World Bank, *State and Trends of Carbon Pricing*, Projects and Operations, (US, Washington D.C: International Bank for Reconstruction and Development/World Bank, 2014) at 76-86 [World Bank, Carbon Pricing]; Centre for Energy and Climate Economics, "Considering a Carbon Tax", (December 2012), Resources for the Future Website, online: <<http://www.rff.org>> at 6-7 [CECE, Carbon Tax].

<sup>108</sup> Nicholas Rivers, "The Case for a Carbon Tax in Canada", *Canada 2020 Publication* (11 November 2014) online: <<http://canada2020.ca>> at 12 [Rivers]. The author states that the international environmental community currently views Canada as an impediment to achieving a more robust international agreement on mitigating emissions due to its recent withdrawal from the Kyoto Protocol. The Kyoto Protocol is an international treaty linked to the United Nations Framework Convention on Climate Change, which commits its Parties by setting internationally binding emission reduction targets. See *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, UNFCCC, UN Doc FCCC/CP/1997/7/Add.1, Dec. 10, (1997); 37 I.L.M. 22 (1998).

(CO<sub>2</sub>) into the atmosphere.<sup>109</sup> Noteworthy is the province of British Columbia (B.C.), which has been commended in several quarters for the success of its carbon tax administration. Specifically, prominent economic authorities such as the World Bank, OECD as well as business and environmental leaders have called [BC's carbon tax] "one of the world's best climate policies: an environmental and economic success."<sup>110</sup>

In July 2008, B.C. became the first jurisdiction in North America to adopt a revenue-neutral carbon tax.<sup>111</sup> The tax is considered "revenue-neutral" because the funds generated by the tax are returned to citizens through reductions in other taxes such as tax cuts in personal and corporate tax liability.<sup>112</sup> In emphasizing the benefits of the revenue-neutral aspect of the tax to taxpayers, the B.C. government noted that the carbon tax has been "revenue negative" because the tax cuts and credits returned to the taxpayers have exceeded the revenue from the tax.<sup>113</sup> In addition, the forecasts of the B.C. budget up to 2016/17 indicate that carbon tax will continue to remain revenue negative.<sup>114</sup> That is, the tax cuts given to taxpayers is projected to continue to cancel out the revenues collected from the carbon tax in the coming years.

At inception, B.C.'s carbon tax was imposed at a rate of \$10 CAD per metric ton ("tonne") of carbon dioxide (CAN\$10/tCO<sub>2</sub>e) with a gradual increase of \$5/tonne annually and reaching its current level of \$30 per tonne of CO<sub>2</sub> (CAN\$30/tCO<sub>2</sub>e) in July 2012.<sup>115</sup> In terms of scope, the carbon tax applies to the purchase or use of fuels within the province.<sup>116</sup> It covers nearly all

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<sup>109</sup> CECE, Carbon Tax, *supra* note 107 at 7. This article notes that British Columbia and Quebec have implemented carbon taxes.

<sup>110</sup> World Bank, Carbon Pricing, *supra* note 107 at 79; British Columbia, Ministry of Finance, "Myths and Facts about the Carbon Tax" (BC: 28 April 2013), online: <<http://www.fin.gov.bc.ca>> [BC, Facts]; Stewart Elgie & Richard Lipsey, "B.C.'s Carbon Tax Shift Works" *Financial Post* (22 January 2015), online: <<http://business.financialpost.com>>; For a detailed overview of the measure, see David G Duff, "The Reality of Carbon Taxes in the 21st Century: Carbon Taxation in British Columbia" (2008) 10 Vt.J. Env'tl. L. 87.

<sup>111</sup> Stewart Elgie & Jessica McClay, "BC's Carbon Tax Shift: The First Four Years", Sustainable Prosperity Policy Commentary, (27 June 2012), online: <<http://www.sustainableprosperity.ca>> at 5 [Elgie & McClay, 2012].

<sup>112</sup> *Ibid* at 5; B.C. Facts, *supra* note 110.

<sup>113</sup> British Columbia, Ministry of Finance, "*Budget and Fiscal Plan – 2014/15 to 2016/17 Carbon Tax Report and Plan*" (February 2014) online: <<http://www.bcbudget.gov.bc.ca>> at 65; World Bank, Carbon Pricing, *supra* note 107 at 86.

<sup>114</sup> World Bank, Carbon Pricing, *supra* note 107 at 79.

<sup>115</sup> *Carbon Tax Act*, SBC 2008, c 40 s 1 [BC Carbon Tax Act]. See generally, Part 3 which provides for the imposition of the tax as well as directions as to how the tax rate is determined. See also, World Bank, Carbon Pricing, *supra* note 107 at 86.

<sup>116</sup> *BC Carbon Tax Act*, *ibid*. The parties described in this definition section indicates that the parties subject to the tax are within BC.

emissions caused by burning fossil fuels (coal, oil and natural gas) in B.C., which amounts to a total of over 70 percent (70%) of the province's carbon pollution.<sup>117</sup> Since its introduction, it has been reported that "the carbon tax has returned \$500 million more to taxpayers in tax reductions than it has raised in revenue".<sup>118</sup>

While carbon taxes are not TEs, one can reasonably evaluate carbon taxes using the generic ex post and ex ante assessments parameters because of certain similarities that exist between the revenue neutral carbon taxation and tax expenditures. Some of these similarities include: (i) carbon taxes, like TEs, are government policy tools aimed at reducing carbon emissions by *influencing* taxpayers' behaviour through the tax system; (ii) carbon taxes are similar to negative tax expenditures in that they increase taxpayers liabilities relative to the benchmark (as opposed to reducing the liabilities under positive tax expenditures); (iii) the revenue neutrality of carbon taxation makes it revenue negative, which has the effect of reducing government revenue in the same way TEs reduce the revenue accruing to the government. Despite these similarities, the ex post evaluation of B.C.'s carbon tax in this thesis is two-fold. First, the thesis conducts the ex post evaluation of the carbon tax in terms of specific criteria for evaluating environmentally related taxation. Thereafter, the thesis also assesses carbon taxation using the generic ex post assessment criteria for TEs. Given the nature of carbon tax as an *environmental tax* and the *similar* features carbon taxation shares with tax expenditures, it is important to evaluate the tax from the aforementioned perspectives for the purposes of completeness and uniformity.

#### **5.1.3.1. Specific Ex- Post Evaluation for Environmentally Related Taxation**

According to the OECD, there are specific criteria that are relevant for evaluating environmentally related taxes.<sup>119</sup> The OECD recommends that environmentally related taxes should be evaluated on the basis of their (i) environmental effectiveness; (ii) dynamic effects; (iii) economic efficiency; (iv) administrative costs; and (v) compliance costs.<sup>120</sup> The generic ex post evaluation criteria for TEs on the other hand, requires an assessment of the relevance, cost, impact and efficiency of the

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<sup>117</sup> World Bank, Carbon Pricing, *supra* note 107 at 78

<sup>118</sup> BC, Facts, *supra* note 110.

<sup>119</sup> OECD, *Environmentally Related Taxes in OECD Countries: Issues and Strategies* (Paris: OECD Publishing, 2001) at 45 [OECD, 2001]. This OECD report documents the growing evidence of the environmental effectiveness of environmentally related taxes in OECD Member Countries.

<sup>120</sup> *Ibid.*

TEs. Given that the OECD criteria (iii) – (v) overlap with themes in the generic ex post evaluation, this section discusses only the OECD criteria (i) and (ii) which are peculiar to environmental related taxation.

In terms of environmental effectiveness, the OECD states that the environmental effect of the tax can be determined by measuring “the extent to which the tax delivers its environmental objectives.”<sup>121</sup> According to the B.C. Ministry of Finance, the objective of carbon taxation is to put a price on carbon in order to: (i) encourage individuals, businesses, industry and others to use less fossil fuel and reduce their greenhouse gas emissions; (ii) send a consistent price signal; and (iii) ensure that those who produce emissions pay for them; and (iv) make clean energy alternatives more attractive. For B.C.’s carbon tax to meet the criterion of environmental effectiveness, the tax must have successfully met these objectives by altering taxpayers’ behavior to generate an improved environmental outcome. A general consensus based on the review of the carbon tax by several scholars indicates that the carbon tax has been highly environmentally effective in terms of its objectives.<sup>122</sup> Noteworthy is the periodic research conducted by Sustainable Prosperity (SP), a national green economy think tank at the University of Ottawa on the efficacy of B.C.’s carbon tax.<sup>123</sup> This group has been tracking the impacts of the carbon tax in B.C. since its introduction in 2008.<sup>124</sup> In addition to the reviews relying on figures provided by Statistics Canada,<sup>125</sup> these periodic reports have also been adopted by the World Bank in discussing and evaluating the B.C. carbon tax, thereby adding credibility to its adoption in this thesis.<sup>126</sup>

According to the 2013 SP review, fuel consumption in B.C. has reduced since the introduction of carbon tax while fuel use in the rest of Canada has increased. In evaluating the environmental effects of the tax, the report compared the consumption of only those fuels that are subject to the

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<sup>121</sup> *Ibid.*

<sup>122</sup> Nicholas Rivers & Dave Sawyer, “Pricing Carbon: Saving Green: A Carbon Price to Lower Emissions, Taxes and Barriers to Green Technology”, (2008), Suzuki Foundation, online: < <http://www.davidsuzuki.org> > at 20-21; Pierre Sadik, “Essentials of a Carbon Tax for Canada”, (2015), Eco Justice website, online: <http://www.ecojustice.ca> > at 10;

<sup>123</sup> Elgie & McClay, 2012, *supra* note 111; Stewart Elgie & Jessica McClay, “BCs Carbon Tax Shift After Five Years: Results. An Environmental (and Economic) Success Story”, Sustainable Prosperity Policy Commentary, (July 2013), online: < <http://www.sustainableprosperity.ca> > [Elgie & McClay, 2013].

