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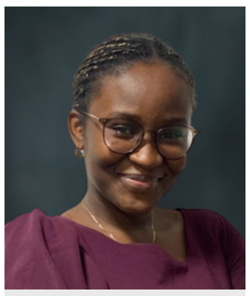

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Implications of the Proposed Increase in Companies Income Tax Rate for Gas Flaring Companies.

Flaring of associated gas during oil production significantly impacts a nation's environment, health, and finances. Over the years, the Nigerian government has put in place measures to dissuade upstream oil companies from engaging in gas flaring. However, according to the World Bank's 2022 Global Gas Flaring Tracker Report, Nigeria still ranks as one of the top seven countries involved in gas-flaring in the world, a position the country has held since 2012.

Despite the punitive measures that have been deployed by the Nigerian government, some upstream oil companies still prefer to flare gas, as they consider the cost of gas flaring to be lower than the cost of capturing, storing, and processing for potential gas utilisation. This is especially the case with fields containing associated gas. Given that gas production was not the primary focus during field development, the need to install gas capturing and production infrastructure (which are ordinarily capital intensive), being an afterthought, may come at an exorbitant cost.

Gas is also sometimes flared for safety reasons due to the high pressure associated with crude oil extraction. The Petroleum Industry Act makes provision for this kind of situations where it exempts gas flared for safety purposes under established regulations, from being assessed to gas flaring penalty.

In addition to existing legislation on gas flaring, the Finance Bill, 2022, seeks to increase the Companies Income Tax (CIT) rate for gas flaring companies. In this article, we will examine prior legislative efforts to discourage gas flaring and we will also consider the implications of the proposed gas flaring provisions in the Finance Bill 2022.

Existing Legislation on Gas Flaring in Nigeria

Since 1969, there have been several regulatory initiatives to reduce gas flaring. Although many of these laws have been found to be ineffective, the government has not relented in implementing new laws and regulations to achieve its objectives. The key legislation include:

- **Associated Gas Re-Injection Act (AGRA)**

  The main objective of the AGRA was to eliminate gas flaring in Nigeria. Section 3(1) of the AGRA provides that *"…no company engaged in the production of oil or gas shall after 1 January, 1984 flare gas produced in association with oil without the permission in writing of the Minister"*. However, the AGRA empowered the Minister of Petroleum Resources (the Minister) to issue a certificate for continued flaring of gas to certain companies subject to certain conditions, one of which is payment of an amount prescribed by the Minister. The AGRA has now been repealed by the Petroleum Industry Act.

- **Flare Gas (Prevention of Waste and Pollution) Regulations 2018 (the Regulation)**

  The Regulation was issued in 2018 pursuant to the provisions of the AGRA empowering the Minister of Petroleum Resources to make regulations on gas flaring. The objective of the Regulation was to reduce the environmental and social impact caused by the flaring of natural gas in Nigeria, protect the environment, prevent waste of natural resources and create social and economic benefits from gas flare capture.

  One of the key highlights of the Regulation is the fees payable for gas flaring. Based on the Regulation, any Company that produces at least 10,000 barrels of oil per day (bopd) will be liable to US$2.00 for every 28.317 Standard Cubic Metre (SCM) of gas flared while companies that produce less than 10,000 bopd will be liable to US$0.50 for every 28.317 SCM of gas flared.

  Furthermore, the draft Gas Flaring and Venting (Prevention of Waste and Pollution) Regulations 2022 seeks to amend the basis of computation of the payment for gas flaring to US$2.00 for every 28.317 SCM of gas flared for companies producing more than 5,000 bopd and US$0.50 for every 28.317 SCM of gas flared for companies producing less than 5,000 bopd.

- **Petroleum Industry Act 2021 (PIA)**

  The PIA also seeks to eliminate gas flaring as Section 104(1) states that any licensee, lessee or marginal field operator that flares or vents natural gas, except in the case of an emergency, pursuant to an exemption granted by the Commission, or as an acceptable safety practice under established regulations, commits an offence and is liable to a fine. The penalty to be paid is based on the Flare Gas (Prevention of Waste and Pollution) Regulations, and it will not be eligible for cost recovery or tax deductibility.

