

## **An Assessment of Nigeria Petroleum Tax Regime Strategy on Foreign Direct Investment**

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**Abstract** –*The study explores and assess the fiscal regime strategy Nigeria opted for in relation to foreign direct investment (FDI). The methodology adopted for the study was both descriptive and exploratory research methods with content analysis drawn from the theoretical and empirical literature on the subject matter. The findings of the study suggest that the Nigerian oil and gas industry experienced a continuous declined in FDI because of the country's fiscal terms arrangement, as such, it could be argued that the oil and gas subsector of the Nigerian economy was not appropriately tapped on the account of the poor regulatory framework couple with weak institution. The study therefore recommends ring fencing the oil and gas activities, as the absence of it may postpone government tax revenue against the income of projects that already generating taxable income and fiscal stability clauses as a tool of stimulating FDI and generate more oil revenue to the government.*

**Keywords:** *Fiscal Regime, Foreign Direct Investment, and Nigerian Oil and Gas Industry*

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Date of Submission: 05-03-2018

Date of acceptance: 26-03-2018

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### **I. Introduction**

The exploration, development, and production of oil and gas resources are highly capital intensive in nature that requires initial up-front, high technological expertise as well as the investment risks associated thereof, due to geological uncertainty within the basin, commercially unquantifiable quantities, and political climate surrounding. As opined by Bindemann (1999) that most of the oil-rich nations lack the requisite resources, technical expertise and the capacity to manage this sector of the economy efficiently, hence the reliance on foreign direct investment by the international oil companies (IOCs) became paramount.

The host government and IOCs are key players in the upstream sub-sector of the oil-rich nation's petroleum industry with competing objectives rather than complementing. The government is faced with the challenges of how efficient is the petroleum fiscal regime design and implemented? Towards ensuring a fair share of its resource, that guarantee an increase in foreign direct investments into the sector. Thereby catalyzing economic growth and development taking into account of the fiscal and quasi-fiscal instruments, such as petroleum profit tax (PPT), royalties, state participation, and production sharing profit (PSC) while encourages productive capacity on part of the IOCs without distortion (Nakhle, 2004).

Studies by Kareem, Kari, Alam, Chukwu and David (2012), Enisan (2017) and Wahab (2017) argued that Nigeria oil and gas industry experienced a continuous declined in FDI because of the country's fiscal terms arrangement. The studies further reveal that the rigidity on the fiscal terms would further be aggravated and have an adverse effect on the country's investment climate if not address by the constituting authority. Similarly, Kyari (2013) affirm that the existing petroleum tax system in Nigeria via joint venture (JV) agreements and production sharing contracts (PSC) are sound in achieving a fair share of oil revenue accruing to the government. Moreover, the study further emphasizes that adequate tax incentives are necessary to put in place for the attraction of more capital inflows in form of foreign direct investment to strengthen the industry, which in turn stimulate global competitiveness.

It is against this backdrop that this paper assesses the upstream petroleum fiscal regime strategy Nigeria opted for and its impact on FDI. So also, the fiscal incentives available to further attract the FDI into the country. How the fiscal terms tailored to investment opportunities in Nigeria? Does the country have an internationally competitive regime that reflects government policies and priorities while sustaining investment from IOCs? Thus, this study aims to address the above aforementioned questions raised in the literature by previous scholars. This research, therefore, is an attempt to contribute practically to the existing literature on fiscal regime strategy in Nigeria oil and gas industry. What motivated this research at this time and in the study area is because of the contemporary and emerging national and international importance oil and gas plays in Nigeria economy, hence, research on this topical issue is imperative.

The study is both theoretically and empirically significant. Theoretically, the findings would serve an instrument for Nigerian government to embark upon administrative reforms to incorporate policies that would attract more FDI into the country's oil and gas subsector while maintaining globally competitive fiscal regime that would attract more revenue generation. Empirically, the study would have a significant contribution to the body of knowledge by bridging the gaps identified in the field through knowledge-based study especially for the researchers, students and academicians and would open up a new area for further study.

## **II. Literature Review**

### **2.1. The Concept of Petroleum Tax Regime**

The terminologies petroleum tax regime and fiscal regime are used interchangeably within the context of this study and it refers to the various taxes that are imposed by a particular oil-rich nation in a specific period. The design and administration of the fiscal regime will determine how the potential wealth are being shared between an oil-rich nation being the owner of the resource and the investor, the provider of capital, technology, and expertise. A country's petroleum fiscal regime constitutes one of several fiscal and quasi-fiscal instruments such as royalty, income tax, special resource rents and their like. Thus, fiscal terms plays a vital role in shaping perceptions of an oil and gas basin's competitiveness (IMF, 2011).