<sup>124</sup> Elgie & McClay, 2012, *supra* note 111 at 6.

<sup>125</sup> Elgie & McClay, 2013, *supra* note 123 at 2, Table 1.

<sup>126</sup> World Bank, Carbon Pricing, *supra* note 107 at 87.

carbon tax in BC to their corresponding consumption in the rest of Canada, on a per capita basis.<sup>127</sup> The comparison was based on the period immediately preceding the introduction of carbon tax in B.C. (between July 1 2007 – June 30 2008) and the period within which the tax had been introduced and implemented (July 1 2008 – June 30 2012).<sup>128</sup> The review found that “BC’s fuel consumption per person has fallen every year since the carbon tax came in; overall, it declined by 17.4 percent from the 2007/08 base year to 2011/12”.<sup>129</sup> In comparison to the rest of Canada, it was noted that B.C.’s fuel consumption “declined 18.8 percent more than in the rest of Canada during this four year period – a remarkably large difference”.<sup>130</sup>

Dynamic efficiency is another useful criterion suggested by the OECD for evaluating environmentally related taxes. The OECD notes that environmentally related taxation ought to incentivize the taxpayers to adopt cheaper and innovative techniques and technology for abatement.<sup>131</sup> In the case of B.C., it is apparent that the increase in gasoline prices due to the taxation on carbon has influenced consumers to purchase more fuel efficient vehicles.<sup>132</sup> Specifically, relevant data indicate that, “[t]he market share of subcompact and compact passenger car sales has increased steadily while the market share of larger cars, SUVs, pickups and minivans has declined.”<sup>133</sup> Even though this change in consumer behaviour can be as a result of multiple factors, the B.C. Ministry of Finance as well as reports from other writers suggest that carbon tax played a dominant role in affecting consumers’ behaviour in choosing a cleaner energy alternative in the purchase of vehicles in the B.C. province.<sup>134</sup>

In terms of innovation of technology, studies conducted on certain communities in B.C. indicate that the carbon tax has encouraged the development of clean energy projects in most of those

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<sup>127</sup> See especially, Elgie & McClay, 2013, *supra* note 123 at 2 (footnote 3). The fuel used in the analysis se include propane, butane, naphtha, motor gasoline, stove oil/kerosene, diesel fuel oil, light & heavy fuel oils, petroleum coke, and still gas.

<sup>128</sup> *Ibid.*

<sup>129</sup> *Ibid.*

<sup>130</sup> *Ibid.*

<sup>131</sup> OECD, 2001, *supra* note 119 at 46.

<sup>132</sup> B.C. Facts, *supra* note 110.

<sup>133</sup> *Ibid.*

<sup>134</sup> *Ibid.*; Ross Beaty, Richard Lipsey & Stewart Elgie, “The Shocking Truth About B.C.’s Carbon Tax: It Works”, *The Globe and Mail*, (9 July 2014), online: < <http://www.theglobeandmail.com>>



communities.<sup>135</sup> Specifically, interviews were conducted on twelve local governments in B.C. by Pembina Institute, an organisation that promotes clean energy solutions through research, education, consulting and advocacy.<sup>136</sup> The findings of the Institute revealed that seven of the twelve communities that were interviewed indicated the carbon tax “as having either a very or somewhat positive role in building the business case for projects they had implemented.”<sup>137</sup> The remainder of the communities interviewed noted that carbon tax had a neutral impact on the business case for their projects because the tax rate “is too low to significantly influence their investment decisions”.<sup>138</sup> Based on these interviews, it is evident that a higher percentage of these communities perceive a positive impact of carbon tax in making decisions for clean energy innovation, especially as there was no “negative impact” recorded in the interviews. In one of the reports, Sarah Webb, a Climate Action program manager in the Capital Regional District was quoted as saying that, “[t]he tax was an external mechanism that helped [the district] quantify the economic differences between ‘business as usual’ and green infrastructure innovation. While we recognize there are some limitations of the carbon tax, it is a step in the right direction to more holistic accounting.”<sup>139</sup>

Based on the above, one can reasonably conclude that the B.C. carbon tax has been substantially successful in terms of its environmental effects and dynamic efficiency as it stimulates clean energy awareness and technological progress in the area of clean energy innovation. Nevertheless, the next section in this thesis also assesses the carbon tax in terms of its continued relevance, costs and administrative efficiency in order to provide a comprehensive ex post evaluation of this tax.

#### **5.1.3.2. Generic Ex-Post Evaluation**

While the aforementioned positive reports on the B.C.’s carbon tax is reflective of its continued relevance in addressing the objectives of the tax, the initial public opinion on the tax was not as favourable. It was noted that the initial reaction to the carbon tax in B.C. was quite controversial

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<sup>135</sup> Kevin Sauve & Matt Horne, “Lessons from B.C.’s Carbon Tax”, *Corporate Knights*, (8 November 2014) online: <<http://www.corporateknights.com>> [Sauve & Horne]; Joshua MacNab, “Carbon Tax Encourages Municipal Climate Action in British Columbia” Pembina Institute, (20 September 2012), online: <<http://www.pembina.org>> [MacNab].

<sup>136</sup> Timothy Shah & Claire Beckstead, “Local Climate Action in British Columbia: Motivations and Policy Impacts”, Pembina Institute, (20 September 2012), online: <<http://www.pembina.org>>.

<sup>137</sup> Sauve & Horne, *supra* note 135.

<sup>138</sup> *Ibid.*

<sup>139</sup> MacNab, *supra* note 135.

as “public support [for carbon tax] dropped as low as 40 percent when the policy was implemented”.<sup>140</sup> However, public support for the tax began to trend upwards and reached a high of sixty-four percent (64%) in November 2012 when B.C.’s carbon tax rate reached its maximum level.<sup>141</sup> In B.C.’s 2013 Carbon Tax Review, more than seventy-five percent (75%) of the 2,200 public submissions received from British Columbians expressed support for the tax.<sup>142</sup> It was noted that this percentage was indicative of public support from the “urban, suburban and rural parts of the province”.<sup>143</sup> The increasing support of the carbon tax in terms of numerical and geographical terms is a good indication of the continued relevance of the carbon tax in British Columbia.

In terms of the cost-effectiveness of carbon taxation, it has been emphasized that experts consider carbon pricing as the most cost-effective tool for reducing GHG emissions.<sup>144</sup> According to the 2013 SP review, the cost effective nature of carbon tax in comparison to other alternatives is a view held by “[a]most all economists, and most Canadian business and environmental leaders.”<sup>145</sup> This tax has been considered efficient for a number of reasons. First the gradual tax rate structure of the tax enables businesses to manage their fuel consumption and plan their future investments.<sup>146</sup> Secondly, the carbon tax puts a price on emissions from consumers along with emissions from industrial activity by charging the same price for every unit of GHG emission on almost all individuals and businesses.<sup>147</sup> Finally, B.C.’s economic growth has kept pace with the rest of Canada thereby suggesting that the implementation of the carbon tax has not had a negative impact on the province’s economy.<sup>148</sup> In terms of GDP growth, available data shows that, “BC’s economy has slightly outperformed the rest of the country over the period that the carbon tax has been in place.”<sup>149</sup> Therefore, the revenue- neutral nature of the carbon tax has not affected the economic growth of B.C. even with the revenue negative figures it has recorded.<sup>150</sup>

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<sup>140</sup> Sauve & Horne, *supra* note 135.

<sup>141</sup> *Ibid.*

<sup>142</sup> *Ibid.*

<sup>143</sup> *Ibid.*

<sup>144</sup> Elgie & McClay 2013, *supra* note 123 at 6.

<sup>145</sup> *Ibid.*

<sup>146</sup> Ekaterina Rhodes & Mark Jaccard, “A Tale of Two Climate Policies: Political Economy of British Columbia’s Carbon Tax and Clean Electricity Standard” (2013) 34:2 Canada Public Policy at S5 [Rhodes & Jaccard].