  In addition, the Act requires a licensee or lessee producing natural gas to submit a natural gas flare elimination and monetisation plan to the Commission within 12 months of the effective date of the Act.

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Current Tax Implications of Gas Flaring

Based on the PIA and existing judicial precedence, gas flaring penalties are not deductible for Petroleum Profits Tax (PPT), Hydrocarbon tax (HCT) or CIT purposes. The Federal High Court in the case between the Federal Inland Revenue Service (FIRS) and Mobil Producing Nigeria Unlimited ruled that payments for gas flaring without the prior permission (evidenced by a certificate/permit) of the Minister, as stipulated in Section 3 of the AGRA, are not deductible for PPT purposes. In addition, Section 104(3) of the PIA also states that fines paid for flaring gas shall not be tax deductible.

Implications of the Gas Flaring provisions in the 2022 Finance Bill

The Finance Bill 2022 (the Bill) seeks to increase CIT[1] rate for gas flaring companies from 30% to 50%. For an upstream company that is yet to complete the conversion to PIA or has no CIT payable in any year of assessment in which it flares gas, the amount to be subject to CIT will be the market value of the gas flared or vented by the Company.

The Bill goes further to define a Gas-flaring Company as*"any medium-sized or large company that vents or flares any associated or non-associated natural gas in any year of assessment, unless such flaring is proven by that company to be in the case of an emergency in accordance with Section 104 of the Petroleum Industry Act, 2021 or any law replacing that statute"*.

Any company that flares gas, whether or not it has converted to the PIA, will be significantly impacted, given that it will be required to pay taxes on non-existent revenue.

More so, the proposed provisions seek to impose a 50% tax on the deemed market value of the gas flared without considering the fact that companies involved in gas production would ordinarily be able to treat operational costs as tax deductible.

To demonstrate the potential effect of this policy on upstream oil companies, we present below a hypothetical scenario:

Items	Amount ($)
Revenue from Crude Oil Production	393,000,000
Deemed Gas Income	114,000,000
Profit After Tax from Crude Oil Production (10% of Revenue)	39,300,000
CIT payable on Gas Flared (50% of Deemed Gas Income)	(57,000,000)
Deficit	(17,700,000)

As shown above, the potential CIT payable of $57million has completely eroded the profit of the Company and it will have to fund the payment of the balance of the CIT either from its retained earnings/cash balance or by raising equity or debt finance. Also, the same entity will still be required to pay gas flaring penalties which will not be tax-deductible. The situation will be far worse where an operator incurs a loss from crude oil production as a result of low oil prices.

Evidently, the proposed amendment will impact the profitability and liquidity position of the affected companies and could potentially result in going concern issues and corporate failure.

Recommendations

It would appear that the severity of the proposed gas flaring provisions in the Finance Bill 2022 were anchored on enabling Nigeria meet its climate change commitment to reducing Greenhouse Gas Emissions. Nonetheless, it seems that the major underlying reason for flaring gas may not have been taken into consideration when drafting the Bill.

This then begs the question: will an increase in the tax rate guarantee a significant level of compliance or will it discourage investors from wanting to invest in the upstream sector? The answer will be impacted by the volume of oil revenues, the significance of proposed incentives on gas utilisation and whether or not operators would look for avenues to bypass the law by under reporting the volume of gas flared.

In meeting Nigeria's climate change commitment, the government should provide incentives to make gas utilisation more attractive and economically viable, rather than imposing stringent taxes that could potentially result in businesses ceasing operations. For instance, the government may need to put an end to gas price regulation to enable companies recover the cost of their investments. Also, for greenfield projects with associated gas, we recommend that the Nigerian Upstream Petroleum Regulatory Commission (NUPRC) should approve such projects only if the field development plans consider gas production.

In the long run, the proposed increase in the CIT rate may do more harm than good considering the adverse effect it may have on the operations of several companies and the country at large. We therefore advise that the proposed amendment be looked into whilst other recommended options are being explored.

[1] Upstream companies that have converted to the PIA fiscal regime will now be liable to both CIT and HCT.

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