### **2.2 An Overview of Nigeria Petroleum Fiscal Regime Strategy**

As claimed by the Nigerian National Petroleum Corporation (NNPC) that Nigeria government in its quest for more capital inflow from IOCs in form of FDI has always anticipated the global oil and gas industry by ensuring a dynamic approach to drawing up rules and fiscal regimes which make the industry one of the most competitive and investors' friendly throughout the world. The country has a road map plan to stimulate FDI which was design in 1991 as revised in 2000, a Memorandum of Understanding (MOU) was signed between the NNPC, representing the Federal Government of Nigeria on one hand and the Operation Companies (OPCOS) such as Shell, Mobil, Chevron, Agip, Elf, and Pan Ocean on the other (NIPIMS, 2010).

The intention of government then was to attract more investments than that already made. Accordingly, major policy shift encountered while ensuring company maintains a minimum profit margin of \$2.30/bbl; after tax and royalties on the company's equity crude. Thus, the companies were encouraged to embark on bullish exploration activities, which enable Nigeria's crude oil reserves to move from 18.0 billion barrels to 22billion barrels in 1992, barely a year after the policy decision be taken (NNPC, 2009).

### **2.3 Nigeria Petroleum Fiscal Arrangements**

Nigeria like other oil rich-nations adopts dynamic fiscal regimes, which comprise four different types of petroleum arrangements operating within the oil and gas subsector of the economy. This arrangement preserves the Contractual framework within which the Nigerian National Petroleum Corporation on behalf of the Nigerian government and the Multinational oil companies conduct Petroleum Operations in Nigeria. The Petroleum Arrangement includes Joint Operating Agreement (JOA), Production Sharing Contract (PSC), Service Contract (SC), and Memorandum of Understanding (MOU) as the nation opened new Frontier areas such as the Inland basins and Deep/ Ultra Deep Waters (NIPIMS, 2010).

#### **2.3.1 Joint Operating Agreements (JOA)**

According to CBN 2013 bulleting, the joint operating agreements sets the guidelines or modalities for running the operations between the NNPC and the JVC as contained in the revised 2000 MOU. Some of the highlight contained therein includes;

- i. To encourage unit cost efficiency, a tax inversion rate of 35% is applicable.
- ii. The guaranteed notional margin of \$2.50/ bbl, after Tax and Royalty to the company in its equity crude and a minimum of \$1.25/ bbl after tax and Royalty on the NNPC Crude which it lifts under the MOU.
- iii. The minimum guaranteed notional margin is premised on the fact that the Technical Cost (TC) of operations is not more than the notional fiscal technical cost, which is present \$4.00/ bbl.

If in any one calendar year, a company's Capital Investment Cost (T2) exceeds \$2.00/ bbl on average, the minimum guaranteed notional margin hall to be increased to \$2.70/ bbl for the company's equity crude and \$1.35/bbl for NNPC's equity crude.

#### **2.3.2 The Production Sharing Contract (PSC)**

The PSC is today the toast of Nigerian Petroleum industry. It is an agreement born in response to the funding challenge faced by the old JV arrangement as well as the desire of the Nigerian government to open up the sector for more FDI. The PSC arrangement governs the understanding between the NNPC and all new participants in the new inland deep & ultra-deep-water acreages. Currently, Statoil, Snepco, Esso, Elf, Nigerian

Agip Exploration Limited, Addax, Conoco and Petrobras, Star Deep Water, Chevron, Oranto Philips is operating the PSC in the country. Accordingly, CBN (2013) bulleting established that its main features are:

- i. The contractor bears all costs of exploration and production without such costs being reimbursable if no finding is made in the acreage.
- ii. Cost is recoverable with crude oil in the event of the commercial find, with provisions made for.
- iii. Tax Oil: This is to offset actual Tax, Royalty and Concession Rental due and payable /deductible in full in the year.
- iv. Cost Oil: To reimburse the contractor for capital investments and operating costs.
- v. Profit Oil: The balance after deduction of Tax Oil and Cost Oil, which is been shared between the NNPC and the contractor in an agreed proportion.