<sup>147</sup> *Ibid.*

<sup>148</sup> Elgie & McClay 2013, *supra* note 123 at 6

<sup>149</sup> *Ibid* at 5.

<sup>150</sup> *Supra* note 113.

In evaluating administrative efficiency, the OECD noted the cost of administering the tax should be relatively minimal.<sup>151</sup> The current structure of B.C.'s carbon tax has been described as a good structure in terms of administrative burden.<sup>152</sup> The implementation of this tax scores high on administrative efficiency because it simply requires a change in the rate of existing fuel and income taxes that the government already administers and the rate of tax credits that the government already distributes.<sup>153</sup> Thus, the administration of B.C.'s carbon tax allows multiple benefits to the government, companies, and final consumers at minimal cost to all parties concerned.

#### **5.1.3.3. Ex-Ante Assessment**

In deciding whether or not to introduce the carbon taxation into Nigeria, this thesis draws on the parameters suggested by the OECD for TEs given the aforementioned similarities B.C.'s carbon tax shares with TEs. Thus, this ex-ante assessment of carbon tax will address the *need* for pollution taxation in Nigeria, the proposed *objectives* of the tax in Nigeria as well as the justification for using pollution tax as a *tool* for reducing emissions as opposed to other alternative market instruments.

The consequent effects of oil spillages and gas flaring discussed in chapter one present a compelling need to reduce the environmental impacts of oil exploration and production activities in Nigeria. Even though Nigeria has existing measures directed at improving the environment, it has not fared well in terms of enforcement of these laws.<sup>154</sup> Particularly, the lack of awareness of environmental issues by the populace coupled with the failure of government to strictly enforce the existing rules have been cited as contributory factors to the current environmental problems in Nigeria.<sup>155</sup> This thesis contends that carbon taxation, especially the variant adopted in B.C., can address these limiting factors. Since the B.C.'s carbon tax is structured as a transfer payment to government which is returned to the taxpayers via tax cuts and tax credits, this thesis argues that

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<sup>151</sup> OECD 2001, *supra* note 119 at 46.

<sup>152</sup> Rhodes & Jaccard, *supra* note 146 at S11.

<sup>153</sup> *Ibid.* In practical terms, the wholesalers pass on the tax to retailers who see the tax itemized on their receipts at the pump. This means that the province only collects the tax directly from a limited number of companies such that individual taxpayers and most businesses do not have to fill new forms solely in respect for carbon taxation.

<sup>154</sup> Cecilia Chinwe Nwifo, "Legal Framework for the Regulation of Waste in Nigeria" *Int'l Multidisciplinary J* (2010) 4:2 491 at 497-99. This article highlights some of the major environmental legislation in Nigeria and their major objectives [Nwifo].

<sup>155</sup> *Ibid.*

(i) the potential for continuous incentives is likely to increase taxpayers' awareness of environmental issues and (ii) the enforcement of the tax is likely to be less cumbersome for the government since the implementation of the pollution tax is tied to existing personal and corporate tax systems.<sup>156</sup> Thus, the implementation of a pollution tax similar to the revenue-neutral carbon tax in B.C. is predominantly self-enforcing for addressing the environmental challenges that accompany oil production in Nigeria.

In determining the objectives of carbon taxation in Nigeria, it is important to determine the proposed scope of application. While the imposition of carbon taxation for *individuals* and *businesses* (as applicable in B.C.) is desirable for the general reduction of carbon and other harmful emissions in Nigeria, introducing an identical structure in Nigeria at the initial phase is likely to reduce public support and acceptance of the tax policy in Nigeria. The thesis considers it advisable that the initial phase of the tax should be directed at upstream oil and gas companies exclusively (i.e., exploration stage) for a number of reasons: (i) the current lack of awareness of environmental issues may confer a superficial innocence on individuals and non-oil businesses, thereby these groups will consider the tax as unwarranted or consider the tax as “paying for other people’s mistakes”; (ii) the past and current oil production activities which resulted in the current and more noticeable environmental degradation in the Niger Delta amplifies the complicity of the oil producing companies; (iii) the initial imposition of the tax on a broad scale may be costly and challenging for the federal government as opposed to implementing the program in the oil and gas industry alone. Therefore, this thesis contends that imposition of the carbon tax on upstream oil and gas companies in the short term and ultimately on individuals and other businesses in the long run is a more politically saleable approach to the introduction of this particular tax in Nigeria. Therefore, the remainder of the thesis considers the tax in the terms of the proposed short term application (upstream oil producing companies).

Based on the proposed scope of its application, this thesis contemplates a hybrid tax transplant given the proposed modifications of B.C.’s carbon tax prior to its introduction into Nigeria’s tax

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<sup>156</sup> Rhodes & Jaccard, *supra* note 146 at S3. This is because the revenue neutral feature of the carbon tax entails that all the revenue collected by the provincial government through the carbon tax must be returned to the carbon taxpayers (British Columbians and B.C. businesses) through tax cuts to their personal income tax and some business taxes. Thus, the availability of the tax cuts can increase awareness of the carbon tax while the administration is less cumbersome because the mechanism for implementation of the personal income tax and the relevant business taxes are already in existence.

system. First, the thesis recommends that the tax should be called an “Oil Exploration Pollution Tax” in order to extend the scope of the tax to include oil spillages and other environmental pollution issues resulting from oil exploration in Nigeria. Also, this thesis recommends that the proposed objectives for the tax should be: (i) to shift the burden of gas flaring, oil spillages and other environmental pollution arising from the exploration and extraction of crude oil to those responsible for it; (ii) to impose a price for harm done to the environment through exploration and extraction of crude oil; (iii) to discourage pollution and protect the Nigerian environment; (iv) to encourage more sustainable behaviour in oil eation and production in Nigeria; (v) to promote greater economic welfare by making clean energy alternatives more attractive to oil and gas businesses.

In terms of approach, it has been observed that “among policy analysts, international organizations, many large companies and academics, there is a nearly universal acknowledgement that a carbon tax represents the optimal policy instrument for reducing greenhouse gases.”<sup>157</sup> Even though carbon tax has been identified as the preferred policy for reducing emissions, there are a number of alternative policy measures that also put a price on carbon which have been adopted in other Canadian provinces and other jurisdictions.<sup>158</sup> For instance, the “benchmark-and-credit” system and the cap and trade policy have been used to reduce greenhouse gas emissions in Alberta and Quebec respectively. Noteworthy is the cap and trade policy which has been a subject of comparison with carbon taxation in the literature.<sup>159</sup> In assessing the better approach between these two dominant alternatives, it is important to describe the cap and trade system of carbon pricing. The cap and trade system like the name implies is a system where the government puts a firm restriction or cap on the overall level of carbon pollution from the industry and reduces this cap annually in order to reach a set pollution target.<sup>160</sup> Thus, the cap and trade system begins with a *fixed quantity of emission* and allows the price of the carbon to emerge through trading while carbon taxes begin with a *fixed price* and subsequently allow the quantity of emissions to emerge in response to the fixed price.

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<sup>157</sup> Rivers, *supra* note 108 at 14.

<sup>158</sup> *Ibid* at 13.

<sup>159</sup> See for example, Rivers, *supra* note 108; Kathryn Harrison, “A Tale of Two Taxes: The Fate of Environmental Tax Reform in Canada”, (2012) 29:3, Review of Policy Research 383 [Harrison].

<sup>160</sup> Harrison, *ibid* at 385.

It has been argued that carbon taxation is a better option than the cap and trade system. Nevertheless, cap and trade system has also been used successfully in some jurisdictions such as the United States and Europe.<sup>161</sup> However, this thesis recommends carbon tax for reducing environmental pollution from oil production activities over the cap and trade system because: (i) the design of carbon tax is simpler, more transparent and can be implemented almost immediately because the tax structures are already in place while the design for the cap and trade system would involve the initial allocation of permits which may take many years;<sup>162</sup> (ii) carbon taxes are likely to drive innovation as the fixed price of the taxes will stimulate innovations in technology as opposed to cap and trade systems where wealthy investors can grandfather the permits of smaller businesses;<sup>163</sup> and (iii) carbon taxes are more administratively efficient as they can be implemented by using existing tax information which the government already has unlike cap and trade system which may require new information requirement from individuals and businesses.<sup>164</sup> Furthermore, the use of carbon tax provides more price certainty which is a very important factor for businesses that aim to work towards a zero environmental footprint in oil and gas exploration and production.

