Introduction

The above legislation, hereinafter referred to as “the Local Content Act (LCA)”, came into force on 22 April 2010 following assent by President Jonathan. Efforts to enact LC legislation has been on since the early 2000s; ‘Nigerianisation’ provisions in the Petroleum Act, JOAs and PSCs, as well as previous LC initiatives which assumed greater fillip with the return to civil rule in 1999, have obviously not achieved the desired effect. Understandably, the enactment of the LCA was popularly regarded as a welcome development in the nation’s quest to optimize value from its oil and gas industry and a (singular) high watermark of the 2011 class of the National Assembly. LC status checks on the energy sector of countries like Brazil, Indonesia, Malaysia, Norway shows that Nigeria is lagging behind in this value optimization objective. However, it is better late than never.

Section 2 LCA mandates all industry stakeholders to “consider Nigerian content as an important element of their overall project development and management philosophy for project execution.” It establishes, and vests regulatory oversight of LCA in the Nigerian Content Monitoring Board (NCMB). Whilst the Act has been subject of much discourse, this piece focuses on salient tax and business issues arising from its provisions.

Supremacy/Universal Application

LCA declares from the outset (section 1): “notwithstanding anything to the contrary contained in the Petroleum Act or in any other enactment or law, the provisions of this Act shall apply to all matters pertaining to Nigerian content in respect of all operations or transactions carried out in or connected with the Nigerian oil and gas industry.” Does the fiscal provisions catch companies like Nigerian LNG, given the recent trial and appellate decisions in NDDC v NLNG (2009) 1 TLRN 25; (2011) 4 TLRN 1? Answer would be yes: ‘notwithstanding’ used in LCA means NLNG’s “veil of protection” vide NLNG (Fiscal Incentives & Assurances) Act would be lifted to subject NLNG to the LCA. The Supreme Court has held in Nigerian Deposit Insurance Corporation v. Okem [2004] 10 NWLR (Pt.880), 107 at 182, that “when the term ‘notwithstanding’ is used in a section of a statute, it is meant to exclude an impinging or impeding effect of any other provision of the statute or section so that the said section may fulfil itself.”

NDDC v. NLNG correctly exemplified the approach that effect must be given to incentive legislation, unless there are express provisions to the contrary. However, such contrary intention is clearly evinced by “notwithstanding anything to the contrary contained …in any other law” in section 1 LCA, to avoid the result whereby the Courts held inter alia that by virtue of the NLNG Act, NLNG was exempted from complying with section 14(2)(b) NNDC Act which provided for payment of ‘NDDC Levy’ of 3% of total annual budget of upstream and gas processing companies operating in the Niger Delta. The other argument that NLNG Act being a private Act could not be repealed by implication vide a subsequent inconsistent provision, would also not avail as a shield from the LCA. Accordingly, NLNG would be liable to make the 1% contribution to the Nigerian Content Development Fund required by the LCA.

LCA and Fiscal Incentives

Section 48 is an interesting provision: “the Minister shall consult with the relevant arms of Government on appropriate fiscal framework and tax incentives for foreign and indigenous companies which establish facilities, factories, production units or other operations in Nigeria for purposes of carrying out production, manufacturing or for providing services and goods otherwise imported into Nigeria.” This writer wonders whether this provision is necessary, given that there is already sufficient framework under which qualifying companies could benefit. These include: (a) Industrial Development Tax (Income Relief) Act, under which pioneer status is granted and which is administered by the NIPC; (b) applicable incentives in CITA and PPTA; (c) Oil and Gas Export Free Trade Zones Act and Nigerian Export Processing Zones Act which, subject to exceptions, exempt approved enterprises within the Zones from Nigerian tax and fiscal obligations; and (d) NIPC Act which established the NIPC as Government’s investment facilitation agency to “coordinate and monitor all investment promotion activities”, “maintain liaison between investors and [MDAs,] institutional lenders and other authorities concerned with investments”, and “for the purpose of promoting identified and strategic or major investment ... in consultation with appropriate Government agencies, negotiate specific incentive packages for the promotion of investment...”

Not the least is the Nigerian Tax Policy (approved by the Federal Executive Council), which leans against ‘discriminatory’ nature of tax incentives in the long term, whilst advocating sparing use of incentives, cum level playing field for all businesses (paras 2.6.4 and 4.4(b)).

Deductibility of LCA Compliance Costs

Further to section 7 mandating operators to submit ‘Nigerian Content Plan’ for all projects to
demonstrate compliance with Nigerian content requirements of the Act, section 25 requires such entity submitting a plan to establish a project office in the catchment area/location of the project “where management and procurement decision making are to take place.” This could be compared with provisions of the Rivers State Employment of Junior Workers (Enforcement) Law 2000.

By section 64, “for the purposes of assessment and verification, all operators and contractors shall provide the Board ... with access their facilities and all documentation and information required for substantiating the Nigerian content reported.” Pursuant to sections 60 and 61, operators are to “submit to the Board their annual Nigerian Content Performance Report covering all projects and activities for the year under review” and “which shall specify by category expenditure the Nigerian content on both current and cumulative cost basis...” Section 70(a) and (k) document key functions of NCMB to “implement the provisions of this Act” and “make auditing procedures and conduct regular audits for the purposes of monitoring and implementing compliances with the provisions of this Act.”