### 2.3.3 The Service Contract (SC)

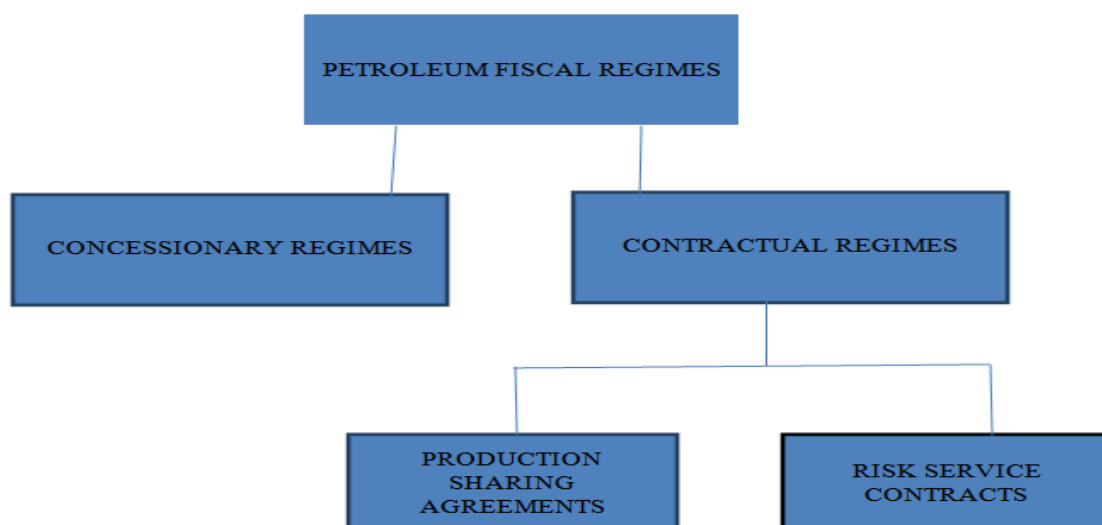
Under the SC arrangement, only Agip Energy and Natural Resources (AENR) operate the SC in Nigeria, under the scheme, the OPL title is held by the NNPC. The operator is designated the Service Contractor and he provides all the funds required for exploration and production works, a feature which this arrangement shares with the PSC. In the event of a commercial find, Contractor's costs is recouped in line with procedures enunciated in the contract. One major difference between the SC and PSC is that SC covers only the OPL, the PSC may span two or more OPLs at a time (NIPIMS, 2010).

Consequently, the SC covers a fixed period of five years and should the results of the efforts in no commercial discovery, the contract automatically terminates. Under the SC, exploration, and development costs are been paid in installments over a period and the contractor has no title to the crude oil produced, although he may be allowed the option to accept reimbursement and remuneration in oil. As an incentive for the risk taken, the contractor has the first option to purchase a certain fixed quantity of crude oil produced from the SC area (NIPIMS, 2010). The graphical presented is given below in fig.1

### 2.4 Fiscal Incentives in Nigeria Oil and Gas Industry

Incentives have become increasingly recognized globally, as most countries of the world, irrespective of emerging or developing economy, now employ a wide variety of incentives in pursuing their economic goals. Fiscal incentives have become an important element of economic policy stimulation used to attract domestic and foreign investment. Fiscal incentives comprised tax and non-tax incentives. While tax incentives provide indirect support to investors in the form of tax breaks, access to subsidized credit and lower customs tariffs among others, non-tax incentives offer direct support to investors in the form of construction and rehabilitation of infrastructure and facilities (CBN, 2013).

**Fig. 1 Nigerian Petroleum Fiscal Regime Strategy**



Source; Authors' compilation (2018)

### 2.4 Empirical Evidence

The alignment of the interests of government and that of IOCs is a key to petroleum tax regime, as buttress from studies by Osmundsen (2005), Nakhle (2008), Broadway and Keen (2008), Lukman (2010), Ogbonna (2012) and Nakhle (2015) who conclusively averred that a good number of the oil-rich nations such as

Lebanon, Cyprus, UK among other oil rich nations at one point in time adopted different fiscal regime with distinctive features, that are mutually beneficial to host government and the IOCs. Thus, it could be argued that there is no uniformity in terms of the appropriate fiscal regime in the world as suggested in the literature, this is because the prevailing circumstances facing a state may differ from one another. However, Bird and Zolt (2003) established that what is an appropriate fiscal regime for any country is determined by its circumstances, needs and objectives and as such a country's tax regime should be determined by taking into consideration its economic structure, tax administration capacity, public service needs, and many other factors.

According to Enisan (2017), the trend analysis of capital inflows into the country shows that the oil and gas sub-sector of the Nigerian economy received the highest share of inward FDI in the 70s but the percentage share for the subsector declined in the 80s and early 90s. It, however, increased tremendously in the late 1990s and early 2000s, which account for about 22 percent from 2005 through 2012. Thus, this shows that the country's oil and gas industry was not well been tapped.