For the purpose of transplanting the carbon tax into Nigeria's legal system, this thesis recommends that the pollution tax can be imposed at a rate to be determined by the FIRS and Nigeria's DPR. This is because the determination of an effective tax rate that will attract the desired behavior (reduction of pollution) involves specialized expertise and data (for instance, chemical composition of the pollutants or behaviour of upstream companies to existing schemes) that is beyond the scope of this thesis. However, the thesis suggests that the pollution tax be introduced at a lower starting rate (as was done in B.C.) and increased over time if the apparent severity of environmental degradation is on the increase. Similarly, the tax rate can also be scheduled to reduce over time if the severity of pollution from oil exploration activities also appears to be decreasing. As earlier mentioned, this thesis maintains that the imposition of the tax at the level of exploration and production is an administratively more efficient way to levy the tax given the current state of Nigeria's oil and gas industry.

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<sup>161</sup> Rivers, *supra* note 108 at 13.

<sup>162</sup> *Ibid* at 15.

<sup>163</sup> *Ibid*.

<sup>164</sup> *Ibid*.

As a result of the dominant role of the NNPC in the Nigerian oil and gas industry, the potential effect of the pollution tax on the NNPC is noteworthy. Under the existing laws, the national oil company is *not* exempt from “liability for any tax, duty, rate, levy or other charge”.<sup>165</sup> The *Petroleum Profits Tax Act*, provides that tax shall be levied on the profits “of *any* company engaged in petroleum operations during that period”.<sup>166</sup> Under the PSC arrangement, the NNPC and the IOC are liable to tax “in accordance with the proportion of the percentage of profit oil split”.<sup>167</sup> Under the JV arrangement, both the NNPC and the IOCs are jointly liable for tax, royalty and rent because the concession is jointly held by the IOC and the NNPC.<sup>168</sup> For PSC and risk service contracts, Nigeria’s petroleum law provides that “the Corporation [NNPC] or the Holder [of the concession] ... shall pay all royalty, concession rentals and PPT on behalf of itself and the Contractor out of the allocated royalty oil and tax oil”.<sup>169</sup> Given that the NNPC holds the concession under both arrangements, this suggests that the NNPC has the responsibility for *paying* tax, rent and royalty even though the tax liability (chargeable amount) is to be split among the parties in the same ratio as the profit oil.<sup>170</sup> In effect, the language of the law indicates that the NNPC alone should be liable for the *payment* of these charges under the PSC and risk service contracts.

Although the NNPC pays taxes, rents and royalties as a “company engaged in petroleum operations”, its influential position as a national oil company remains significant. Despite its liability to pay taxes, the *NNPC Act* provides that “oil pipelines and other installations” belonging to the NNPC such as oil rigs and refineries are exempt for the purpose of imposition of “any tax, duty, rate, levy or other charge whatsoever, whether general or local”.<sup>171</sup> This means that the NNPC enjoys certain exemptions which are not available to other stakeholders. This preferential status of the NNPC is also evident in its role as a petroleum revenue collection agent since the

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<sup>165</sup> *Nigerian National Petroleum Corporation Act*, LFN 2004, c N123, s 16 [NNPC Act].

<sup>166</sup> PPTA, *supra* note 89, s8, [emphasis added].

<sup>167</sup> *Ibid*, s 22(4).

<sup>168</sup> *Petroleum Act*, *supra* note 98, s7; Bayo Adaralegbe, “Petroleum Development Arrangements in Nigeria’s Oil and Gas Sector” (PowerPoint presentation delivered at the ESQ Oil and Gas Seminar, 15-16 June, 2011) at 66. [Adaralegbe].

<sup>169</sup> *Deep Offshore and Inland Basin Production Sharing Contracts Act Decree No 9 of 1999*, LFN 2004 c D3 s 11 (1) [DOIBPSCA] provides that the NNPC (or the holder of the concession) is to pay royalty, concession rentals and PPT “on behalf of itself and the Contractor out of the allocated royalty oil and tax oil”. PDPR, *supra* note 98, reg 61 also provides that “[t]he licensee or lessee shall pay to the Minister not more than one month after the end of every quarter” royalty at the specified rates

<sup>170</sup> DOIBPSCA, *ibid*, s 12.

<sup>171</sup> NNPC Act, *supra* note 165, s 16.

government collects royalties, fees and taxes from operators in the oil and gas sector through the FIRS and the NNPC.<sup>172</sup>

Due to the dual role of the NNPC as taxpayer and tax collector (such as tax oil which the NNPC collects under the PSC), the impact of the pollution tax on the NNPC is particularly noteworthy. Consequently, this thesis suggests that the imposition of the pollution tax should recognize the existing fiscal responsibilities and exemptions of the NNPC. Specifically, the application of the pollution tax could be structured to mirror the current corporate income tax structure in Nigeria's petroleum industry. That is, the NNPC and the IOCs should be jointly liable to pay pollution tax in proportion to their participating interests under the JV arrangements. Similarly, the licensee or the lessee under the PSCs and risk service contracts should be liable for the payment of the pollution tax under those arrangements. In terms of exemption, the parties (NNPC and IOCs) should also be exempt from the pollution tax under arrangements where the parties currently enjoy tax exemptions. For instance, income derived from associated gas framework agreements –which are currently exempt from PPT – should also be exempt from pollution tax for both parties. This thesis contemplates that the implementation of the pollution tax in this manner will be useful for administrative efficiency of the pollution tax. Even though the potential impact of these recommendations on the NNPC is likely to be of great significance to government's decision making, this thesis is optimistic that the long-term benefits of the recommendations will be recognized and given more preference by the federal government.

## **5.2. Administrative Measures**

In addition to the fiscal incentives above, there are certain tax administrative measures which have the potential for petroleum sector reforms in Nigeria. In order to increase the viability of these measures in Nigeria's legal system, the administrative recommendations provided in this thesis consider and acknowledge the relevant legal considerations between the two jurisdictions discussed in 2.3. The two administrative measures proposed in this thesis are the Informants Lead Program and the Mandatory Reporting Standards for the Extractive Sector.

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<sup>172</sup> Chioma Atuokwu, "Taxation for a Sustainable Development in Africa – A Case Study of Taxation in the Nigerian Oil and Gas Sector" (2009) ISODEC 1 at 4.



### 5.2.1. Informants Lead Program

In dealing with corruption and lack of accountability, Nigeria can borrow from the Canadian government by implementing certain features of the “Informant Leads Program” (ILP).<sup>173</sup> This is a program instituted by the CRA and provides an avenue for individuals to report tax non-compliance in an anonymous capacity.<sup>174</sup> In Canada, the ILP has three variants depending on the source of information or the nature of income under consideration.<sup>175</sup> The first variant enables informants to notify the CRA of domestic tax fraud. The second variant is the Offshore Tax Informant Program (OTIP) which is geared towards international tax evasion and avoidance.<sup>176</sup> For OTIP, the informants can receive up to 15% of the federal tax collected as reward where information provided leads to collection of such offshore taxes. The third and the most recent inclusion to the ILP is geared towards internal fraud and misuse among CRA employees.<sup>177</sup>

According to the CRA, the mandate of the ILP is to coordinate all the leads received by the CRA from informants so that the CRA can determine if there is an element of non-compliance with tax legislation and ensure that the appropriate departments receive those leads for investigations and enforcement of action.<sup>178</sup> The nature of information that the CRA may consider useful in determining whether or not to undertake an investigation, audit or other action include the name, contact information, social insurance number, date of birth and spouse’s name of the person or people one suspects of such non-compliance.<sup>179</sup> Where the information relates to a corporate entity, the CRA may require from the informant details relating to the business name, names of the shareholders as well as names of related companies.<sup>180</sup> Informants can pass the information they wish to give to the CRA by phone, email, facsimile or online through the CRA website.<sup>181</sup>

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<sup>173</sup> Canada Revenue Agency, “Informant Leads Program” (15 January 2014), online: Canada Revenue Agency <<http://www.cra-arc.gc.ca>> [CRA ILP].

<sup>174</sup> *Ibid.*

<sup>175</sup> Steve Rennie, “CRA sets up a snitch line for its own staff”, *The Star* (16 September 2014), online: <<http://www.thestar.com>> [Rennie].

<sup>176</sup> Canada Revenue Agency, “Offshore Tax Informant Program”, (14 January 2014) online: Canada Revenue Agency <<http://www.cra-arc.gc.ca>> [CRA OTIP].

<sup>177</sup> Rennie, *supra* note 175.

<sup>178</sup> CRA ILP, *supra* note 173.

<sup>179</sup> Canada Revenue Agency, “What to tell us”, (17 January 2012), online: Canada Revenue Agency <<http://www.cra-arc.gc.ca>>.

<sup>180</sup> *Ibid.*

<sup>181</sup> CRA ILP, *supra* note 173.

