

# GBENGA BIOBAKU & CO.

BARRISTERS AND SOLICITORS

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## Arbitrability of tax issues arising from production sharing contracts

### – *FIRS v. NNPC*

#### Summary

The Federal High Court, Abuja in the case of *Federal Inland Revenue Service VS. Nigerian National Petroleum Corporation & Others* recently decided that an Arbitration Tribunal lacks jurisdiction to determine issues relating to taxation or connected with the Federal Government revenue as such jurisdiction is exclusively conferred on the FHC by the Constitution of the Federal Republic of Nigeria.

The facts of the case are that the Contractor Parties in OML 118 commenced Arbitration proceedings against NNPC pursuant to the Arbitration provisions of the PSC. The main reliefs sought by the Contractor Parties at the Arbitration related to the applicable Royalty Rate; that PPT returns prepared by the Contractor should be used to allocate Tax Oil; that in calculating Tax Oil, Investment Tax Credit (ITC) should only be deducted from qualifying expenditure and that Capital Allowances shall be allowed at 20% in the year in which they were incurred.

While the arbitration was on-going, the *FIRS* took out an Originating Summons at the Federal High Court against NNPC and the Contractor Parties to challenge the Arbitration proceedings. In the main, *FIRS*'s argument was that in view of section 251 of the Constitution of the Federal Republic of Nigeria the Arbitral Tribunal does not have jurisdiction to determine the subject matter of the Arbitration which deals with taxation of NNPC and the Contractor Parties. Based on the foregoing, *FIRS* asked the Court amongst other, for an order revoking the Arbitration Clause of the PSC in so far as it relates to taxation or in the alternative an order excluding taxation and matters related thereto from the ambit of the Arbitration between the Contractor Parties and NNPC; a declaration that the arbitration provisions in the Production Sharing Contract and the Defendants submission to an arbitration on matters exclusively reserved for the Federal High Court is unconstitutional, null, void and of no effect.

#### Analysis

The Contractor Parties challenged the jurisdiction of the Court to hear the case on the basis that *FIRS* had no *locus standi* to institute and maintain the action. They were of the view that *FIRS* had failed to disclose any legal interest of its own affected or to be affected by the outcome of the Arbitration which would warrant the outcome of the declaration sought in the case and urged the Court to strike out the suit without going into the merit of the substantive suit. However, the Court took the view that the issues raised by *FIRS* pertain to tax and issues incidental thereto and noted that *FIRS* is the statutory body established by law as the sole Federal authority responsible for the assessment and collection of taxes on behalf of the Federal Government of Nigeria. The Court was also of the view that if *FIRS* perceived that its statutory functions are going to be affected by any dispute, it will have the requisite *locus standi* to bring an action to seek remedy. The Court accordingly held that *FIRS* had a basis to bring the action and that the Court has jurisdiction to entertain the case.

The Contractor Parties took the position that the arbitration is a purely contractual matter between Parties to the PSC which the Court lacked jurisdiction to look into and/or determine. It was their contention that the Originating Summons filed by the *FIRS* failed to disclose any real or actual breach or threatened interference with its powers, functions or obligations under the law nor did it disclose how the outcome of the arbitration will affect the discharge of its statutory duties. The Contractor Parties also argued that there was nothing in the Originating Summons to indicate that any of the Parties in the arbitration has used or intended to use the result of the arbitration proceedings to erode any obligation owing to *FIRS* and that accordingly, *FIRS* has failed to disclose any reasonable cause of action against the NNPC and the Contractor Parties. After reviewing the further submissions canvassed by the Parties, the Court held as follows:

"I am left in no doubt that the issues raised by the Plaintiff pertains to tax and issues incidental thereto. It is not in dispute at all, that the Plaintiff in this case is the Statutory body established by Law to wit: Federal Inland Revenue Service (Establishment) Act, 2007 as the Sole Federal Authority responsible for the assessment and collection of Taxes on behalf of the Federal Government of Nigeria. It stands to reason therefore that in any dispute where the Plaintiff perceived that its statutory functions are going to be affected by such dispute it will necessarily have the requisite *locus standi* to bring an action to seek remedy. So, to my mind in the instant case, it is preposterous to argue as the 2nd – 5th Defendants did,



"I am left in no doubt that the issues raised by the Plaintiff pertains to tax and issues incidental thereto.... It stands to reason therefore that in any dispute where the Plaintiff perceived that its statutory functions are going to be affected by such dispute it will necessarily have the requisite *locus standi* to bring an action to seek remedy."