The most important point is that all LCA compliance costs would be tax deductible, being “expenses wholly, exclusively, necessarily and reasonably incurred in the production of” the company’s profits (section 24 CITA; cf. section 104(a) PPTA). Gulf Oil Co. Nigeria Ltd v. FBIR [1997] 2 NLVR (Pt.514), 698, where the Court of Appeal followed the locus classicus, Shell v. FBIR [1996] 8 NLVR (Pt. 468), 256 as well as earlier cases like Western Soudan Exporters Ltd v. FBIR (2010) 3 TLRN 159 has settled the issue.

A side issue is whether the FIRS may disallow LCA compliance costs, based on quantum? In my view, once a company’s Nigerian content compliance status satisfies the NCDMB, the FIRS is obliged to allow all the related costs: they should prima facie be allowable deductions by FIRS. Quantum/reasonableness would be a question of fact in the circumstances. Parallels can be drawn from established regulatory practice whereby Nigerian regulators rely on (sister) sectoral regulators that have specialised knowledge of the relevant sector. Thus FIRS and CBN relies on NOTAP’s approval of ‘technology quotient’ service agreements between Nigerian companies and non-residents to allow fees thereunder as both tax deductible and eligible transaction for the purposes of accessing the official market to procure foreign exchange and offshore repatriation of same.

II. Contract Value Contributions to the LC Fund

Section 104(1) establishes the Nigerian Content Development Fund for implementing Nigerian content development in the oil and gas industry. Specifically, section 104(2) provides that “the sum of one percent of every contract awarded to any operator, contractor, subcontractor, alliance partner or any other entity involved in any project, operation, activity or transaction in the upstream sector of the Nigerian oil and gas industry shall be deducted at source and paid into the Fund.” Although no remittance timeline is stipulated, “reasonable time” can be implied, which in most cases could be paralleled with the respective windows within which WHT deductions and VAT must be remitted.

It also stands to reason that the 1% deduction would be in the currency of payment of the contract sum. Failure to deduct or remit the 1% is an offence (like other noncompliance with LCA, section 68), and liable upon conviction to fine of 5% of the project sum or cancellation of the project.

Although section 104 should apply to all contracts in the industry, businesses could seek to avoid this provision through gross-up arrangements, albeit they may find their bids becoming uncompetitive as a result. It may thus be a matter of business judgment whether to gross-up the 1% contribution to the Fund vis a vis potential risk of regulatory perception as an attempt to frustrate intention of the LCA; or, regarded as conduct breaching the LCA, and therefore an offence, pursuant to section 68.

The issue may actually be moot because of likely low visibility of any gross-up arrangement to the regulator. Furthermore, since impact of the 1% deduction as additional cost of doing business would be mitigated by the ability of contractors to deduct same for tax purposes, the gross-up option may not be compelling.

Competitiveness Issues

The prospect of “exclusive consideration to Nigerian indigenous service companies which demonstrate ownership of equipment, Nigerian personnel and capacity to execute such work to bid on land and swamp operating areas... for contracts and services” (section 3(2)) could incentivize investment, which would more often than not, be tax deductible. Section 16 stipulates: “the award of contract shall not be solely based on the principle of the lowest bidder where a Nigerian indigenous company has capacity to execute such job and the company shall not be disqualified exclusively on the basis that it is not the lowest financial bidder, provided the value does not exceed the lowest bid price by 10%.” Section 14 also provides in part: “…the bid containing the highest level of Nigerian content shall be selected provided the Nigerian content... is at least higher than its closest competitor.”

These provisions could mean increased tax revenue: the higher Nigerian bid/contract sum will implicate more VAT and WHT than would have been otherwise applicable with the lowest (successful) bid. Furthermore, the differential (between lowest and higher successful bids), represents additional cost of business for the client, which is however mitigated by the deductibility of such costs. The circumstances of the client and contractor respectively would determine where the differential would have enjoyed more optimal tax treatment: the amount of deductions available to the contractor typically affects how much of the differential would comprise part of contractor’s assessable profits.

Conclusion

The LCA is a good example of law being used as an instrument of social engineering in furtherance of national strategic objectives. As the Minister makes Regulations for the purpose of giving effect to the LCA (section 101), and the Board enforces the LCA, players in the Nigerian oil and gas space will do well to be mindful of the tax impact as a component of their business strategy.

LeLaw Disclaimer:

Thank you for reading this article. Although we hope you find it informative, please note that same is not legal advice and must not be construed as such. However, if you have any enquiries, please contact the author, Afolabi Elebiju at: a.elebiju@lelawlegal.com

LeLaw (Barristers & Solicitors), Plot 9A Olatunji Moore Street, Off TF Kuboye Road, Lekki Phase I, Lagos, NIGERIA www.lelawlegal.com