Although the CRA acknowledges that the informant may not have all the information above, the more details that are available to the CRA, the sooner the CRA can initiate appropriate action.<sup>182</sup>

As an informant under the ILP, providing personal contact information is not mandatory.<sup>183</sup> However, the 2013 Economic Action Plan indicates that there may be financial incentives to providing contact information as an OTIP informant.<sup>184</sup> Under this arrangement, informants may be entitled to rewards if they have knowledge of major international tax non-compliance that results in the CRA's collection of outstanding tax liability.<sup>185</sup> Specifically, the CRA will enter into a contract that will result in financial rewards for the informant "only if the information provided results in total additional assessments or reassessments exceeding \$100,000 in federal tax".<sup>186</sup> This contract will provide for payment to the informant between five percent (5%) to fifteen percent (15%) of the federal tax collected (i.e., excluding penalties, interest and provincial taxes) and such payment is only payable after the erring taxpayers have paid the taxes to the CRA.<sup>187</sup> For the awards to be paid, the non-compliant activity must relate to transactions conducted partially or entirely outside Canada or involve foreign property or property located or transferred outside Canada.<sup>188</sup> While eligibility is not restricted to Canadian citizens alone, an informant must meet the program criteria.<sup>189</sup> For instance, informants will not qualify for the financial rewards if: (a) the informant is involved in the non-compliance and has been convicted of tax evasion for the matter; (b) the individual is the authorized representative of the taxpayer involved; (c) the informant is already obligated to disclose the information to the CRA, and (d) the information lacks integrity or is already in the possession of the CRA.<sup>190</sup> A number of OECD member countries including the United Kingdom, United States and Germany already provide rewards for information regarding tax non-compliance.<sup>191</sup> Thus, the provision of rewards in exchange for tax

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<sup>182</sup> *Ibid.*

<sup>183</sup> *Ibid.*

<sup>184</sup> Canada, Economic Action Plan 2013, "Jobs, Growth and Long-Term Prosperity", Canada Economic Action Plan website, online: <<http://actionplan.gc.ca>> at 367 [Economic Action Plan 2013]. However, an informant's contact information remains confidential even for reward purposes.

<sup>185</sup> *Ibid.*

<sup>186</sup> *Ibid.*

<sup>187</sup> *Ibid.*

<sup>188</sup> *Ibid.*

<sup>189</sup> CRA OTIP, *supra* note 176.

<sup>190</sup> *Ibid.*

<sup>191</sup> Economic Action Plan 2013, *supra* note 184 at 155.

information is not peculiar to Canada alone. This thesis suggests that Nigeria can benefit from this “rewards” aspect of the OTIP as well as certain aspects of the ILP.

Currently, Nigeria has an existing whistleblowing program directed at domestic fraud and corruption among FIRS employees.<sup>192</sup> However, this whistleblowing program does not specifically address and/or reward the supply of information relating to international tax evasion and avoidance. While this thesis does not recommend the adoption of the first and third variant of Canada’s ILP, it identifies two areas of improvement for Nigeria’s existing measures and recommends the adoption of the OTIP as a complementary measure to these tax evasion reducing mechanisms.

Nigeria’s whistleblowing program for domestic tax fraud and internal fraud among tax administrators is carried out by the Values and Doctrines Division (VDD) of the FIRS.<sup>193</sup> This division was created in 2005 as a result of the “dwindling public perception and confidence” towards the FIRS.<sup>194</sup> The VDD was created to improve the whistleblower unit of the FIRS called the Anti-Corruption and Transparency Unit (ACTU) which had earlier been established to serve as a window through which informants could reach the FIRS Chairman with information regarding corrupt practices involving the FIRS and its staff.<sup>195</sup> The VDD has a mandate to prevent, detect, investigate and ultimately refer for prosecution FIRS staff and non-staff who are found complicit in tax fraud cases.<sup>196</sup> Similar to the CRA’s ILP, informants can report suspected cases of fraud to the FIRS through the FIRS dedicated telephone numbers, email addresses or on the FIRS website in an anonymous capacity.<sup>197</sup>

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<sup>192</sup> For an overview of Nigeria’s whistleblowing program, see Ifueko Omoigui Okauru, *Federal Inland Revenue Service and Taxation Reforms in Democratic Nigeria* (Ibadan, Nigeria: Safari Books Limited, 2012) at 41 [Okauru]. For an instance where Nigeria’s whistleblowing program has been used for detection of tax fraud, see especially News Agency of Nigeria, “FIRS Sues Jimoh Ibrahim, Air Nigeria, For Forgery, ₦5 Billion Tax Fraud – NAN”, *Sahara Reporters*, (21 June 2012), online: <<http://saharareporters.com>> [FIRS Sues].

<sup>193</sup> Okauru, *ibid* at 41.

<sup>194</sup> *Ibid.*

<sup>195</sup> *Ibid.*

<sup>196</sup> *Ibid.*

<sup>197</sup> *Ibid* at 42; Federal Inland Revenue Service, “Fraud Alert”, online: Federal Inland Revenue Service website <<http://www.firs.gov.ng>>.

In terms of efficacy of whistleblowing measures, evidence suggests that the most common forms of corruption detection in recent times is done through whistleblowing.<sup>198</sup> For instance, a 2007 survey conducted by KPMG (a global network of professional firms providing tax, audit and advisory services) noted that out of 360 instances of fraud in businesses in Europe, the Middle East, and Africa, the main source of detection was through anonymous tipping by informants and whistleblowers.<sup>199</sup> Even though whistleblowing has also been instrumental in providing viable leads on tax fraud to the FIRS, the program has not reached the desired level of success as an anti-corruption mechanism.<sup>200</sup> It has been noted that risks associated with whistleblowing such as ostracism, loss of job or means of livelihood, threat to informant's life or their loved ones as well as loss of income and/or time in cases of tax litigation are factors that deter potential informants from providing valuable information to the FIRS.<sup>201</sup>

Perhaps the successes recorded in the aforementioned KPMG survey is attributable to the existence of legislation and policies that support whistleblowing in these regions.<sup>202</sup> Even though Nigeria is signatory to several international conventions that emphasize whistleblowing for the purpose of reducing corruption,<sup>203</sup> there is currently no legal protection for whistleblowers as Nigeria's Whistle Blower Protection Bill ("WBPB") awaits presidential assent.<sup>204</sup> The current Nigerian laws which encourage whistleblowing protect the identity of the informants but have no

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<sup>198</sup> See Abdulsalam Ajeturmobi, "Whistle-blowing As A Potent Anti-Corruption Tool" *Punch Newspaper* (10 February 2012), online: < <http://www.punchng.com>>. [Ajeturmobi]

<sup>199</sup> *Ibid.*

<sup>200</sup> FIRS Sues, *supra* note 192.

<sup>201</sup> See, Vincent A Onodugo, "Whistle Blowing: Inspiring Chartered Accountants" (Paper delivered at the 44<sup>th</sup> Annual Accountants Conference, at the International Conference Centre Abuja, 10 September 2014), online: <http://icanig.org>> at 18-9 [Onodugo]. This paper also discusses global legislation and policies in support of whistle blowing and gives context to the aforementioned factors that militate against whistle blowing in Nigeria.

<sup>202</sup> For instance, Canada has the *Public Servants Disclosure Protection Act*, SC 2005, c46. Similarly, the United States has the *US Sarbanes-Oxley Act*, HR 3763 (107<sup>th</sup>). Section 806 of this U.S legislation grants protection to employees of publicly traded companies against retaliation in fraud cases. The United Kingdom has the *UK Public Interest Disclosure Act* 1998, c23. Section 2(1) and 3 (1A) of the UK legislation grants protection to individuals who make certain disclosures in good faith and public interest. For other countries and their whistleblowing policies, see Onodugo, *ibid* at 27-8.

<sup>203</sup> See Ajeturmobi, *supra* note 198. Some conventions Nigeria has signed and ratified include the *African Union Convention on Preventing and Combating Corruption*, 11 July 2003, AU Assembly, 2<sup>nd</sup> Ord Sess art 5 (entered into force 5 August 2006) and UN General Assembly, *United Nations Convention Against Corruption*, 31 October 2003, A/58/422 art 33 (entered into force 14 December 2005).

<sup>204</sup> SB 233, *Whistle Blower Protection Bill 2008*, 7th Sess, National Assembly June 2011- June 2015, (second reading 9 May 2012) [WBPB]. This bill was passed by the Senate in June 2015 and is awaiting presidential assent by the newly elected administration in Nigeria. See Emmanuel Aziken & Dapo Akinrefon, "Buhari To Fight Graft With 5 Special Laws", *Vanguard* ( 16 June 2015), online: <<http://www.vanguardngr.com>>

additional provisions that address instances where such identity is erroneously or negligently compromised.<sup>205</sup> However, the new bill is very promising in this regard as it *inter alia*, contains specific provisions that protect informants from victimization and also provides for compensation to eligible informants.<sup>206</sup> In order to improve the efficacy of whistleblowing as a tax fraud detection measure in Nigeria, this thesis suggests the prompt passage of the WBPB into law as this will not only energize the FIRS and anti-corruption agencies but also empower Nigerians to fight corruption. Secondly, this thesis recommends that policies directed at the protection of potential informants from victimization should also be included in corporate governance documents for private businesses and non-tax parastatals.