-A. Bello, J

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that the Plaintiff has no *locus standi* to bring this action in which it alleges that its statutory functions to assess and collect tax for the Federal Government will be adversely affected in the Arbitral proceedings between the Defendants in this case, merely on the ground that it is not party to the arbitral proceedings. It is the very reason of its not being a party to the Arbitral proceedings that makes it imperative for the Plaintiff to file this suit to protect its perceived interest in the subject matter of the arbitration. This Court is not concerned at this stage, with whether the Plaintiff will succeed because *locus standi* of a Plaintiff to sue is not dependent on whether or not its case will succeed. It is against this backdrop that I hold the view that the Plaintiff in this case has the *locus standi* to bring the present action. On this score therefore, this Court has the jurisdiction to entertain the case.”



On a review of the argument by the Parties, the Court held that “shorn of all pretences” the issues in dispute between NNPC and the Contractor Parties at the arbitration are issues dealing with tax and revenue accruing to the Federal Government. In determining the substantive case, the Court therefore held that it had exclusive jurisdiction to hear tax matters and that tax matters were not arbitrable, regardless of the fact that Parties are bound by the sanctity of their contracts. The Court was of the opinion that parties cannot by contract confer jurisdiction on the Arbitration Tribunal. After considering the prayers sought by the Contractor Parties at the arbitration, the Court held as follows:

“Looking at the above reliefs, I will say that shorn of all pretences, the issues in question between the Claimants and 1st Defendants which were submitted to Arbitration arose out of alleged breaches by NNPC of the Agreement in lifting tax oil based on its assessment of the taxes payable to the Plaintiff and by extension to the Federal Government of Nigeria, instead of using the tax returns sent to it for filling by the Contractor. So for all intents and purposes, the claim of the Claimants before the Arbitral Tribunal is in effect for a refund of all overpaid taxes paid by NNPC on behalf of the 2nd – 5th Defendants, through what they alleged as over lifting of tax oil by which means all taxes accruable to the Federal Government are paid. While it is conceded that the Parties are bound by the sanctity of their contracts and the issue in dispute arose out of the Contract Agreement (PSC) the question still remains whether Parties can by an Agreement purport to confer jurisdiction on an Arbitration Tribunal to determine issues relating to taxation of Companies or connected with the Federal Government Revenue when such jurisdiction is exclusively conferred on this Court by the Constitution of the Federal Republic of Nigeria. The answer I must say is an emphatic No. In other words, the Constitution of the Federal Republic of Nigeria precludes any other Court in Nigeria other than the Federal High Court, not to talk of an inferior Arbitration Tribunal, from exercising jurisdiction over tax matters relating to Federal Government Revenue. I agree entirely with the Plaintiff that any determination of issues raised in the Claimants claim before the Arbitration Tribunal will impact negatively and will not only infringe on the functions and the duties of the Plaintiff but will adversely affect the revenue that would accrue and/or had accrued to the Federal Government of Nigeria.”

Based on this reasoning, the Court consequently granted the reliefs sought by FIRS in its Originating Summons to wit: a declaration that the claims of the Contractor Parties touching on taxation is not one which is allowed by law to be settled by arbitration; that the determination or claim by way of award will infringe on the right of FIRS to assess and collect tax and generate revenue for the Federal Government; that the reference of the claim of the Contractor against NNPC upon which terms reference has been made to arbitration is contrary to public policy; an order excluding tax and matters related thereto from the ambit of the arbitration agreement between NNPC and the Contractor Parties; an order restraining NNPC and the Contractor Parties from taking any benefit from the arbitral proceedings or awards made pursuant thereto and a declaration that the arbitration provisions in the PSC and the submission to an arbitration on matters exclusively reserved for the Federal High Court is unconstitutional.

## Conclusion

The decision of the Federal High Court in this case has cast uncertainty over the scope of the Arbitration provisions of the PSCs as it relates to tax issues and incidental matters. The Contractors Parties however, have filed an appeal against the decision at the Court of Appeal. It is instructive to note that the Supreme Court of Nigeria had in the case of *Kano State Urban Development Board VS. Fanz Construction Company Limited (1990) 4 NWLR Part 172 Page 1*, given a guideline on the categories of matters which cannot be the subject of an arbitration agreement and therefore cannot be referred to arbitration to wit: an indictment for an offence of a public nature; disputes arising out of an illegal contract; disputes arising under agreements void as being by way of gaming or wagering; disputes leading to a change of status, such as divorce petitions; any agreement to give the arbitrator the right to give judgment in rem.

Given the position of the Supreme Court in the above case, we are of the view that there is a strong possibility that the decision of the Federal High Court will be overturned by the Court of Appeal based on the principle of *stare decisis*.

“...the Constitution of the Federal Republic of Nigeria precludes any other Court in Nigeria other than the Federal High Court, not to talk of an inferior Arbitration Tribunal, from exercising jurisdiction over tax matters relating to Federal Government Revenue.

-A. Bello, J

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