Kareem et al. (2012) asserted that UNCTAD World investment report in 2007 reveal that FDI inflow to West Africa has dominated by inflow to Nigeria, which received 70% of the sub-regional total inflow and 11% of the African's total inflow. Interestingly, Nigeria oil and gas sector received 90% of the FDI.

### **III. Methodology**

The paper adapted both descriptive and exploratory research methods with analytical presentation drawn from the theoretical and empirical literature on the subject matter.

### **IV. Discuss of Findings**

From the fiscal regime point of view, the findings of the study suggest that the oil and gas subsector of the Nigeria economy has not appropriately tapped on the account of poor regulatory framework couple with weak institution. This concur with previous studies by Wahab (2017), and CBN (2013) who argued that Nigeria fiscal regime strategy was not globally competitive as a result of the country's unfavorable political climate, weak macroeconomic environment and weak monitoring institution which invariably discourage foreign direct investment.

The study also posits that the current petroleum industrial bill (PIB), which declined assent by the president if approved, would further aggravate the situation as claim by other stakeholders in the upstream subsector of the oil and gas industry. This is in consistent with the findings of CBN bulleting 2013 that the implementation of the fiscal incentives is not attractive and if the PIB pass in its current form may not be revolutionary as expected.

### **V. Conclusion And Recommendations For Policy**

In this study, we explored and assessed the fiscal terms Nigeria opted for in relation to FDI and it was found that the country adopted multi facet fiscal terms for its oil and gas industry such as PSC, JV and SC. The study also identified two major fiscal incentives in pursuing the country's economic goals, which become an important element of economic policy stimulation used to attract both domestic and foreign investors. Fiscal incentives comprised of tax and non-tax. While tax incentives aim to provide indirect support to investors in form of tax breaks, access to subsidized credit facilities, lower customs tariffs among others, non-tax incentives offer direct support to stimulate investors in the form of public utilities such as construction and rehabilitation of infrastructural facilities to easy the cost of doing business in Nigeria.

In our concluding remarks, we argued that the multiple fiscal terms might have deterrent effects on revenue accruing to the government because of the weak macroeconomic environment couple with weak institution, which invariably discourages FDI. As such, we hold the opinion that the oil and gas subsector of the Nigerian economy was not globally competitive. In addition, poor regulatory framework could also be a contributing factor.

From the lesson discovered in this study, it is apparently clear to mention that maintaining a feasible and effective fiscal terms arrangement could be a cardinal principle towards striking a balance between the interest of Nigerian government and that of the IOCs via FDI. To ensure this, we recommend the establishment of frameworks that are consistent to spurring the international competitiveness of the oil and gas industry, which in return greatly enhanced revitalization of the economy in a larger scale. Thus, the study recommends the ring fencing oil and gas activities as the absence of it may postpone government tax revenue because a company that undertakes a series of projects would deduct both exploration and development cost from each new project against the income of projects that already generating taxable income.

The study, further recommend the establishment of fiscal stability clauses, as this mechanism mitigate risks and enjoined optimum returns to the investors. Finally, the country needs to invest heavily on security and provide infrastructural base that will help regain back investors' confidence.

### **Research limitations/implications**

This is a review paper that sums up scholarly articles both descriptive and inferential research about Nigeria petroleum tax strategy in relation to FDI. However, it does not; use empirical data to corroborate its findings with previous studies in the literature. It would be interesting, to empirically investigate the impact of fiscal and quasi-fiscal instruments of the fiscal terms on FDI. Empirically, investigate the economic impact of the current PIB on IOCs operations in Nigeria and empirically investigate the attractiveness of the proposed incentives in the Petroleum Profit Tax (PPT) Act and other Acts.

### **Practical implications**

The paper assesses the impact of Nigerian fiscal regime strategy on foreign direct investment and the findings therein provides an insight to operators and non-operators, legislators, academicians and other stakeholders in the industry to aid their decision making. The study also contributes practically to the existing literature on Nigeria fiscal regime strategy opted for in relation to foreign direct investment as well as the incentives necessary to attract more FDI into the subsector of the economy.

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Mustapha Ibrahim "An Assessment Of Nigeria Petroleum Tax Regime Strategy On Foreign Direct Investment "IOSR Journal of Economics and Finance (IOSR-JEF) , vol. 9, no. 6, 2018, pp. 62-66.