As a complementary measure to the existing whistleblowing program in Nigeria, this thesis also recommends the simple tax transplant of the OTIP for addressing international tax evasion in Nigeria. Given the prevalence of tax evasion in Nigeria (as discussed in 1.3.1.4), one may reasonably argue that the element of financial reward for non-compliance with tax laws may entice potential informants and ultimately increase the amount of unreliable information received by the FIRS. Another valid concern could be the possibility of the informants submitting false information based on revenge-motive such as business competitors, aggrieved spouses, former employees or business partners. However, these concerns can be addressed in a number of ways: (i) they can be addressed by ensuring that significant time and resources are invested into the FIRS administrative systems for vetting informants and the information received; (ii) heavy fines and penalties can also be imposed as a deterrence measure on FIRS staff and/or informants that submit false information under the proposed transplant given the rate of internal corrupt practices within the FIRS; (iii) in addition to fines and penalties, the incidence of providing false information based on revenge-motive can also be reduced by placing the burden of proving the *absence* of such motive on the prospective informant. Since informants that wish to receive rewards are expected to submit their personal information, the FIRS may request the prospective informants to provide

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<sup>205</sup> In addition to tax legislations allowing anonymity of the informants, Nigeria's *Corrupt Practices and Other Related Offences Act*, LFN 2004, c C31, s 64 and the *Economic and Financial Crimes Commission (Establishment) Act*, LFN 2004 c E1, s 39(1) provide for the protection of the identity of the informants but there is no mechanism to protect these individuals when such identity is negligently compromised. For actual whistleblowing scenario and current legislative attitude to whistleblowing in Nigeria, see Ibrahim Sule, "Sanusi: The Whistleblower and the Nigerian Laws", *Sahara Reporters*, (10 March 2014), online: <<http://saharareporters.com>>

<sup>206</sup> WBPB, *supra* note 204, Part IV.

details of the nature of their relationship to the alleged non-compliant party.<sup>207</sup> Even though the claims of a prospective informant cannot be directly verified or rebutted by the alleged non-compliant party due to the element of anonymity of informants, the existence of such requirement could be a deterrence for the submission of false information to the FIRS. Given that one of the major challenges of oil and gas tax administration in Nigeria relates to evasion of taxes by multinational oil companies, this thesis contends that the OTIP could be a suitable medium through which suspected cases of international tax evasion and aggressive tax avoidance can be reported to the FIRS for the purpose of appropriate action. Nevertheless, the whistleblowing measures discussed in this thesis can only play a vital role in the reduction of corruption, fraud and mismanagement in Nigeria's tax administration if they are fairly and properly implemented in Nigeria's tax and legal system.

### **5.2.2. Mandatory Reporting Standards for the Extractive Sector**

In June 2013, the Canadian government unveiled plans to implement a mandatory reporting requirement for corporations in the extractive sector of its petroleum industry.<sup>208</sup> The purpose of the mandatory reporting standards is to honour and implement Canada's international commitments made to its G-7 counterparts to enhance transparency and accountability of eligible payments made by certain entities in the extractive industry.<sup>209</sup> Specifically, the reporting standards legislation – called the *Extractive Sector Transparency Measures Act*<sup>210</sup> (“ESTMA”) came into force on 1 June 2015 and requires public disclosure payments made by mining and oil and gas corporations engaged in the commercial development of oil, gas and minerals to all levels of government both domestic and abroad (including Aboriginal entities), on a project-by-project basis.<sup>211</sup>

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<sup>207</sup> Onodugo, *supra* note 201 at 29. Some questions that can be useful to the FIRS in assessing the credibility of the informant include: (i) Is the informant acting in public interest? (Public Interest Test); (ii) Is the informant acting in good faith? (Good Faith Test); (iii) Has the informant (especially in corporate cases) exhausted internal channels before external sources? (Benefit of Doubt Test); (iv) Does the whistleblowing prejudice the ability of the informant to do their job? (Impact Test); (v) Were the actions of the informant proportionate to the public interest at state? (Proportionality Test).

<sup>208</sup> Canada, Parliament of Canada, “Canada Commits to Enhancing Transparency in the Extractive Sector”, Prime Minister of Canada website, (12 June 2013) online: <<http://pm.gc.ca>>

<sup>209</sup> Canada, Government of Canada, “Mandatory Reporting Standards for the Extractive Sector”, Government of Canada website, (25 June 2015) online: <<http://open.canada.ca>> [Mandatory Reporting]

<sup>210</sup> *Extractive Sector Transparency Measures Act*, SC 2014, c 39 [ESTMA].

<sup>211</sup> Canada, Government of Canada, “Harper Government Delivers on Commitment to Enhance Transparency of Extractive Industry”, Government of Canada website, (1 June 2015) online: <<http://open.canada.ca>>.

The ESTMA requires Canadian extractive companies to publicly report payments including taxes, royalties, fees and production entitlements of \$100,000 (CAD) or more which they pay to all levels of government in Canada and abroad.<sup>212</sup> The legislation applies to two major categories of business entities that are directly or indirectly engaged in the commercial development of oil, gas or minerals in Canada or abroad.<sup>213</sup> The first category are entities that are listed on a stock exchange in Canada while the second category are entities that have a place of business in Canada, do business in Canada or have assets in Canada and meet or exceed two of the following conditions for at least one of its two most recent financial years (a) has at least \$20 million (CAD) in assets; (b) has at least \$40 million (CAD) in revenue; and/or (c) employs an average of 250 employees.<sup>214</sup> Based on the foregoing, the ESTMA is not restricted to Canadian-headquartered entities alone as foreign and domestic companies (including their subsidiaries) operating in Canada can potentially be captured within the ambit of this legislation if they have a controlling interest in any extractive project in Canada or abroad.<sup>215</sup>

Where an entity is required to disclose eligible payments under the ESTMA, such entity is required to file with the applicable minister (as appointed by the Governor in Council) a report in the prescribed form indicating all payments made to a payee during a fiscal year.<sup>216</sup> The concept of “payee” in the ESTMA comprises Canadian government, foreign governments (at subnational and local levels) and also includes boards, corporations, commissions, trusts or other bodies or authorities that perform a function for a government.<sup>217</sup> Notably, and in furtherance of the corruption detection and deterrence objective of the ESTMA, a payment that is made to an employee or public office holder of any of the payees is deemed to have been made to that government body, and must also be reported.<sup>218</sup> Thus, the ESTMA requires public disclosure of lawful payments to governments as well as payments that could potentially violate anti-corruption legislation in Canada.<sup>219</sup> In addition to filing the annual reports in the prescribed form with the

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<sup>212</sup> See ESTMA, *supra* note 210. For the nature of payments to be reported, see s 2 and for the threshold of payments to be reported see s 9(2).

<sup>213</sup> *Ibid*, s 2.

<sup>214</sup> *Ibid*, s 8 (1).

<sup>215</sup> Canada, Government of Canada, “Key Elements of the Extractive Sector Transparency Measures Act”, Government of Canada website, (26 June 2015) online: <<http://open.canada.ca>> [Key Elements].

<sup>216</sup> ESTMA, *supra* note 210 at s 9.

<sup>217</sup> *Ibid*, s 2.

<sup>218</sup> *Ibid*, s 3.

<sup>219</sup> An example of such anti-corruption legislation is the *Corruption of Foreign Public Officials Act*, SC 1998, c 34.

minister, reporting entities are required to make such reports public (annually) by, for example posting the reports on their corporate websites.<sup>220</sup> Where a reporting entity does not have a website, the minister will specify an alternative means to making the report accessible to the public.<sup>221</sup>

Since Canada's approach for mandatory reporting for the extractive industry is similar to the United States and European Union approaches (and may also emerge elsewhere), the ESTMA contains a substitution clause.<sup>222</sup> This clause allows the minister to determine that the reports originating from another jurisdiction (including provinces and/or foreign countries) can be submitted to satisfy Canada's reporting requirement subject to certain conditions the minister may impose.<sup>223</sup> For instance, a report that meets a province's mandatory reporting standards can (subject to ministerial approval) be determined to be an acceptable substitute for the federal standards. This provision allows for administrative efficiency as a reporting entity could choose to file a provincial report to meet the federal law. In addition to the above, the minister has authority to request for an audit or further information relating to payments made to governments from a reporting entity for the purpose of enforcing compliance with the ESTMA.<sup>224</sup>

In terms of exemption from the reporting standards, the ESTMA does not provide for an exemption clause.<sup>225</sup> Even though Canada, like the EU and the US, has acknowledged that there may be instances where the mandatory reporting standards require disclosure of information that is prohibited by another country's laws or the terms of a contract, no exemptions have been made for countries or contracts under their respective reporting regime.<sup>226</sup> Apart from nullifying the transparency objective of the ESTMA, allowing such exemptions is likely to encourage governments or reporting entities who wish to withhold information from interested parties to enact such prohibitory or anti-disclosure legislation or terms of contracts.<sup>227</sup> Thus, an exemption

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<sup>220</sup> ESTMA, *supra* note 210 at s 9 (5) provides for the Minister's exercise of discretion in making the reports available to the public; Key Elements, *supra* note 215.

<sup>221</sup> ESTMA, *ibid.*

<sup>222</sup> Key Elements, *supra* note 215.

<sup>223</sup> ESTMA, *supra* note 210, s 10.

<sup>224</sup> *Ibid.*, s 14.

<sup>225</sup> ESTMA, *supra* note 210.

<sup>226</sup> Mandatory Reporting, *supra* note 209.

<sup>227</sup> Alan Detheridge, "On Transparency Bill, Canada Should Stand Its Ground Against Big Oil", *The Globe and Mail*, (18 November 2014), online: <<http://www.theglobeandmail.com>>.



clause may only serve to undermine the fundamental purpose of the ESTMA which is to provide access to information for transparency and accountability purposes.

In Nigeria, the *Nigerian Extractive Industries Transparency Initiative Act* (“*NEITI Act*”),<sup>228</sup> which is aimed at developing transparency and accountability in Nigeria’s extractive industry, provides a similar mandate to the ESTMA. Under the *NEITI Act*, extractive companies (including foreign companies with a permanent establishment in Nigeria) are required to disclose to the NEITI, payments such as royalties, taxes, signature bonuses, levies and sales of equity crude and all other payments due to the Nigerian federal government from all extractive industry companies.<sup>229</sup> In contrast to the ESTMA, the only eligible payee under the *NEITI Act* is the Nigerian federal government who is also required to make disclosures to the NEITI.<sup>230</sup> Therefore, the *NEITI Act* requires extractive companies to disclose *payments* made to the Nigerian federal government while the government (including state-owned enterprises like the NNPC) disclose *receipts* to the NEITI.<sup>231</sup> These submissions are independently assessed for accuracy by the NEITI and communicated in a report to create public awareness about how the country should improve the management of its natural resources.<sup>232</sup>

Notably, the NEITI audit reports have exposed massive decay and corrupt practices in Nigeria’s oil and gas industry.<sup>233</sup> For instance, the NEITI was instrumental in uncovering unremitted funds of about \$2 million (USD) from IOCs arising from underpayments and underassessments based on payments and receipts submitted to the NEITI in 2013.<sup>234</sup> In addition to uncovering funds, the NEITI audits have also been instrumental in identifying other lapses in the oil and gas industry such as poor metering infrastructure for crude oil and the incapacity of regulatory agencies to verify royalty and petroleum profit tax computations.<sup>235</sup> Despite the laudable achievements of the

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<sup>228</sup> *Nigeria Extractive Industries Transparency Initiative Act*, LFN 2007 s2 [NEITI Act].

<sup>229</sup> *Ibid*, s 3.

<sup>230</sup> *Ibid*.

<sup>231</sup> *Ibid*.

<sup>232</sup> *Ibid*, s 4.

<sup>233</sup> Zainab Ahmed, “EITI Implementation in Nigeria: Outcomes, Impacts and Challenges”, (Paper delivered at the Global Commodities Forum, 7<sup>th</sup> – 8<sup>th</sup> April 2014), online: <http://unctad.org/meetings> at 14-5 [EITI Paper]. A NEITI audit report also exposed \$9.8 billion as potential revenue due to underassessment, underpayment and variance between what companies paid and what government received in the form of taxes, royalties and other eligible payments. See also, Adeola Yusuf, “NEITI Uncovers IOC’s \$30b Unremitted Fund”, *Daily Independent Nigeria* (14 May 2013), online: <http://dailyindependentnig.com>.

<sup>234</sup> EITI Paper, *ibid* at 15.

<sup>235</sup> *Ibid* at 14.

NEITI in improving transparency and accountability of Nigeria's oil and gas industry, two major factors that undermine the effectiveness of the initiative are lack of funds and failure of the government to implement the findings in the NEITI audit reports.<sup>236</sup> For instance, the NEITI's budget dwindled by about fifty percent (50%) between the years 2011 to 2013, thereby jeopardizing the agency's noble objectives.<sup>237</sup> However, the current government administration's commitment to implement the findings in previous NEITI audit reports provides a basis for renewed optimism about the future of the NEITI especially in terms of the role it can play in Nigeria's petroleum sector reforms.<sup>238</sup> Thus, this thesis simply recommends the hybrid transplant of certain features in the ESTMA that have the potential to improve the current NEITI initiative in Nigeria.

Although the mandate of Nigeria's *NEITI Act* is similar to the objective of the ESTMA,<sup>239</sup> this thesis recommends certain measures in the ESTMA to improve the NEITI initiative for a number of reasons: (a) the persistent lack of transparency and accountability in the oil and gas industry indicates that there is room for improvement in enforcing the *NEITI Act*, (b) the scope of *NEITI Act* does not extend to payments made to foreign governments; and (c) the *NEITI Act* allows for discretionary disclosure of reports but does not make it mandatory for reporting entities to make public disclosures of the payments made. One may reasonably argue that the efficacy of (b) and (c) above cannot be verified given that the ESTMA was recently enforced in Canada, however, this thesis contends that the inclusion of these measures in the NEITI provisions may be very instrumental to broaden the scope of NEITI's operations and ultimately improve the accuracy of its audit reports.

Specifically, this thesis recommends that the *NEITI Act* should be revised to include the reporting and disclosure by all extractive industry companies (including the NNPC) of eligible payments made to all levels of government both domestic and abroad, on a project-by-project basis. Secondly, the *NEITI Act* should be revised such that the reporting entities are required to make public disclosure of payments exceeding \$82,000 USD (or as determined by the legislators) which

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<sup>236</sup> "Crippling NEITI through Underfunding", Editorial, *Punch* (26 June 2013), online: <[www.punchng.com](http://www.punchng.com)>.

<sup>237</sup> *Ibid.*

<sup>238</sup> Everest Amaefule, "Federal Government Pledges to Implement NEITI Audit Reports", *Punch* (18 June 2015), online: <<http://www.punchng.com>>.

<sup>239</sup> NEITI Act, *supra* note 228 at s 2.

is paid by the reporting entities to all levels of government in Nigeria and abroad.<sup>240</sup> In addition to the desire for uniformity, this thesis does not suggest the naira equivalent for the transplant because Nigeria's petroleum industry is a global industry that uses United States dollar denominated transactions to drive transactions across international boundaries, therefore, eligible payments are likely to be in dollars.<sup>241</sup> Furthermore, the failure to apply a threshold for disclosure of payments to the public may hinder efficient administration of the initiative. As applicable in Canada, the thesis suggests that compliance with the public disclosure requirement may be done by reporting entities posting such annual reports on their corporate websites and where a reporting entity does not have a website, the NEITI may specify an alternative means to making the report accessible to the public. This thesis contemplates that emulating these provisions of the ESTMA may be beneficial for improving transparency and accountability of Nigeria's petroleum sector.

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<sup>240</sup> \$100,000 CAD is approximately \$81,171.80 USD and approximately ₦ 16.1 million. The choice of currency is buttressed by Nigeria's oil and gas income tax computation requirement which mandates tax computation be done in "the currency in which the transaction was effected". Thus, tax liability is usually computed and payable to the FIRS in US dollars based on the returns filed. See PPTA, *supra* note 99 at s 40.

<sup>241</sup> *Ibid.*

## CHAPTER SIX

### PROSPECTS, CHALLENGES AND CONCLUSION

In the preceding chapters, this thesis examined certain inefficiencies in Nigeria's petroleum industry and made five (5) recommendations for reforms: (i) the SR&ED tax credit; (ii) the Clean Energy Generation Equipment – Accelerated Capital Cost Allowance; (iii) Pollution Tax; (iv) Informants Lead Program; and (v) Mandatory Reporting Standards for the Extractive Sector. The evaluative comparison between Nigeria and Canada's oil and gas tax regimes conducted in this thesis shows that certain aspects of Nigeria's tax system should be maintained while some aspects could adopt certain Canadian measures. The comparison of the Canadian and Nigerian petroleum tax regimes conducted in this thesis reveals that certain measures employed in the Canadian oil and gas system can positively influence petroleum sector reforms in Nigeria. However, the thesis acknowledges that there are other measures not recommended in this thesis which also have the potential to address or complement the aforementioned recommendations for Nigeria's petroleum sector reforms.<sup>1</sup> Furthermore, it is important to note that some of the proposed recommendations are intended to complement the existing measures or regulations in Nigeria's tax and legal system while others may provide an option in cases where such regulation or measure have proved insufficient or inappropriate.

#### 6.1. Challenges and Prospects

Notwithstanding the highly anticipated viability of the aforementioned recommendations, this thesis acknowledges that there are certain limiting factors that could impede successful reforms of the Nigerian petroleum sector. For instance, the implementation of a pollution tax requires adequate information on pollution levels in order to be able to set the optimal tax rate adequately. Obtaining accurate data for this exercise may be a challenging task due to poor data management resulting from inadequate technology. Moreover, a market-based instrument like environmental taxation needs adequate enforcement, which is one of the factors limiting current environmental regulations in the Nigerian oil and gas industry. In addition to these possible challenges, additional

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<sup>1</sup> For instance the country-by-country reporting advocated by the OECD. See OECD, *Action 13: Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting* (Paris: OECD Publishing, 2015).

factors that could limit the implementation of the other recommendations factors include political discord in the leadership of the country and the arduous process of policy implementation.

A case in point which reflects these challenges is the much anticipated PIB. Considering the omnibus feature of this bill, its passage has been long awaited by stakeholders in the oil and gas industry since its introduction in 2008.<sup>2</sup> At different times, the National Assembly,<sup>3</sup> the presidency and the national oil company (NNPC) have been held responsible for the delay in the passage of the bill.<sup>4</sup> This situation has had a negative impact on the economic climate of the petroleum industry as the delay in passage of the bill has resulted in uncertainties for investors.<sup>5</sup> Thus, this thesis acknowledges that the policy implementation of the proposed recommendations may be a challenge to the proposed reforms.

In addition to the above, administrative corruption in the oil and gas industry is another major area that can limit the positive impact and efficacy of the proposed measures. Even though corruption is not peculiar to Nigeria alone, one may reasonably question the prospects of the proposed recommendations after being transplanted into the Nigerian legal and tax system. However, there is great optimism within the local and international community that the newly elected political dispensation will bring integrity into public administration in Nigeria.<sup>6</sup> Perhaps, the new administration's agenda to "leave no stone unturned in a bid to eliminate corruption in Nigeria" and the recent expression of commitment by the G-7 to help Nigeria "tackle insecurity and develop its oil and gas sectors" can substantially allay the aforementioned concerns regarding the fate of

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<sup>2</sup> ThisDay Newspaper, "Long Wait for PIB Passage and Effects on Nigerian Economy", *ThisDay Live* (18 October 2011), online: <<http://www.thisdaylive.com>>.

<sup>3</sup> Rotimi Akinwumi, "Again, Reps delay passage of PIB" *Daily Independent* (29 October 2014), online: <http://dailyindependentnig.com>; Emman Ovuakporie, "NNPC, The Presidency, responsible for delay in passage of PIB Bill —Rep", *Vanguard News* (13 May 2014), online: <<http://www.vanguardngr.com>>

<sup>4</sup> *Supra* note 2.

<sup>5</sup> The Punch Newspaper, "Delay in PIB passage affecting economy —Group", *The Punch* (23 April 2014), online: <<http://www.punchng.com>>.

<sup>6</sup> The recently elected President — President Muhammadu Buhari is a former Nigerian military Head of State who has been described as a man of discipline with the personal attributes of honesty and diligence. Thus, there is a presumption that with his antecedent and determination, he has the capacity to fight corruption that is plaguing the country. See generally, James Emejo, "World Bank Commends Buhari's Move to Address Past Corrupt Practices", *ThisDay Newspaper*, (14 April 2015) online: <<http://www.thisdaylive.com>>; David Aduge-Ani, "Buhari Will Stop Corruption in Nigeria —Anekwe", *Leadership* (4 April 2015), online: <<http://www.thisdaylive.com>>; Olatunji Daud, "You Must Eradicate Corruption, Obasanjo tells Buhari", *Vanguard* (31 March 2015), online: <<http://www.vanguardngr.com>>

the proposed transplants.<sup>7</sup> While these pronouncements are admirable and provide a good premise for the optimistic expectations for restoring integrity into public administration (especially the oil and gas industry), the proper application and administration of the proposed transplants are very useful for the desired reforms to take effect.

## **6.2. Conclusion**

Despite the potential challenges discussed and the conflicting views on the transferability of laws between jurisdictions discussed in the thesis, the prospects for proposed recommendations are very high. This is because the thesis anticipated concerns that can legitimately arise in the process of legal transplants and acknowledged these concerns in suggesting recommendations for reforms. For instance, a policy maker may reasonably inquire whether these recommendations (being legal transplants) will be deemed “successful” when the laws (or measures) are adapted to fit the Nigerian legal system or whether such transplant will be considered “successful” if Nigeria achieves the same results as Canada based on the application of the transplanted laws. In anticipating concerns of this nature, the thesis adopted a fusion of Watson, Legrand and Kahn-Freund’s schools of thought as the most pragmatic and feasible approach for safeguarding the fate of legal transplants in Nigeria’s legal system. The thesis considered the major factors postulated by the three schools in its design for “borrowing” of laws between Nigeria and Canada. Specifically, the thesis considered: (i) Nigeria’s *desire* for reforms in conformity with Watson’s view; (ii) the suitability of Canadian *ideas* in meeting the needs of Nigeria’s oil and gas industry; (iii) the *socio-political context* of the prospective Canadian rule in terms of the three political factors postulated by Kahn-Freund; and (iv) *acknowledgment* of the socio-political environment of both jurisdictions as directed by Kahn-Freund and Legrand.

In identifying the *desire* for petroleum sector reforms, the thesis identified the oil and gas industry inefficiencies and the current attempts being made by the federal government in addressing the petroleum industry inefficiencies. These discussions highlighted the real need for oil and gas sector reforms and the benefit of transplanting Canadian measures to address the major defects in Nigeria’s legal system. Secondly, this thesis evaluated the functionality of Canadian ideas in meeting the needs for Nigeria’s oil and gas sector reforms by exploring the desirable features of

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<sup>7</sup> Augustine Ehikioya, “I Will Eliminate Corruption In Nigeria”, *The Nation* (16 June 2015), online: <<http://thenationonline.net>>

the Canada's oil and gas industry and providing justification for the choice of the industry as a comparator. In addition, theories of legal transplants were examined so that the relevant concerns for the suitability of the intended legal export are clear and identifiable. These theories generally confirmed the use of transplants for law reforms although the success of the exercise varied among the schools. Nonetheless, the three schools of thought provided a reference point and theoretical basis for assessing the fate of the recommendations proffered in this thesis.

In relation to the *socio-political context* of the prospective rule, this thesis considered the three political factors postulated by Kahn-Freund. Specifically, it considered the *political interests* and the *disparities* in the forms of democratic government by acknowledging the types of democratic governments in the two jurisdiction and the legislative implication of the systems of government in the two jurisdictions. The thesis also recognised the influence of *organised groups* by considering the acceptance of certain recommendations to the public (such as the need for revenue neutrality to make pollution tax more sellable to stakeholders). In *acknowledging* the socio-political environment of both jurisdictions, there were substantial modifications to most of the Canadian measures before proposing their adoption for Nigeria's petroleum sector reforms.

Although the plight of the PIB raises concerns for the fate of the proposed recommendations, the prospects of the above propositions remain positive for a number of reasons. First, the thesis envisages that the passage of the PIB would trigger petroleum sector reforms. Second, it anticipates that the passage of the bill will provide a favourable fiscal regime for the other reformative policies like those recommended in this thesis. Third, the PIB offers a legislative precedent for the formulation of the proposed policies in order to avoid similar delays.<sup>8</sup> Thus, the prospects for a successful implementation of the recommendations outweighs the challenges.

Even though the proposed recommendations may assist in improving certain aspects of Nigeria's petroleum sector in a theoretical context, the transformation of Nigeria's petroleum industry into a globally competitive tax system remains a collective responsibility of all stakeholders. Therefore, the willingness of the major stakeholders in Nigeria's petroleum industry is crucial to

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<sup>8</sup> As mentioned earlier, the delayed passage of the PIB has been partly attributed to failure of all the stakeholders (such as the legislature, oil corporations and national oil company) to reach a common ground on the proposed terms in the bill. Therefore, the legislative journey of the PIB provides a guide for the nature of stakeholder consultations that may be useful for implementing legislation for petroleum reforms (like those proposed in this thesis).

the implementation of any of the proposed recommendations. Particularly, corporate taxpayers involved in petroleum operations need to lend their hands, when required, for enforcement of these tax reform initiatives.

While this thesis concludes that the tax system has a role in petroleum sector reforms through the transplant of tax-based measures between Nigeria and Canada, this thesis can only *predict* the success of such reforms as indicated in the ex-ante evaluations above. The accurate and precise determination of the rate of success of these transplants in the Nigerian legal system is a subject for further research and thus, remains an open question for the purpose of this thesis. Despite the fact that the recommendations in this thesis do not purport to provide the final solution to all the challenges in Nigeria's petroleum sector, it is anticipated that they will make a worthy contribution to Nigeria's oil and gas reforms. Ultimately, it is hoped that this thesis provides an insight on the reformative role of taxation in other sectors of Nigeria's economy.



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